

Insurance
That is personal,
inclusive and
a force for good



Profit before tax**£451.4m**

(2019: £509.7m)

Combined operating ratio^{1,2}**91.0%**

(2019: 92.2%)

Operating profit¹**£522.1m**

(2019: £546.9m)

Customers**450k+**

Customers benefited from support measures

Society**£7m+**

Donated to charities and good causes

Return on tangible equity¹**19.9%**

(2019: 20.8%)

Solvency capital ratio^{1,3}**191%**(2019: 189% adjusted⁴)**Dividends and capital returns⁵****£595.2m**

(Includes £195.5m special dividend to replace the cancelled 2019 final dividend)

(2019: £128.6m adjusted⁴)**People****£3.8m**

Invested in free shares for our people

Planet**100%**

Carbon neutral via offsetting

Strategic report

Introduction	1
2020 highlights timeline	2
Investment case	4
Business model	6
Chair's statement	8
Section 172(f) statement	10
Chief Executive Officer's review	11
Market overview	16
Our key performance indicators	18
Finance review	20
Operating review	36
Sustainability	44
Streamlined Energy and Carbon Reporting	68
Non-financial information statement	68
Risk management	69

Governance

Chair's introduction	76
Board of Directors	78
Executive Committee	81
Corporate governance report	83
Committee reports	97
Directors' Remuneration Report	113
Directors' report	140

Financial Statements

Contents	145
Independent Auditor's report	146
Consolidated Financial Statements	157
Notes to the Consolidated Financial Statements	162
Parent Company Financial Statements	215
Notes to the Parent Company Financial Statements	217

Other information

Additional information	222
Glossary and Appendices	224
Forward-looking Statements	
Disclaimer	231
Contact information	232

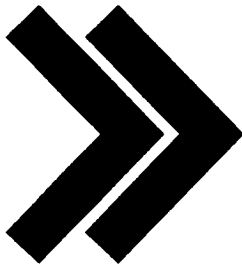
Notes:

- See glossary on pages 224 to 226 for definitions and Appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
- A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration. See glossary on page 224 for definitions.
- Estimates based on the Group's Solvency II partial internal model.
- The 2019 comparatives for dividends and capital returns and the solvency capital ratio have been adjusted to remove the cancelled 2019 final dividend and £120 million of share buyback. (The reported numbers were solvency capital ratio of 165% and capital returns of £447.0 million). See page 18 for further details.
- See page 28 for the dividend policy.

Our vision is to create a world where insurance is personal, inclusive and a force for good.

To deliver this we need to build an insurance company of the future with technology and data at its core, adapting to an ever-changing world, delivering more for customers at speed.

As we navigated the challenges that 2020 presented, we focused on supporting our customers, the wellbeing of our people, contributing to society and stepping up our plans to tackle climate change.



We believe embracing sustainable practices creates a better corporate culture, more reliable products and brings long-term rewards for our shareholders.

2020 Highlights

Claims teams take over 6,500 calls from customers helping to support them following Storm Ciara

Sign Social Mobility Pledge

New ad campaign launches for **Direct Line**

£3.5 million Community Fund launches, distributing £2 million in two weeks to charities supporting the most vulnerable

£2m
distributed in two weeks

Our Finance team delivers a new cloud-based Oracle accounting ledger and claims payment system

2020



January

Privilege offers full end-to-end motor insurance service on new platform, for both new business and renewal customers

March

Direct Line for Business rolls out new Van and Tradesperson products on its digital platform

Covid-19: The Group moves the majority of its operations to homeworking, guaranteeing usual pay regardless of whether individual working practices are affected

May

Green Flag refreshes "Green Flag Rescue Me" app allowing more claims to be serviced digitally

Our Travel team continues to settle claims for over 26,000 customers and repatriate over 900 customers stranded abroad

900+
travel insurance customers repatriated

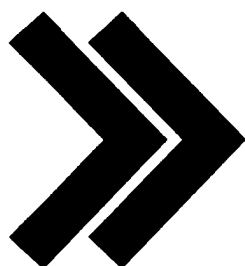
Darwin live on four price comparison websites ("PCWs")

Migrates to a new mainframe platform as part of the Group's technology transformation

Group becomes a 100% carbon-neutral business by investing in high social impact projects to offset our Scope 1, 2 and 3¹ emissions

Launch a new counter fraud operating system

Group successfully transitions a number of business areas to **agile ways of working**



450k+
customers benefit from support measures²

August

Group announces intention to set **Science-Based Targets** to strengthen our disclosures on tackling emissions

Strong Churchill new business growth, increased share of new business on PCWs across Motor and Home

October

Group announces new **diversity and inclusion targets** for improving Black, Asian and Minority Ethnic representation in senior leadership roles

New "Mileage MoneyBack" proposition offers Direct Line Motor customers a flexible approach to manage their car insurance

December

Task Force on Climate-related Financial Disclosures: Issue our first comprehensive disclosure on how the Group approaches climate change risks and opportunities

Notes:

1. Scope 3 emissions which are under our direct control – see page 61.
2. Payment deferrals, mileage refunds for motor customers, waiving cancellation fees and reducing cover.

Find out more about our plans for 2021 in the Chief Executive Officer's Review on pages 11 to 17

Transforming to drive competitiveness

Delivering strong shareholder returns

We have a track record of delivering strong returns to shareholders, having distributed £1.2 billion in dividends over the past three years. This, together with our share price performance, has delivered an attractive total shareholder return.

Diversified business model

As a UK-focused company, we have the ability to be a deep specialist in our chosen markets and our range of channels and products gives us real diversification and scale.

Total shareholder return (%)

This represents the cumulative dividends paid and change in share price over a three-year period

Gross written premiums (£m)

Operating profit (£m)

£1.2bn

Dividends paid to shareholders
in the last three years

Transforming to drive competitiveness

We are transforming our technology and changing the way we work to increase the competitiveness of our business, with the aim of improving the quality of our earnings, with a greater proportion coming from current-year business.

Best at direct

To be the UK's leading insurer, because we anticipate our customers' needs and develop services and products they want to buy.

Win on price comparison websites (PCWs)

To deliver a step change in our pricing and trading capability so that our leading PCW brands win customers from our competitors.

Extend our reach

To utilise the potential of our investments and capabilities to win more customers through acquisitions and brand partnerships.

Technical edge

To use our data, scale, skill and insight across claims, pricing and underwriting to deliver value to customers.

Nimble and cost efficient

To transform into an agile, cost effective business to drive efficiency and simplicity for us and our customers.

Great people

A home for empowered people who celebrate difference, and challenge the status quo to deliver for our customers.

See page 12 for more information

Improving the sustainability of our earnings

In 2020 we made good progress against our targets to improve the sustainability of our earnings, growing current-year contribution to operating profit and delivering a strong combined operating ratio. Our focus on supporting our customers, our people and wider society led to an increase in costs in 2020.

Costs

Target: Expense ratio^{1,2} of 20% in 2023

2020:

24.5%

Normalised current-year operating profit^{1,3}

Target: At least 50% contribution to total operating profit by 2021

2020:

65.4%

Following an elevated contribution in 2020 due to lower claims frequency associated with Covid-19 disruption

Normalised combined operating ratio ("COR")^{1,4}

Target: Between 93-95% throughout the medium term

2020:

91.7%

Return on tangible equity ("RoTE")¹

Target: At least 15% per annum over the long term

2020:

19.9%

Notes:

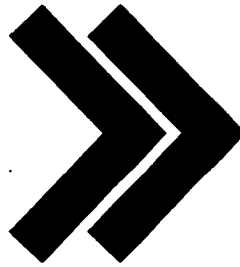
1. See glossary on pages 224 to 226 for definitions and Appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
2. Applies to operating expenses excluding restructuring and one-off costs.
3. Normalised for weather and changes to the Ogden discount rate. Reported contribution 66.7%.
4. Normalised for weather and changes to the Ogden discount rate. Reported COR 91.0%.

Business model

Protecting our customers

We help people carry on with their lives, giving them peace of mind now and in the future.

Across the business we have a number of real strengths and our customers and our people are at the heart of our business.



Giving customers a choice of brands and channels

We know how to build brand value and have some of the most loved brands in the UK which are available direct, through PCWs, or via specialist brokers. We also partner with some of the UK's leading banks.

Motor



We are Britain's leading personal motor insurer measured by in-force policies¹, mainly represented through our well-known brands Direct Line, Churchill, Privilege, our Darwin brand, and also through our partners

Home



We are one of Britain's leading personal home insurers measured by in-force policies¹. We reach our customers by selling home insurance products through our brands Direct Line, Churchill and Privilege, and our partner NatWest Group

Rescue and other personal lines



We are one of the leading providers of rescue, travel and pet insurance in the UK. Green Flag is the third largest roadside recovery provider². We are also the second largest travel and the fourth largest pet insurer³

Commercial



We protect commercial businesses through our brands, including NIC and Direct Line for Business

Notes:

1. Includes Direct Line, Churchill, Privilege, Darwin and partner brands: RBS, NatWest. © Ipsos MORI 2021, Financial Research Survey (FRS), six months ended January 2021. c. 14,000 adults (aged 16+) surveyed across Great Britain. Interviews were conducted online and by telephone, and weighted to reflect the overall profile of the adult population.
2. Mintel Vehicle Recovery – September 2020.
3. Mintel Pet Insurance – August 2020 & Mintel Travel Insurance – February 2021.

This is how we create value

We have a number of strengths, from strong brands to rich data, to leading claims skills, that are hard to replicate and provide real long-term value.

Premiums

Our diversified model enables us to offer a range of products across a range of distribution channels.

Investment return

Our diversified investment portfolio provides additional income whilst also ensuring we can support our long-term claim commitments. See page 33.

Accident repair centres

We own 21 accident repair centres, the largest owned network of any insurer, delivering lower repair costs and providing data-led insight enabling us to react to emerging trends and helping inform pricing.

Claims management

We have deep specialism in claims handling, including market-leading counter-fraud capability.

Costs

We invest in market-leading brands and strong customer service, whilst targeting cost reduction measures in order to increase our competitiveness.

Tax

We manage our tax obligations responsibly contributing either directly or indirectly £888 million in tax to the Exchequer this year. See more on page 35.

A triple win

We aim to deliver a sustainable and thriving business that generates attractive shareholder returns.

A win for customers

by sharing real value with them.

Our customers

We earn our customers' trust by demonstrating how we are acting in their best interests.

450k+

Customers benefited from support measures

A win for our people and shareholders

who are invested in our success.

Our people

We encourage a culture that celebrates difference and empowers people so that they can thrive.

£3.8m

Invested in free shares for our people

Shareholders

We have a track record of delivering strong returns to shareholders. This, together with our share price performance, has delivered an attractive total shareholder return.

£1.2bn

Paid in dividends over the last three years

A win for society and the planet

because our long-term success is intrinsically linked to the success of the community and environment around us.

Society

We use our expertise to improve outcomes for society and the communities we serve.

£7m+

Donated to charities and good causes

The planet

We protect our business from the impact of climate change and give back more to the planet than we take out.

100%

Carbon neutral via offsetting

Working for all
our stakeholders

Danuta Gray
Chair of the Board

In 2020, our resilience and agility enabled us to support our customers and communities, distribute surplus capital and progress building the capability designed to deliver our sustainable strategy.

I would like to start my first statement as Chair by recognising the efforts of all my Direct Line Group (the "Group") colleagues in navigating the turbulent conditions that we experienced in 2020.

The resilience and adaptability demonstrated by our people has been commendable. The Covid-19 pandemic has affected all our stakeholders and I am proud of the senior leadership team for responding swiftly and effectively and for addressing the rapidly changing needs of the Group's stakeholders, including our customers, our workforce and the communities we serve.

In the extraordinary market conditions caused by lockdowns and market uncertainty related to Brexit and other global economic factors, our disciplined underwriting model produced a combined operating ratio of 91.0% (2019: 92.2%). Profit before tax was down 11.4% to £451.4 million (2019: £509.7 million) but our strong capital position has enabled us to increase our final dividend to 14.7 pence and commence a share buyback of up to £100 million. This is on top of the £30 million share buyback we made in March 2020 before we prudently cancelled the programme against a background of market volatility.

New leadership and Board changes

I am delighted to have been chosen by my fellow Directors to succeed Mike Biggs as Chair following his retirement from office in August 2020. It was a pleasure to have served with him as an independent Non-Executive Director and, on behalf of the Board, I extend our thanks to Mike for his exemplary stewardship of the Board as Chair since before the Company separated from the Royal Bank of Scotland and listed on the London Stock Exchange in 2012. Mike formed the Board, led it through the IPO and was instrumental in defining the Group's

enviable culture and ambition. We are indebted to him for his wisdom, for the contribution of his deep experience, honed over four decades in the financial services sector, and for his legacy of inclusivity and solidarity in the Board's culture. The selection process which led to my appointment as Chair is summarised in the Governance report on page 91.

"The resilience and adaptability demonstrated by our people has been commendable."

We announced in December that Jane Hanson, who was appointed as an independent Non-Executive Director in December 2011, will be stepping down from the Board at the conclusion of the Annual General Meeting in May 2021. On behalf of the Board, I would like to thank Jane for her energetic leadership of the Board Risk Committee and for her hard work as a member of the Audit, Investment and Sustainability Committees.

Adrian Joseph OBE joined the Board as an independent Non-Executive Director on 1 January 2021. As the business is transformed into a technology- and data-led company, with the customer at its heart, Adrian's deep experience of digital, artificial intelligence and data will be an important addition to the Board's capabilities.

We are committed to our diversity and inclusion agenda, including our target of increasing female representation in our senior leadership team. Details about the progress we are making on Board diversity appear in our Nomination and Governance Committee report on pages 106 to 108 and further information about changes to the Board and its Committees is set out on page 91.

Strategy

Our vision is to create a world where insurance is personal, inclusive and a force for good. Our purpose is to help people carry on with their lives, giving them peace of mind now and in the future. We have worked exceptionally hard to deliver against that purpose throughout the challenging events of 2020.

Our strategic objectives aim to ensure that we build technological and organisational capability to continue providing products which meet our customers' changing needs and are available through multiple channels, to continue providing outstanding customer service and value for money, to create value for our investors, to support our communities and to protect the environment.

Dividend and capital management

The Group's solvency capital ratio as at 31 December 2020, prior to any proposed dividends or incremental capital returns, was 213%. The Board has recommended a final dividend of 14.7 pence per share, an increase of 2.1% on the special interim dividend of 14.4 pence announced with our interim results, which reflected a full catch up of the cancelled 2019 final dividend.

Reflecting the strength of the Group's capital position, and in line with our dividend policy to return capital to shareholders which is expected to be surplus to the Group's requirements for a prolonged period, the Group intends to commence a share buyback programme. The Board has approved a share buyback programme of up to £100 million, with an initial tranche of up to £50 million expected to be completed by the time of the half-year results.

After the proposed final dividend and £100 million share buyback, the estimated solvency capital ratio was 191% as at 31 December 2020. The Group has outstanding Tier 2 debt issued in 2012 with nominal value of £250 million and a first call date during the first half of 2022. Excluding this debt, the Group's solvency ratio after the proposed final dividend and share buyback would be 172%. In February 2021, the Group acquired the head lease of its Bromley office site, which reduced the Group's coverage ratio by an additional 6 percentage points.

Assuming a return to more normal circumstances, the Group intends to move towards the middle of its risk appetite range of 140% to 180% of its solvency capital requirement, consistent with its previously stated target.

Our customers

Customer experience is at the heart of everything we do, and it is the central element that connects all our people regardless of role. We recognise that the Covid-19 pandemic has had a huge, in some cases devastating, effect on many of our customers and we have sought to respond with sensitivity to customers whose travel plans have been disrupted, who find themselves under financial strain, or who have experienced bereavement. The Board oversees the Group's conduct, aiming to ensure that the Group acts in our customers' best interests and that there is an active and constructive dialogue with its insurance regulators on customer conduct matters.

Linking remuneration to performance

We remain focused on ensuring that executive pay is aligned with the Group's strategy of targeting sustainable shareholder and customer value, that it reflects investor experience and, particularly in respect of 2020, that it reflects the way in which the business has interacted with its customers, its people and its communities.

A significant proportion of executive remuneration is delivered through shares and shareholding requirements and our incentive schemes' performance measures are aligned with the long-term performance measures considered important by investors.

“We have responded with sensitivity to the huge disruption that Covid-19 has caused to many of our customers.”

The Group's share price on 31 December 2020 was 319.0 pence (2019: 312.5 pence). Total shareholder return (“TSR”), which includes dividend payments, increased by 9.0 percentage points for the year (2019: 7.0 percentage point increase). During 2020, the Group's share price grew by 2.1% (2019: 1.9% decrease), reflecting increased investor confidence following the Capital Markets Day at the end of 2019 and the delivery of strong financial results in March 2020. This was partially offset by concerns over margin contraction in Motor and Home following the publication of the FCA's Pricing Practices Report (“PPR”) which put pressure on UK Personal Lines stocks.

In April 2020, the Group took the difficult decision to cancel the 2019 final dividend of 14.4 pence and the £150 million share buyback programme, in recognition of heightened uncertainty in the macroeconomic environment due to Covid-19, although its solvency position was strong. At the time of the interim results in August 2020, the Group's financial resilience in the face of Covid-19 enabled it to declare a regular interim dividend and catch-up on the cancelled 2019 final dividend. We are grateful to our shareholders for their understanding during this challenging period.

Over the past three years, the Group has delivered a TSR of 7.9% compared to the FTSE 350 (excluding investment trusts) reduction of 5.0%, having returned £1.2 billion to shareholders during the period.

More information on the Group's remuneration policy and share awards is disclosed in the Directors' remuneration report on pages 113 to 139.

Sustainability and culture

In December 2020, we published our first Task Force on Climate-related Financial Disclosures Report and our first Sustainability Report. These set out the progress the Group has made against its Environment, Social and Governance agenda, including the Group's intention to set Science Based Targets which will strengthen our disclosures across Scope 1, Scope 2 and Scope 3 emissions, as well as the actions we took in response to the Covid-19 pandemic to support our people, customers and communities. For definitions of terms used, please see the glossary on pages 224 to 226.

Climate-related risks and opportunities have grown in importance for us as a business. As an insurance company, understanding and managing risk is of fundamental importance, and we recognise that climate change poses material long-term risks to the business.

We are embracing the sustainable practices that we believe underpin a better corporate culture, offering products that meet our customers' needs and providing greater long-term sustainability for investors.

The Board believes that working for all our stakeholders is the foundation needed for delivering long-term sustainability. The Board recognises the importance of setting the tone of the Group's culture and embedding it throughout the organisation. More information about this can be found in the Governance introduction on page 76.

In November 2019, we set out our vision for building a world where insurance is personal, inclusive and a force for good. At that time, we could not have anticipated the extraordinary events of 2020 and now more than ever, it is essential that we live up to that ambition and play our part in supporting the communities we serve. The DLG Community Fund of £3.5 million is being used to support the communities where our largest sites are based as well as several national charities.

Our People

We pride ourselves in having an empowering culture that celebrates difference and authenticity, and encourages each colleague to bring their whole self to work. The Group's success and resilience is due in no small part to the contribution of its people. In a year which could have produced very different outcomes, the Board and I are grateful for the hard work, initiative and commitment of our people, who have continued to live the Group's values and to demonstrate dedication to serving our customers.

I would also like to thank each member of the Board for their significant contribution, commitment and service and I look forward to my first full year as Chair of the Board working with them in supporting and encouraging our management team in the execution of the Group's ambitious strategy.

DANUTA GRAY

Chair of the Board

Section 172(1) statement

Direct Line Group is a leading motor, home and commercial insurer which depends on its reputation for high standards of business conduct and on the trust and confidence of its stakeholders to operate sustainably in the long term. The Group seeks to put its customers' best interests first, continually invests in and engages with its employees, supports the communities in which it operates and strives to generate value for shareholders.

The Directors of Direct Line Insurance Group plc (the "**Company**") have been subject to the duties codified in law, which include the duty to act in the way in which they consider, in good faith, would be most likely to promote the success of the Group for the benefit of its members as a whole, having regard to the stakeholders and matters set out in Section 172(1) of the Companies Act 2006 ("**Section 172(1)**").

The Board recognises that the Group has a range of stakeholders with diverse interests and an analysis of its principal stakeholders can be found on pages 48 to 61 and on page 86.

Section 172(1) considerations are embedded in decision-making at Board-level and are demonstrated throughout its governance framework.

The underlying principles of promoting the success of the Company for the benefit of its members as a whole, and of considering stakeholders when making decisions that could affect them, is understood by the senior leadership team and consideration and respect for stakeholders is demonstrated throughout the Group.

The Group has adapted to a change of working practices throughout the year and keeps engagement mechanisms under review so that they remain effective and so that the Board understands the evolving needs of its stakeholders.

In taking decisions, the Directors carefully consider the balance of interests of the stakeholders who might be affected. The Board and its Committees discuss stakeholders and their interests during the cycle of Board meetings, and in 2020 we increased both the frequency and length of meetings, not least to focus on stakeholder needs as a result of the Covid-19 pandemic.

We are committed to ensuring that the Group takes action both to protect the business and to reduce its direct and indirect impact on the environment.

In March 2020, the Board considered it prudent to cancel its share buyback programme and, in April 2020, to cancel the 2019 final dividend as a result of the volatile conditions arising from the Covid-19 pandemic, although an interim and a special interim dividend were paid later in the year when conditions stabilised and on the basis of a strong capital position. See pages 86 to 87 for more detailed examples of how the Board considered Section 172(1) when making decisions that affected its stakeholders.

Navigating an extraordinary year

Penny James
Chief Executive Officer

Despite the many challenges we faced in the year as a result of the Covid-19 pandemic, we traded well and prioritised support for our customers, our people and local communities. I am proud that our people, even when working remotely, have continued both to care for our customers and to help us build an insurance company of the future.

I am proud of what the Group has achieved during 2020. Once again, we have demonstrated financial resilience by delivering another good set of results, whilst supporting our customers, our people and local communities through the challenges of the pandemic. Despite the disruption and uncertainty that 2020 has brought, we have made real progress towards becoming a technology-driven business which can adapt quickly to the changing world around us and deliver more for our customers at speed. We could not have done this without our highly engaged people, who have demonstrated the commitment and flexibility needed to do what it takes for our customers and to drive forward our business plans regardless of their personal circumstances. I am grateful to them for their dedication, skill and support.

Business performance and the impact of Covid-19

In 2020, we delivered another year of strong profitability at the same time as growing our direct own brand policy count. The investments we have made in systems and capability over the last few years are showing through in this growth and are contributing to underlying improvements in current-year underwriting profitability. Overall Covid-19 led to a modest net benefit to the result. Despite the impact of the pandemic, we made further progress in delivering the change required to implement the Group's transformation plans.

“In 2020, we delivered another year of strong profitability at the same time as growing our direct own brand policy count.”

We traded well through the year, delivering growth in our Home, Commercial and Green Flag Rescue businesses despite prolonged periods of lockdown when new business shopping dropped significantly. Retention has held up well. In contrast average premiums have fallen as risk mix has reduced, with fewer new drivers on the road as no driving tests have been conducted for parts of the year and fewer new cars have been purchased. In the midst of these trends we are happy to see direct own brand policy growth of 2.2% and gross written premium broadly flat.

At a headline level we delivered operating profit of £522.1 million, a combined operating ratio of 91.0% and a return on tangible equity of 19.9%, well ahead of our target of at least 15% over the long term. Operating profit of £522.1 million was £24.8 million lower than 2019 (£546.9 million) due to higher major weather costs of £43.0 million (2019: £6.0 million) and reduced prior-year reserve releases, partially offset by improved current-year profitability.

Forging ahead with our strategy

Our values

Do the right thing

Aim higher

Take ownership

Say it like it is

Work together

Bring all of yourself to work

Our vision and purpose

Vision

We want to create a world where insurance is personal, inclusive and a force for good

Purpose

We help people carry on with their lives, giving them peace of mind now and in the future

Performance against strategic objectives

Best at direct

- Superhero branding campaign launched
- New Motor "Mileage MoneyBack" proposition
- Launched Van and Tradesperson products on new Direct Line for Business platform
- Green Flag awarded "Superbrand" status

Technical edge

- Launched new market-leading Motor counter-fraud system
- Expanded electric vehicle repair capabilities
- Launched a free on-line risk management portal for every NIG policyholder
- Green Flag launched a new cloud-based claims system

Win on price comparison websites

- Privilege Motor new business and renewals now live on the new platform
- Increased PCW focus including Churchill Home
- Darwin brand launched on two more PCWs
- Churchill Motor started roll-out to new platform in Q1 2021

Nimble and cost efficient

- New agile operating model embedded across digital, data and pricing
- Increased proportion of service interactions through digital channels
- Launched new property strategy following success of remote working

Extend our reach

- Agreed a two-year extension with NatWest Group for Home
- Enhanced API capabilities to enable potential Home partners to link and test
- Increased our presence in the on-demand mobility market

Great people

- Our people continued to deliver our transformation agenda while working remotely
- Our engagement scores remained high as we focused on the security and wellbeing of our people
- Awarding free shares and ensuring all eligible employees receive a bonus for the year

Sustainability pillars *See page 44 for more information*

Customers

People

Society

Planet

Governance

Overall, the impact of the pandemic led to a modest net benefit to our financial result, with the effects concentrated in four main areas:

- Reduction in motor claims frequency falling to below normal levels from Q2
- Increase in Travel claims, relating to both claims volumes and claims handling costs as well as additional commission payments
- An estimated £6 million in Covid-19 related business interruption claims
- Investments to support our customers, people and society totalling £93 million

Motor claims frequency levels were significantly lower than normal due predominantly to lockdown restrictions leading to claims frequency falling to around half normal levels during Q2. Whilst it increased during the second half of the year, claims frequency did not return to pre-Covid-19 levels during 2020. However, severity costs have increased due to the costs of making accident repair centres Covid-19 safe, longer repair times and consequently higher credit hire costs. We have seen an increase in the volume of claims within our Travel business and so have also incurred additional claims handling costs supporting our customers. In terms of business interruption, our standard wordings were clear from the outset and we were not party to the FCA's test case nor the appeal to the Supreme Court, which has been relevant to many commercial insurers, and our overall Covid-19 related business interruption claims are estimated at £6 million.

Consistent with our "Force for Good" vision, we have invested extensively in our customers in the form of premium refunds, waived fees and reduced premiums, and also in our people by protecting jobs at the most critical points in lockdown, preserving salaries and incentives in return for flexibility and investing in strengthening home working capability. And finally we have invested in society: we have helped local communities with over £7 million of donations helping 100,000s of households and contributing to the ABI Covid-19 Support Fund. In total these initiatives represent an impact of around £93 million, of which £34 million is within our operating expenses and £59 million is within our loss ratio.

"As we transform the business both in terms of the technology we use and our agility, we are changing the way the organisation works."

A further effect was felt in our investment portfolio where we saw investment return fall from £134.6 million in 2019 to £95.1 million in 2020, reflecting the dual impact of lower reinvestment rates and a small number of writedowns in the investment portfolio. When we look at some of the volatility in the market over the period we are pleased with the overall performance of the portfolio.

Prior to the pandemic we had set out to achieve improvements in our current-year loss ratio and therefore to improve the profitability of the business we write. Offsetting this we had expected to see the level of releases from prior year business reduce, reflecting changes in the level of Motor excess of loss reinsurance some years ago. During 2020, prior-year reserve releases reduced to £173.8 million (2019: £294.5 million). Although the improvements in our loss ratio undoubtedly benefited from the impact of the Covid-19 pandemic, we are confident we have made progress in increasing the current-year contribution to operating profit.

Overall we have sought to do the right thing by all our stakeholders throughout 2020, and believe the underlying performance and quality of change delivery in the year indicate we are on track to deliver on our targets.

Strategic update

2020 was always a critical change delivery year on our path to building the insurance company of the future – technology and data led but with the customer at its heart. I have been very pleased by our ability to continue delivering major transformational change, even from our homes. The table opposite outlines some of our key achievements.

Many of the foundation blocks are now in place and we are increasingly moving to extracting benefits from the technology we have implemented rather than focusing purely on technology delivery.

As we transform the business both in terms of the technology we use and our agility, we are changing the way the organisation works. We have found through 2020 that we can create and protect the culture of the Group, even with almost everyone working from home, and our regular people surveys tell us that our people want the personal flexibility that homeworking offers. Our intention, therefore, is to take this opportunity to change the way we use our premises in future so they support collaboration, training and teamwork rather than being an everyday place of work for most people.

We will remain focused around our core hub sites so our people can get together, but believe our approach gives both cost savings and advantages for our people, allowing us to support greater social mobility and assist us in identifying top talent. To this end we are reviewing our office site property strategy and have chosen to buy out our Bromley lease, the run costs of which were above market rate. This will accelerate the costs from the future 17 years of the lease and so we will take a charge to Solvency II own funds in 2021 of £85 million as we effectively de-leverage the business and, in return, make savings in excess of £10 million per annum from 2022, incremental to our original cost target plans. We will then have greater freedom to create the nature of property usage this business needs.

With the potential impact of the FCA Pricing Practices report, discussed in the Market Overview section later, combined with whiplash reform, currently due to be effective from May 2021, a mixed picture is emerging in terms of lockdowns in H1 and uncertainty over the long-term level of driving in our new "normal", and there are clearly many moving parts.

That said, capital generation has been strong and our perception is that the level of risk in the system, with vaccines rolling out and a Brexit deal in place, is beginning to reduce. As a result we are declaring a final dividend of 14.7 pence per share and announcing a share buyback programme, as we reiterate our target of operating around the middle of our risk appetite range of 140% to 180% in normal circumstances. The share buyback will be for up to £100 million, with an initial tranche of up to £50 million expected to be completed by the time of the half-year results.

As you move through the Strategic report we will seek not only to guide you through understanding our financial performance and how that positions us for the future but also to bring to life examples of the technology development and the benefit we believe it will bring. I hope it will allow you to feel why we are so excited about the progress we have made and the opportunity ahead.

Looking into 2021 we will be continuing the roll-out of our technology transformation and increasingly turning our attention to utilising these new platforms to deliver benefits for our customers.

Our plans include:

- Continuing the migration of Direct Line and Churchill Motor policies onto our new platform, enabling us to improve customers' online journey and extend our product range even further.
- Continuing the journey towards greater digitalisation, applying advanced analytical techniques to enhance the customer experience.
- Rolling out a new policy and pricing system for Green Flag enabling it to grow beyond traditional breakdown services and look after customers' motoring needs in and out of an emergency.

'Bring all of yourself to work' is a value lived vibrantly across the Group but after extensive discussions with our people, we launched a new diversity and inclusion strategy and set ourselves stretching targets around ethnicity and gender in our leadership so that we are truly inclusive and reflect the customers we serve.

- Being well placed for customers and at a competitive advantage to other players in a post FCA pricing practices market.

We are also heavily focused on improving efficiency in order to meet our cost targets by:

- Continuing organisational transformation to further digitalise customer journeys, automate business processes and adopt new ways of working, as we aim to step change both customer experience and the efficiency of our cost base.
- Realising the benefits of agile ways of working throughout the organisation with the aim of reducing the cost and increasing the pace of change.

These plans are designed with fantastic customer experience and propositions at their heart. Supporting our activities and central to the long-term sustainability of the business, we have deeply embedded and fundamental principles:

- Our values sit at the very heart of our everyday behaviours.
- Our sustainability pillars bring environmental, social and governance ("ESG") factors into the heart of our strategic thinking, whether that's our customers, our people, our society, our planet, or the importance of strong governance – they all play central roles in helping deliver our business in a sustainable way.

2020 - a year like no other

Supporting our customers

450k+

Over 450,000 customers supported through payment deferrals, waiving cancellation fees and mileage refunds

26k+

More than 26,000 customer travel claims settled and over 900 customers repatriated

Free

Free Rescue cover, fast-track claims and free home emergencies cover for NHS staff

Supporting our people

9,000

Moved 9,000 people to home working and supported our motor accident repair centres to open safely and keep Britain moving

Protected

Protected roles and salaries during initial lockdown, without government support, and offered maximum flexibility to help our people manage home and work

Free shares

£3.8 million distributed as a thank you to our people

Supporting our communities

£3.5m

Established our first Community Fund which distributed £3.5 million to 250 charities, helping over 200,000 people

£1.5m

Extended our Community Fund into 2021 with £1.5 million to support charities dealing with the impact of the Covid-19 pandemic

£3.6m

Contributed £3.6 million to the Association of British Insurers Covid-19 Support Fund

Supporting a greener future

Reduce

Committed to setting Science-Based Targets¹ for Scope¹, 2 and 3 to help the Group reduce its carbon footprint

Carbon neutral

Became a 100% carbon-neutral business by investing in high social impact projects to offset our Scope¹, 2 and 3² emissions

Report

Published our first Task Force on Climate-related Financial Disclosures ("TCFD") Report³

Notes:

1. See glossary on pages 224 to 226 for definitions.
2. Scope 3 emissions which are under our direct control.
3. For more information please see our published 2020 TCFD Report on the Group's website at www.directlinegroup.co.uk/2020_TCFD.

Market overview

Consumer trends

In 2020 we saw a number of trends emerging through the year. Ultimately these tell us that our strategy is the right one. Those trends are:

- Consumers' willingness to interact digitally has been transformed. Digitalisation is at the heart of our technology transformation so this trend is entirely aligned with our plans.
- Agility is a must. We need to be quicker at implementing changes to fulfil changing customer needs.
- The working model has changed. Knowing our people can deliver from home has provided an opportunity to change how we use our offices in a way that supports what our people tell us they want and offers opportunities to recruit people irrespective of geography.
- Car technology continues to evolve rapidly. Having the largest owned repair network of any UK insurer gives us the opportunity to develop further commercial insights.
- Cross collaboration is a must. We can achieve more by working together; co-operation across industries is essential to tackling climate change and ensuring greater diversity.

Financial Conduct Authority Pricing Practices

In September 2020 the FCA released its General Insurance Pricing Practices Final Report, which remains a key focus for us. It included the FCA's proposed remedy package aiming to ensure retail home and motor insurance products offer fair value to customers. The FCA recognised that insurers do not make excessive profits and their key proposal was that firms should offer renewal prices no higher than the equivalent new business price through the same sales channel. The consultation period ended on 25 January 2021 and we look forward to understanding the final details some time in Q2 2021.

This is an area where we have already been proactive for several years by implementing a range of measures to reduce the differential in pricing between our new business and renewal customers. We are supportive of the aims of the FCA and believe that, in a world where prices become less of a differentiator, our strong brands, diversified business model and the capabilities we are building will enable us to win in the future market. On the way there is uncertainty around the detailed application of the rules, the timelines for implementation and the nature of short-term volatility as the market rebalances. We have prepared for a range of outcomes and we continue

"We recognise that our actions as a business can contribute to climate risk mitigation and help accelerate the transition to a low carbon and sustainable future."

to work with the FCA to assist it in navigating some of the issues and are seeking to help shape the right outcome for our customers and shareholders.

Climate

The impact of climate change has far reaching implications for economies around the world. Our Planet pillar, which aims to protect our business from the impact of climate change and give back to the planet, more than we take out, drives our approach. We recognise that our actions as a business can contribute to climate risk mitigation and help accelerate the transition to a low carbon and sustainable future. We take this seriously and have continued to challenge ourselves to reduce emissions and energy consumption through greater transparency.

We have previously published our Scope 1 and 2 emissions, but this year we wanted to go further. For the first time we broke down our emissions across our offices and our accident repair centres to help us to focus our plans on where we can have the most impact. Alongside this we evaluated our Scope 3 emissions starting with those under our direct control and purchased goods and services which make a substantial contribution to our overall emissions. Our first comprehensive TCFD report (see page 62) provides us with a roadmap to strengthen our strategic response in tackling climate change and we see the Bank of England's Climate Biennial Exploratory Scenario ("CBES"), in which the Group has been invited to participate, as a way to help enhance our climate change scenario analysis capability.

The Group's focus in 2021 is to evaluate the Scope 3 emissions arising out of our investment portfolio and we will begin to scope out Science-Based Targets, which are a set of goals to provide a clear route

to reduce emissions, to submit to the Science Based Target Initiative (SBTi) for approval. Finally, we know that we are on a journey and cannot reduce our emissions overnight, therefore we became carbon neutral through offsetting, as we work to reduce our emissions over time.

Note:

1. See glossary on pages 224 to 226 for definitions.

UK economy and Brexit

Following the recession in 2020, economic uncertainty is expected to remain high throughout H1 2021 as a result of the Covid-19 pandemic, although the UK Government has acted to support UK businesses and employees and prevent lasting damage to the economy. However, the uncertainty surrounding the pandemic makes the overall impact and recovery progress unclear.

The disruption to global trade and supply chains caused by the pandemic could increase the risk of inflation in the long term. The Group's investment portfolio is positioned defensively and additional steps could be taken, such as further shifting the portfolio towards defensive sectors or increasing more allocation to cash. The portfolio also contains a proportion of short-maturity bonds which could be sold relatively quickly if necessary.

As a UK-based business with UK customers, we identified that the biggest potential financial exposure for the Group, from a disruptive or disorderly Brexit, would be to market volatility. We continue to work through the operational effects of Brexit for customers and supply chains but the potential effects have been helped by a trade deal which has avoided otherwise expected tariffs on EU goods needed to serve our customers.

“Given the progress we are making on our transformation, we enter 2021 with real momentum and are confident in delivering our vision of being a technology and data led insurance company of the future with our customers at its heart.”

Outlook

The capability delivered as the Group looks to transition from technology transformation into business transformation underpins the improvement in the current-year profitability and provides a platform for growth, underwriting improvements and cost efficiency. Through increased digitalisation and self-serve, enabled by new ways of working, we aim to deliver significant customer and efficiency improvements and underpin our target of an operating expense ratio of 20% by 2023. The new ways of working during 2020 have enabled us to think more ambitiously about how we use our office space and we have therefore launched a property strategy which aims to help deliver incremental savings to this target. In addition, greater pricing sophistication and counter-fraud initiatives aim to continue the improvement in the current-year loss ratio. The Group remains on track to maintain the contribution from current-year operating profit at more than half of the Group's total operating profit and we reiterate our ongoing target of achieving at least a 15% return on tangible equity per annum.

The Group targets a combined operating ratio of 93-95% for 2021 and over the medium term, normalised for weather, although we acknowledge there will be increased uncertainty for a period as we progress through the implementation of the FCA pricing practices proposals and as the market reacts to the ongoing Covid-19 pandemic.

2020 has been a testing year for everyone and I am proud of how we have responded as a Group, demonstrating throughout the resilience of our business model. We had strong momentum coming into the Covid-19 crisis and have delivered a good financial result whilst simultaneously navigating the Covid-19 pandemic, supporting our various stakeholders and staying true to our vision and purpose throughout. Given the progress we are making on our transformation, we enter 2021 with real momentum and are confident in delivering our vision of being a technology and data led insurance company of the future with our customers at its heart.

Penny James

Chief Executive Officer

Our key performance indicators

Combined operating ratio¹ (%)

Definition

A measure of financial year underwriting profitability. A COR of less than 100% indicates profitable underwriting. The COR is the sum of claims, expense and commission ratios and compares the cost of doing business against net earned premium generated.

Expense ratio
Commission ratio
Loss ratio

Aim

We aim to make an underwriting profit. The target in the medium term is a COR in the range of 93% to 95% normalised for weather.

For additional performance information see page 24

Remuneration

We base part of the Annual Incentive Plan ("AIP") awards on profit before tax. The COR is closely linked to this.

For additional information see pages 117 and 123

Basic earnings per share¹ (pence)

This is calculated by dividing the earnings attributable to shareholders less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares in issue.

We have not set a target. However, growing earnings per share is considered an indicator of a healthy business.

For additional performance information see page 27

This is a broad measure of earnings and reflects the results of the Group after tax less Tier 1 coupon payments. We base part of the AIP awards on profit before tax.

For additional information see page 117 and 123

Capital returns² (£m)

The amount of cash paid in dividends to shareholders and amount of share buybacks funded from the Group's retained profits. (See page 192 for dividend breakdown).

Buybacks
Special
Ordinary

We aim to grow the regular dividend in line with business growth. Additionally, we look to return any capital to shareholders which is expected to be surplus to our requirements for a prolonged period.

For additional performance information see page 28

We base Long-Term Incentive Plan ("LTIP") awards partly on relative total shareholder return performance, which includes dividends. Directors also receive dividends on their beneficial shareholdings and accrue these on unvested LTIP awards.

For additional information see pages 117 and 127

Return on tangible equity¹ (%)

The return generated on the capital that shareholders have in the business. This is calculated by dividing adjusted earnings by average tangible equity.

We aim to achieve at least a 15% RoTE per annum over the long term.

For additional performance information see page 27

We base the LTIP awards partly on adjusted RoTE over a three-year performance period.

For additional information see page 117 and 127

Notes:

- See glossary on pages 224 to 226 and Appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
- The 2019 dividends and capital returns have been adjusted to remove the cancelled 14.4p final dividend and £120 million of the share buyback as announced in March/April 2020. (The reported number were dividends and capital returns of £447.0 million).
- The 2019 solvency capital ratio has been adjusted to remove the cancelled 14.4p final dividend and £120 million of the share buyback as announced in March/April 2020. (The reported number was a solvency capital ratio of 165%.)

Solvency capital ratio^{4,5} (%)**Definition**

A risk-based measure expressing the level of capital resources held as a percentage of the level of capital that is required under Solvency II.

Aim

Under normal circumstances, the Group aims to maintain a solvency capital ratio around the middle of the risk appetite range of 140% to 180%.

Remuneration

Solvency capital ratio within our risk appetite is an indicator of capital strength, which is one of the gateways for the AIP awards and an underpin for LTIP awards.

For additional performance information see page 28

For additional information see page 117

Employee engagement (%)

Engagement is about being proud to work for the Group and helping us to succeed. It means that employees are not just happy or satisfied, but doing something to help us achieve our Company goals.

To make the Group best for employees and best for our customers. We gauge employee engagement through our employee opinion survey and we aim for high employee engagement scores each year.

The AIP awards include a weighting to a balance of employee metrics, including engagement.

For additional People information see page 50

For additional information see page 117 and 125

Net promoter score^{6,6} (points)

Net promoter score ("NPS") is an index that measures the willingness of customers to recommend products or services to others. It is used to gauge customers' overall experience with a product or service, and customers' loyalty to a brand.

We aim to increase our net promoter score over time.

The AIP awards include a weighting to a balance of customer metrics, including NPS.

For additional performance information see page 48

For additional information see page 117 and 124

Customer complaints^{6,7} (%)

The number of complaints we received during the year as a proportion of the average number of in-force policies.

This measure indicates where our customer service has not met expectations to the extent that the customer has initiated a complaint. We aim to improve this over time.

The AIP awards include a weighting to a balance of customer metrics, including complaints.

For additional information see page 117 and 124

4. Estimates based on the Group's Solvency II partial internal model.

5. On an aggregated 12-month rolling basis, with 2013 rebased to 100.

6. For the Group's principal underwriter, U K Insurance Limited.

7. FCA complaints reporting requirements have changed for periods after 29 June 2016. Before 29 June 2016, only complaints resolved after two business days were classed as FCA reportable. From July 2016 all complaints resolved are classed as FCA reportable.

Strong capital position, good results

Neil Manser

Acting Chief Financial Officer

We made good progress against our targets to improve the sustainability of our earnings in a challenging environment and maintained our balance sheet strength.

Financial highlights

Direct own brands in-force policies grew by 2.2% driven by strong segments of growth across the business including Home, Commercial and Green Flag Rescue, whilst Motor was broadly stable. Total in-force policies reduced due to lower partnerships and Travel volumes.

Direct own brands gross written premium was stable with growth across Home and Commercial direct own brands and Green Flag Rescue offset by lower average premiums in Motor. Overall gross written premium reduced by 0.7% due to falling partnership and Travel premium.

Increased major weather costs of £43.0 million (2019: £6.0 million) contributed to lower operating profit of £522.1 million, £24.8 million (4.5%) lower than 2019 (£546.9 million). Covid-19 restrictions reduced claims frequency in Motor and Commercial, although this was partially offset by investment in initiatives to protect our customers, people and society, lower investment asset returns and the impact of the Covid-19 pandemic on Travel. Overall, the impact of the pandemic was a modest net benefit to the result.

Combined operating ratio improved to 91.0% (2019: 92.2%). Normalised combined operating ratio¹, of 91.7%, was ahead of target of 93% to 95% predominantly due to the lower claims frequency in Motor.

Progress on the Group's transformation continued to drive improved current-year profitability via increased pricing and underwriting sophistication in Commercial and improved counter-fraud capability in Motor.

Profit before tax of £451.4 million was £58.3 million lower than 2019, following the reduction in operating profit alongside £39.4 million of restructuring and one-off costs as the Group invested in cost-saving initiatives.

Proposed final ordinary dividend of 14.7 pence per share, increased 2.1%² and announcing a share buyback programme of up to £100 million. Intention to move back towards the middle of the Group's capital risk appetite range assuming more normal circumstances.

Notes:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
2. The 2019 final dividend of 14.4 pence was subsequently cancelled and paid as a special interim dividend in 2020.

Financial highlights continued

	FY 2020 £m	FY 2019 £m
In-force policies (thousands)	14,615	14,789
Of which: direct own brands (thousands)	7,454	7,290
Gross written premium	3,180.4	3,203.1
Of which: direct own brands	2,225.6	2,227.8
Net earned premium	2,960.5	2,984.9
Underwriting profit	267.8	232.1
Instalment and other operating income	159.2	180.2
Investment return	95.1	134.6
Operating profit	522.1	546.9
Restructuring and other one-off costs	(39.4)	(11.2)
Finance costs	(31.3)	(26.0)
Profit before tax	451.4	509.7
Tax	(84.2)	(89.8)
Profit after tax	367.2	419.9
Key metrics		
Current-year attritional loss ratio ^{1,2}	62.3%	71.6%
Loss ratio ^{1,2}	57.9%	61.9%
Commission ratio ^{1,2}	8.6%	7.1%
Expense ratio ^{1,2}	24.5%	23.2%
Combined operating ratio ^{1,2}	91.0%	92.2%
Investment income yield ²	2.1%	2.4%
Net investment income yield ²	1.8%	2.1%
Investment return yield ²	1.6%	2.2%
Basic earnings per share (pence)	25.8	29.5
Diluted earnings per share (pence)	25.5	29.2
Return on tangible equity ²	19.9%	20.8%
Return on equity	13.1%	15.5%
Dividend per share – interim (pence)	7.4	7.2
– final (pence)	14.7	14.4
– total ordinary (pence)	22.1	21.6
– special (pence)	14.4	–
Share buyback actioned (10.4 million shares)	30.0	–
Share buyback proposed ³	100.0	150.0
	31 Dec 2020	31 Dec 2019
Net asset value per share (pence)	199.7	193.4
Tangible net asset value per share (pence)	141.5	142.0
Solvency capital ratio post dividends ^{3,4}	191%	165%

Notes:

1. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration.
2. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
3. The solvency capital ratio as reported at 31 December 2019 is after taking into account the then expected 14.4p final dividend and the £150 million share buyback announced on 3 March 2020. The impacts of the cancellation of the dividend (as announced on 8 April 2020) and of the share buyback programme (as announced on 19 March 2020 after £30 million of the buyback had been executed) would have added 24 percentage points to the ratio as reported to give an adjusted solvency capital ratio of 189%.
4. Estimates based on the Group's Solvency II partial internal model.

Performance

Operating profit¹

	FY 2020 £m	FY 2019 £m
Underwriting profit	267.8	232.1
Instalment and other operating income	159.2	180.2
Investment return	95.1	134.6
Operating profit	522.1	546.9

Operating profit (£m)

Current-year operating profit
Prior-year reserve releases

Note:

- See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.

The Group again delivered an operating profit in 2020 above £500 million and saw underlying progress towards achieving more than 50% of the profit arising from the current year. The results have been affected by the usual variability around weather events but the addition of the factors surrounding Covid-19 make them more difficult to navigate than in previous years.

First, the Group experienced major weather event claims of £43.0 million in 2020, below our expectations of £64 million but higher than the very benign weather experienced in 2019 (£6.0 million).

Second, the impact of the Covid-19 pandemic can be seen across all the main lines within the income statement, with the largest impact from reduced claims frequency in Motor. Whilst it is difficult to be exact about the impact of Covid-19 on the results, as the length of the pandemic has made initially 'one-off' impacts now more business as usual in their nature, (for example motor market pricing), this review will indicate the broad direction of these impacts.

Overall the Group incurred £93 million in supporting customers, our people and society as part of our "Force for Good" initiatives. This support included customer refunds, job protection, charity donations and supplier support measures. Over this period the Group has not taken any Government support. The cost of these initiatives are all recognised in the underwriting result.

Furthermore, within the underwriting result there are four additional factors: a net reduction in motor claims from significantly reduced driving, partly offset by higher claims severity; a reduction in motor premiums as a result of fewer new drivers and market-wide

premium deflation; additional travel claims and claims handling costs; and business interruption claims in Commercial. These factors together had a net positive impact on the underwriting result.

Outside of the impact from Covid-19, prior-year releases reduced to £173.8 million during 2020 (2019: £294.5 million), reflecting changes in the level of Motor excess of loss reinsurance some years ago and were materially offset by improvements in the underlying current-year loss ratio across Motor and Commercial.

Overall this delivered an increase in underwriting profit to £267.8 million (2019: £232.1 million).

Lower motor premium and claims volumes, primarily arising from the Covid-19 pandemic, led to a reduction in instalment and other operating income to £159.2 million (2019: £180.2 million).

Investment return decreased to £95.1 million (2019: £134.6 million), reflecting the dual impact of lower reinvestment rates and lower valuations on property in the investment portfolio.

Taking all of this together, operating profit decreased by £24.8 million to £522.1 million (2019: £546.9 million) and current-year operating profit, as a proportion of total operating profit, improved to 66.7% (65.4% on a normalised basis). Whilst current-year profitability has benefited from the impact of Covid-19 related factors in 2020, the Group remains on track for its target of achieving more than half of the Group's annual operating profit from current-year earnings by the end of 2021.

In-force policies and gross written premium

In-force policies (thousands)

At	31 Dec 2020	31 Dec 2019
Direct own brands	3,943	3,921
Partnerships	118	122
Motor	4,061	4,043
Direct own brands	1,837	1,765
Partnerships	801	829
Home	2,638	2,594
Rescue	3,400	3,450
Travel	3,499	3,648
Pet	145	157
Other personal lines	61	122
Rescue and other personal lines	7,105	7,377
Of which: Green Flag direct	1,114	1,063
Direct own brands	560	541
NIG and other	251	234
Commercial	811	775
Total in-force policies	14,615	14,789
Of which: direct own brands	7,454	7,290

Own brand policies increased to 7.5 million (2019: 7.3 million) driven by growth in Home, Commercial and Green Flag Rescue, whilst Motor was broadly stable. Total in-force policies reduced slightly to 14.6 million (2019: 14.8 million) primarily due to reductions in Home partnerships, as Prudential and Sainsbury's partnerships are closed to new business, and the impact of Covid-19 on Travel sales.

Gross written premium

	FY 2020 £m	FY 2019 £m
Direct own brands	1,567.6	1,591.7
Partnerships	49.3	59.9
Motor	1,616.9	1,651.6
Direct own brands	411.6	407.7
Partnerships	166.3	178.9
Home	577.9	586.6
Rescue	166.7	167.5
Travel	134.0	151.3
Pet	72.8	72.6
Other personal lines	44.3	44.6
Rescue and other personal lines	417.8	436.0
Of which: Green Flag direct	83.1	79.0
Direct own brands	163.3	149.4
NIG and other	404.5	379.5
Commercial	567.8	528.9
Total gross written premium	3,180.4	3,203.1
Of which: direct own brands	2,225.6	2,227.8

Gross written premium of £3,180.4 million (2019: £3,203.1 million) reduced by 0.7% with strong premium growth in Commercial offset by lower Motor and Home partnership premiums and the impact of Covid-19 disruption in Travel. Direct own brands gross written premium was broadly stable at £2,225.6 million (2019: £2,227.8 million). Growth across Commercial, Green Flag Rescue and Home own brands was offset by Motor.

Underwriting profit and combined operating ratio¹

	FY 2020	FY 2019
Underwriting profit (£ million)	267.8	232.1
Loss ratio	57.9%	61.9%
Commission ratio	8.6 %	7.1%
Expense ratio	24.5%	23.2%
Combined operating ratio	91.0%	92.2%

Note:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation.

Overall underwriting profit increased to £267.8 million (2019: £232.1 million) with an improvement in the combined operating ratio to 91.0% (2019: 92.2%). The loss ratio improved significantly to 57.9% (2019: 61.9%) as higher major weather-related claims and lower prior-year reserve releases were more than offset by the net positive effect of Covid-19 related factors. These included reduced claims frequency in Motor, only partially offset by premium deflation in Motor, higher claims handling costs in Travel and a cautious estimate of Travel claims. The improvement in the loss ratio was partially offset by a higher commission ratio and higher expense ratio. The commission ratio increased primarily as a result of increased profit share payments, particularly on packaged bank accounts, and volume related commission payments to PCWs, while the expense ratio increased due to investment in initiatives to protect our customers, people and society. Excluding costs related to the protection of our customers and people against the Covid-19 pandemic, the Group made progress in reducing its underlying expense base.

Ratio analysis by division

	Notes	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
For the year ended 31 December 2020						
Net earned premium	4	1,484.8	555.8	422.9	497.0	2,960.5
Net insurance claims	4	888.1	309.1	261.1	255.3	1,713.6
Prior-year reserve releases	34	100.6	10.8	5.6	56.8	173.8
Major weather events		n/a	(27.0)	n/a	(16.0)	(43.0)
Attritional net insurance claims		988.7	292.9	266.7	296.1	1,844.4
Loss ratio – current-year attritional		66.6%	52.7%	63.0%	59.6%	62.3%
Loss ratio – prior-year reserve releases		(6.8%)	(1.9%)	(1.3%)	(11.4%)	(5.9%)
Loss ratio – major weather events ¹		n/a	4.8%	n/a	3.2%	1.5%
Loss ratio – reported	4	59.8%	55.6%	61.7%	51.4%	57.9%
Commission ratio	4	3.2%	8.1%	16.4%	18.7%	8.6%
Expense ratio	4	24.7%	23.4%	23.9%	25.4%	24.5%
Combined operating ratio	4	87.7%	87.1%	102.0%	95.5%	91.0%
Current-year combined operating ratio		94.5%	89.0%	103.3%	106.9%	96.9%
For the year ended 31 December 2019						
Net earned premium	4	1,507.7	573.6	425.2	478.4	2,984.9
Net insurance claims	4	1,043.3	268.4	284.4	251.5	1,847.6
Prior-year reserve releases	34	180.5	41.4	7.6	65.0	294.5
Major weather events		n/a	(3.0)	n/a	(3.0)	(6.0)
Attritional net insurance claims		1,223.8	306.8	292.0	313.5	2,136.1
Loss ratio – current-year attritional		81.2%	53.5%	68.7%	65.6%	71.6%
Loss ratio – prior-year reserve releases		(11.9%)	(7.2%)	(1.8%)	(13.6%)	(9.9%)
Loss ratio – major weather events ¹		n/a	0.5%	n/a	0.7%	0.2%
Loss ratio – reported	4	69.3%	46.8%	66.9%	52.7%	61.9%
Commission ratio	4	2.6%	9.7%	6.4%	18.5%	7.1%
Expense ratio	4	22.9%	23.8%	22.1%	24.5%	23.2%
Combined operating ratio	4	94.8%	80.3%	95.4%	95.7%	92.2%
Current-year combined operating ratio		106.6%	87.6%	97.2%	109.2%	102.1%

Note:

1. Home and Commercial claims for major weather events, including inland and coastal flooding and storms.

Ratio analysis by division

Loss ratio Commission ratio Expense ratio Current-year combined operating ratio

The current-year attritional loss ratio excludes prior-year reserve releases and claims costs from major weather events, although in 2020 it was impacted by Covid-19 disruption. The Group's current-year attritional loss ratio of 62.3% improved by 9.3 percentage points compared to 2019, due to reduced Motor claims frequency alongside improved underlying current-year performance across all lines. Home and Commercial experienced increased major weather costs, up £24.0 million and £13.0 million respectively compared to 2019.

Prior-year reserve releases reduced in 2020 to £173.8 million (2019: £294.5 million), equivalent to 5.9% of net earned premium (2019: 9.9%) and were concentrated towards more recent accident years. In 2019 prior-year reserve releases included a £16.9 million reserve strengthening in relation to the change in the Ogden discount rate to minus 0.25%. Assuming current claims trends continue, prior-year reserve releases are expected to remain a significant contribution to profits. The sensitivity analysis on page 32 includes information on the effect of claims inflation.

The Group's current-year combined operating ratio improved by 5.2 percentage points to 96.9% (2019: 102.1%) as a 9.3 percentage point improvement to the current-year attritional loss ratio was partly offset by a 1.3 percentage point increase in claims due to major weather events, a 1.5 percentage point increase in the commission ratio and a 1.3 percentage point increase in the expense ratio.

Operating expenses before restructuring and one-off costs

	Note	FY 2020 £m	FY 2019 £m
Staff costs ¹		255.6	261.5
IT and other operating expenses ²		196.0	158.0
Marketing	10	106.6	113.9
Insurance levies	10	80.4	81.5
Depreciation and amortisation ^{3,4}	10	85.8	78.8
Total operating expenses before restructuring and one-off costs		724.4	693.7

Notes:

- Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
- IT and other operating expenses include professional fees and property costs.
- Depreciation and amortisation includes a £6.6 million impairment charge (2019: £1.3 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.
- Includes depreciation on right-of-use assets of £14.8 million (2019: £14.2 million).

Operating expenses before restructuring and one-off costs increased by £30.7 million to £724.4 million (2019: £693.7 million). This resulted in an increase in the expense ratio of 1.3 percentage points to 24.5% (2019: 23.2%). The increase in costs was entirely due to investment in initiatives for our customers, people, suppliers and the wider society in the context of the Covid-19 pandemic. In total these initiatives are estimated to have increased operating expenses by £34 million and in some cases had the effect of delaying cost saving programmes which were planned for 2020. Adjusting for these initiatives, operating expenses were broadly flat year on year and we reiterate our 20% expense ratio ambition for 2023.

Instalment and other operating income

	Note	FY 2020 £m	FY 2019 £m
Instalment income		109.3	114.0
Other operating income:			
Revenue from vehicle recovery and repair services	7	24.0	28.3
Vehicle replacement referral income	7	12.2	19.1
Legal services income	7	8.8	11.3
Other income ¹	7	4.9	7.5
Other operating income		49.9	66.2
Total instalment and other operating income		159.2	180.2

Note:

- Other income includes mainly fee income from insurance intermediary services.

Instalment and other operating income, which is primarily driven by premium and claims volumes, decreased by £21.0 million to £159.2 million. Instalment income fell primarily due to lower motor premium, whereas lower other operating income reduced due to Covid-19 related lower motor claims frequency.

Investment return

	Note	FY 2020 £m	FY 2019 £m
Investment income		127.1	146.4
Hedging to a sterling floating rate basis		(20.3)	(22.1)
Net investment income		106.8	124.3
Net realised and unrealised (losses)/gains excluding hedging		(11.7)	10.3
Total investment return	6	95.1	134.6

Investment yields

	FY 2020	FY 2019
Investment income yield ¹	2.1%	2.4%
Net investment income yield ¹	1.8%	2.1%
Investment return yield ¹	1.6%	2.2%

Note:

- See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.

Total investment return decreased by £39.5 million to £95.1 million (2019: £134.6 million) with a reduction in investment income and write downs on investment property. Lower reinvestment rates, following interest rate cuts made by both the US Federal Reserve and the Bank of England during Q1 2020, led to a lower net investment income yield of 1.8% (2019: 2.1%).

Realised and unrealised losses excluding hedging were predominantly driven by lower investment property valuations and a reduction in gains from bond disposals. Overall the investment portfolio performed well in the context of challenging market conditions.

In 2021, the Group expects a net investment income yield of around 1.5% with minimal gains.

The Group's investment strategy aims to deliver several objectives, which are summarised below:

- to ensure there is sufficient liquidity available within the investment portfolio to meet stressed liquidity scenarios;
- to match periodic payment orders ("PPOs") and non-PPO liabilities in an optimal manner; and
- to deliver a suitable risk-adjusted investment return commensurate with the Group's risk appetite.

Reconciliation of operating profit

	Note	FY 2020 £m	FY 2019 £m
Motor	4	363.5	302.6
Home	4	101.4	150.6
Rescue and other personal lines	4	6.8	39.1
Commercial	4	50.4	54.6
Operating profit	4	522.1	546.9
Restructuring and one-off costs		(39.4)	(11.2)
Finance costs	11	(31.3)	(26.0)
Profit before tax	4	451.4	509.7
Tax	12	(84.2)	(89.8)
Profit for the year attributable to the owners of the Company		367.2	419.9

Operating profit by segment

All divisions contributed to profit in 2020, demonstrating the diversity of the Group's multi-product, multi-brand and multi-channel portfolio. Motor operating profit increased significantly primarily due to the reduction in claims frequency whereas Home operating profit reduced primarily due to higher weather-related costs and lower prior-year reserve releases. Commercial continued to generate strong profit despite higher weather claims while improved Rescue operating profit of £51.2 million (2019: £45.2 million) offset a weak result in other personal lines, mainly from Travel.

Restructuring and one-off costs

In order to support its cost reduction targets, the Group announced approximately £60 million of restructuring and one-off costs across 2019 and 2020 at its Capital Markets Day in November 2019. The Group incurred £39.4 million of restructuring and one-off costs in 2020 bringing the total cost to date to £50.6 million. As part of the Group's response to the Covid-19 pandemic to support its people it paused some elements of its restructuring programme. The Group expects the remaining £9 million in relation to this cost reduction programme to be incurred during 2021.

In addition, the Group is reviewing its office site property strategy and has bought out the lease of its Bromley office thus accelerating payment of an existing long-term liability. This transaction will incur restructuring costs of £85 million in 2021.

Finance costs

Finance costs increased to £31.3 million (2019: £26.0 million) primarily due to interest on the £260 million Tier 2 subordinated debt issued in June 2020.

Effective corporation tax rate

The effective tax rate for 2020 was 18.7% (2019: 17.6%), which was slightly lower than the standard UK corporation tax rate of 19.0% (2019: 19.0%) driven primarily by tax relief for the Tier 1 coupon payments partly offset by disallowable expenses. The effective rate is higher than 2019, which benefited from the release of an overprovision from a prior year.

On 3 March 2021 the Chancellor announced that the rate of UK corporation tax will increase to 25% from 1 April 2023. This is not reflected in the figures above as it was not substantively enacted at the balance sheet date, however, the effect is not expected to be material.

Profit for the year and return on tangible equity¹

Profit for the year was lower at £367.2 million (2019: £419.9 million) in line with the reduction in operating profit as well as increased restructuring and one-off costs and finance costs.

Return on tangible equity decreased to 19.9% (2019: 20.8%) due primarily to a £24.4 million decrease in adjusted¹ profit after tax to £384.1 million (2019: £408.5 million). Profit after tax was adjusted for restructuring and one-off costs and coupon payments in respect of Tier 1 notes.

Note:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.

Earnings per share

Basic earnings per share decreased by 12.5% to 25.8 pence (2019: 29.5 pence). Diluted earnings per share decreased by 12.7% to 25.5 pence (2019: 29.2 pence) mainly reflecting the reduction in profit after tax.

Cash flow

The Group's cash and cash equivalents increased by £271.9 million during the year (2019: £196.1 million decrease) to £1,168.2 million.

The Group generated operating cash flows before movements in working capital of £398.6 million (2019: £370.3 million), an increase of £28.3 million due to the increase in profit for the year adjusted for non-cash movements. After taking into account movements in working capital, the Group generated £402.6 million (2019: £182.4 million), an increase of £220.2 million. The Group has considerable assets under management; the cash generated from these reduced by £58.0 million to £315.9 million following reductions in the Group's assets under management, as a result of dividend payments. Net cash generated from operating activities was £584.7 million (2019: £462.1 million).

Net cash used in investing activities of £161.0 million reflected the Group's continuing investment in its major IT programmes (2020: £140.7 million, 2019: £175.7 million).

Net cash used in financing activities of £151.8 million comprised £312.5 million (2019: £420.7 million) in dividends and Tier 1 capital coupon payments in the year, partly offset by net proceeds of £257.2 million on the Tier 2 subordinated debt issued in June. Dividends paid in the year comprised the 7.4 pence first interim dividend and 14.4 pence special dividend announced in the half-year results in 2020.

Net cash used in financing and investing activities partly offset the £584.7 million generated from operating activities and resulted in a net increase in cash and cash equivalents of £271.9 million (2019: £196.1 million decrease) to £1,168.2 million (2019: £896.3 million).

The levels of cash and other highly liquid sources of funding that the Group holds to cover its claims obligations is continually monitored to ensure that the levels remain within the Group's risk appetite.

Net asset value

At 31 December	Note	2020 £m	2019 £m
Net assets ¹	16	2,699.7	2,643.6
Goodwill and other intangible assets	16	(786.8)	(702.5)
Tangible net assets	16	1,912.9	1,941.1
Closing number of Ordinary Shares (millions)	16	1,351.8	1,366.6
Net asset value per share (pence)	16	199.7	193.4
Tangible net asset value per share (pence)	16	141.5	142.0

Note:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.

Net assets at 31 December 2020 increased to £2,699.7 million (31 December 2019: £2,643.6 million) and tangible net assets decreased to £1,912.9 million (31 December 2019: £1,941.1 million) reflecting the 2020 retained profit and increases in available-for-sale reserves. This was offset by additional expenditure on intangible assets as the Group continued to invest in the business.

Balance sheet management

Capital management and dividend policy

The Group aims to manage its capital efficiently and generate long-term sustainable value for shareholders, while balancing operational, regulatory, rating agency and policyholder requirements. The Group aims to grow its regular dividend in line with business growth.

Where the Board believes that the Group has capital which is expected to be surplus to the Group's requirements for a prolonged period, it would intend to return any surplus to shareholders. In normal circumstances, the Board expects that a solvency capital ratio around the middle of its risk appetite range of 140% to 180% of the Group's solvency capital requirement ("SCR") would be appropriate and it will therefore take this into account when considering the potential for special distributions.

In the normal course of events the Board will consider whether or not it is appropriate to distribute any surplus capital to shareholders once a year, alongside the full-year results.

The Group expects that one-third of the annual dividend will generally be paid in the third 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. The Company may consider a special dividend and/or a repurchase of its own shares to distribute surplus capital to shareholders.

The Board has recommended a final dividend of 14.7 pence per share (2019: 14.4 pence), an increase of 2.1% on the special interim dividend of 14.4 pence per share announced at the time of the interim results which reflected a full catch up of the cancelled 2019 final dividend. The Board has also approved a share buyback of up to £100 million, with an initial tranche of up to £50 million expected to be completed by the time of the half-year results. This reflects the Board's continued confidence in the Group's capital position and the sustainability of its earnings. In normal circumstances, the Board expects the Group to operate around the middle of its solvency capital ratio risk appetite range of 140% to 180%.

After the dividend and share buyback, the estimated solvency capital ratio was 191% as at 31 December 2020. The Group has outstanding Tier 2 debt issued in 2012 with nominal value of £250 million and a first call date during the first half of 2022. Excluding this debt, the Group's solvency ratio after the dividend and share buyback would be 172%. In February 2021, the Group acquired the head lease of its Bromley office site, which reduced the Group's coverage ratio by an additional 6 percentage points.

The final dividend will be paid on 20 May 2021 to shareholders on the register on 9 April 2021. The ex-dividend date will be 8 April 2021.

Capital analysis

The Group is regulated under Solvency II requirements by the PRA on both a Group basis and for the Group's principal underwriter, U K Insurance Limited. In its results, the Group has estimated its Solvency II own funds, SCR and solvency capital ratio as at 31 December 2020.

Capital position

At 31 December 2020, the Group held a Solvency II capital surplus of £1.22 billion above its regulatory capital requirements, which was equivalent to an estimated solvency capital ratio of 191%, after the proposed final dividend and share buyback.

The Group's SCR and solvency capital ratio are as follows:

At 31 December	2020	2019
Solvency capital requirement (£ billion)	1.34	1.32
Capital surplus above solvency capital requirement (£ billion)	1.22	0.85
Solvency capital ratio after proposed final dividend and share buyback	191%	165%

Movement in capital surplus

	2020 £bn	2019 £bn
Capital surplus at 1 January	0.85	0.89
Capital generation excluding market movements	0.59	0.60
Market movements	(0.02)	0.06
Capital generation	0.57	0.66
Change in solvency capital requirement	(0.02)	(0.06)
Surplus generation	0.55	0.60
Capital expenditure	(0.16)	(0.19)
Tier 2 debt issue	0.26	–
Cancellation of 2019 year-end distribution and reinstatement for 2020 half year ¹	0.12	–
Interim dividend	(0.10)	(0.10)
Final dividend ²	(0.20)	(0.20)
Share buyback	(0.10)	(0.15)
Net surplus movement	0.37	(0.04)
Capital surplus at 31 December	1.22	0.85

Notes:

1. Relates to the cancellation of the 2019 cash dividend (£198 million) and share buyback (£120 million) offset by the special dividend subsequently declared at half year 2020.
2. Foreseeable dividends included above are adjusted to exclude the expected dividend waivers in relation to shares held by the employee share trusts, which are held to meet obligations arising on the various share option awards.

Movement in capital surplus (£bn)

In 2020, the Group generated £0.57 billion of Solvency II capital and added £0.26 billion via a Tier 2 debt issue, whilst cancelled distributions added £0.12 billion to own funds. This was offset by £0.16 billion of capital expenditure and distributions of £0.40 billion. Capital expenditure reflects the significant investment the Group is making in building future capability, including the development of the next generation core personal lines IT systems. In 2021 annual capital expenditure levels are expected to reduce to around £120 million. In addition, £85 million of restructuring costs in relation to the purchase of the Bromley office lease will decrease capital generation in 2021.

Change in solvency capital requirement

	2020 £bn
Solvency capital requirement at 1 January	1.32
Model and parameter changes	-
Exposure changes	0.02
Solvency capital requirement at 31 December	1.34

The Group's SCR has increased by £0.02 billion in the year due to exposure changes. Model and parameter changes were largely offsetting.

Scenario and sensitivity analysis

The following table shows the impact on the Group's estimated solvency capital ratio in the event of the following scenarios as at 31 December 2020. The impact on the Group's solvency capital ratio arises from movements in both the Group's solvency capital requirement and own funds.

Scenario	Impact on solvency capital ratio	
	31 Dec 2020	31 Dec 2019
Deterioration of small bodily injury motor claims equivalent to that experienced in 2008/09	(6pts)	(7pts)
One-off catastrophe loss equivalent to the 1990 storm "Daria"	(8pts)	(9pts)
One-off catastrophe loss based on extensive flooding of the River Thames	(8pts)	(9pts)
Change in Solvency II reserving basis for PPOs to use a real discount rate of minus 1% ¹	(10pts)	(8pts)
100bps increase in credit spreads ²	(9pts)	(9pts)
100bps decrease in interest rates with no change in the PPO real discount rate	(3pts)	1pt

Notes:

- The PPO real discount rate used is an actuarial judgement which is reviewed annually based on the economic outlook for wage inflation relative to the PRA discount rate curve.
- Only includes the impact on available-for-sale ("AFS") assets (excludes illiquid assets such as infrastructure debt) and assumes no change to the SCR.

Own funds

The following table splits the Group's own funds by tier on a Solvency II basis.

At 31 December	2020 £bn	2019 £bn
Tier 1 capital before foreseeable distributions	1.84	1.80
Foreseeable dividend and share buyback	(0.30)	(0.35)
Tier 1 capital – unrestricted	1.54	1.45
Tier 1 capital – restricted	0.38	0.37
Tier 1 capital	1.92	1.82
Tier 2 capital – subordinated debt	0.53	0.26
Tier 3 capital – deferred tax	0.11	0.09
Total own funds	2.56	2.17

During 2020, the Group's own funds increased from £2.17 billion to £2.56 billion. Tier 1 capital after foreseeable distributions represents 75% of own funds and 143% of the estimated SCR. Tier 2 capital relates solely to the Group's £0.53 billion subordinated debt. The amount of Tier 2 and Tier 3 capital permitted under the Solvency II regulations is 50% of the Group's SCR and of Tier 3 alone is less than 15%. Therefore, the Group currently has no ineligible capital. The maximum amount of Restricted Tier 1 capital permitted as a proportion of total Tier 1 capital under the Solvency II regulations is 20%. Restricted Tier 1 capital relates solely to the Tier 1 notes issued in 2017.

Reconciliation of IFRS shareholders' equity to Solvency II own funds

At 31 December	2020 £bn	2019 £bn
Total shareholders' equity	2.70	2.64
Goodwill and intangible assets	(0.79)	(0.70)
Change in valuation of technical provisions	0.04	(0.06)
Other asset and liability adjustments	(0.11)	(0.08)
Foreseeable dividend and share buyback	(0.30)	(0.35)
Tier 1 capital – unrestricted	1.54	1.45
Tier 1 capital – restricted	0.38	0.37
Tier 1 capital	1.92	1.82
Tier 2 capital – subordinated debt	0.53	0.26
Tier 3 capital – deferred tax	0.11	0.09
Total own funds	2.56	2.17

Reconciliation of IFRS shareholders' equity to Solvency II own funds (£bn)

Tier 1 capital – unrestricted	Tier 2 capital
Tier 1 capital – restricted	Tier 3 capital

Leverage

The Group's financial leverage increased by 5.6 percentage points to 24.2% (2019: 18.6%). The increase was primarily due to the issue of £260 million of Tier 2 subordinated debt in June 2020.

At 31 December	2020 £m	2019 £m
Shareholders' equity	2,699.7	2,643.6
Tier 1 notes	346.5	346.5
Financial debt – subordinated debt	516.6	259.0
Total capital employed	3,562.8	3,249.1
Financial-leverage ratio¹	24.2%	18.6%

Note:

- Total IFRS financial debt and Tier 1 notes as a percentage of total IFRS capital employed.

Credit ratings

Moody's Investors Service provide insurance financial-strength ratings for U K Insurance Limited, the Group's principal underwriter. Moody's rate U K Insurance Limited as "A1" for insurance financial strength (strong) with a stable outlook.

Reserving

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 associated claims handling costs. The Group considers the class of business, the length of time to notify a claim, the validity of the claim against a policy, and the claim value. Claims reserves could settle across a range of outcomes, and settlement certainty increases over time. However, for bodily injury claims the uncertainty is greater due to the length of time taken to settle these claims. The possibility of annuity payments for injured parties also increases this uncertainty.

The Group seeks to adopt a conservative approach to assessing liabilities, as evidenced by the favourable development of historical claims reserves. Reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal actuarial best estimate. This margin is set by reference to various actuarial scenario assessments and reserve distribution percentiles. It also considers other short and long-term risks not reflected in the actuarial inputs, as well as management's view on the uncertainties in relation to the actuarial best estimate.

The most common method of settling bodily injury claims is by a lump sum. When this includes an element of indemnity for recurring costs, such as loss of earnings or ongoing medical care, the settlement calculations apply the statutory discount rate (known as the Ogden discount rate) to reflect the fact that payment is made on a one-off basis rather than periodically over time. The current Ogden discount rate is minus 0.25% for England and Wales, minus 0.75% in Scotland, and 2.5% in Northern Ireland.

The Group reserves its large bodily injury claims at the relevant discount rate for each jurisdiction, with the overwhelming majority now reserved at minus 0.25% as most will be settled under the law of England and Wales. The Ogden discount rate will be reviewed again at the latest in 2024. There has been an ongoing reduction in large bodily injury exposures as a result of continued positive prior-year development of claims reserves, and a higher proportion of reserves being covered by reinsurance as a result of the decision to opt for a lower reinsurance attachment point from 2014 onwards.

If the claimant prefers, large bodily injury claims can be settled using a PPO. This is an alternative way to provide an indemnity for recurring costs, making regular payments, usually for the rest of the claimant's life. These claims are reserved for using an internal discount rate, which is progressively unwound over time. As it is likely to take time to establish whether a claimant will prefer a PPO or a lump sum, until a settlement method is agreed the Group makes assumptions about the likelihood that claimants will opt for a PPO. This is known as the PPO propensity.

The Group's prior-year reserve releases were £173.8 million (2019: £294.5 million) with good experience in large bodily injury claims being a key contributor.

Looking forward, the Group expects to continue setting its initial management best estimate with an appropriate degree of conservatism. Assuming current claims trends continue, the contribution from prior-year reserve releases is expected to remain significant.

Claims reserves net of reinsurance 2020 (£m)

£2,591.7m

Claims reserves net of reinsurance 2019 (£m)

£2,670.0m

Motor
Home
Rescue and other personal lines
Commercial

The Covid-19 pandemic has led to the largest shock to the UK economy on record and the outlook remains unusually uncertain at year end 2020. Much depends on the evolution of the pandemic and measures taken to protect public health, as well as the transition to the new trading arrangements between the EU and the UK. In addition to concerns about general indicators of economic health, such as falls in gross domestic product, rising unemployment and rising public sector debt ratios, the Group's reserves are exposed to the risk of changes in claims development patterns and claims inflation resulting from the pandemic. Changes in claims frequency present greater uncertainty for the unearned part of the business, whereas uncertainty over the level of claims severity has a greater impact on the earned claims reserves. Claims severity risk is particularly acute with respect to care costs for large bodily injury claims and car repair costs due to potential supply chain interruptions. The Group has therefore developed additional claims inflation scenarios, which look at 100 basis point changes in the claims inflation assumed in the actuarial best estimate over the next two years and these can be found in the table below.

Sensitivity analysis – the discount rate used in relation to PPOs, changes in the assumed Ogden discount rate and claims inflation

The table below provides a sensitivity analysis of the potential net impact of a change in a single factor (the internal discount rate used for PPOs, the Ogden discount rate or claims inflation) with all other assumptions left unchanged. Other potential risks beyond the ones described could have additional financial impacts on the Group.

At 31 December	Increase / (decrease) in profit before tax ^{1,2}	
	2020 £m	2019 £m
PPOs³		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	45.9	48.5
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(62.7)	(66.5)
Ogden discount rate⁴		
Impact of the Group reserving at a discount rate of 0.75% compared to minus 0.25% (2019: 0.75% compared to minus 0.25%)	43.7	53.3
Impact of the Group reserving at a discount rate of minus 1.25% compared to minus 0.25% (2019: minus 1.25% compared to minus 0.25%)	(61.1)	(75.0)
Claims inflation		
Impact of a decrease in claims inflation by 100 basis points for two consecutive years (new scenario in 2020)	32.4	--
Impact of an increase in claims inflation by 100 basis points for two consecutive years (new scenario in 2020)	(32.2)	--

Notes:

1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at 31 December and should not be interpreted as predictions.
3. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0% for reserving. The PPO sensitivity has been calculated as the direct impact of the change in the real discount rate with all other factors remaining unchanged.
4. Ogden discount rate sensitivity has been calculated on the direct impact of a permanent change in the discount rate in England and Wales with all other factors remaining unchanged. The Group will consider the statutory discount rate when setting its reserves but not necessarily provide on this basis. This is intended to ensure that reserves are appropriate for current and potential future developments.

The PPO sensitivity above is calculated on the basis of a change in the internal discount rate used for the actuarial best estimate reserves as at 31 December 2020. It does not take into account any second order impacts such as changes in PPO propensity or reinsurance bad debt assumptions.

Reinsurance

The objectives of the Group's reinsurance strategy are to reduce the volatility of earnings, facilitate effective capital management, and transfer risk outside the Group's risk appetite. This is achieved by transferring risk exposure through various reinsurance programmes:

- Catastrophe reinsurance to protect against an accumulation of claims arising from a natural perils event. The retained deductible is £130 million and cover is placed annually on 1 July up to a modelled 1-in-200 year loss event of £1,125 million.
- Motor reinsurance to protect against a single claim or an accumulation of large claims which renews on 1 January. The retained deductible is set at an indexed level of £1 million per claim but the reinsurance is only 75% placed up to a level of £10 million and the protection above £10 million is subject to an additional aggregate retention of £37.5 million. This programme was renewed on 1 January 2021.
- Commercial property risk reinsurance to protect against large individual claims with a retained deductible of £4.0 million which renews annually on 1 July.

Investment portfolio

The investment strategy aims to deliver several objectives, which are summarised below:

- to ensure there is sufficient liquidity available within the investment portfolio to meet stressed liquidity scenarios
- to match PPO and non-PPO liabilities in an optimal manner
- to deliver a suitable risk-adjusted investment return commensurate with the Group's risk appetite

Asset and liability management

The following table summarises the Group's high-level approach to asset and liability management.

Liabilities	Assets	Characteristics
More than 10 years, for example PPOs	Property and infrastructure debt	Inflation-linked or floating
Short and medium term – all other claims	Investment-grade credit	Fixed – "Key rate duration matched"
Tier 1 equity	Investment-grade credit	Fixed
Tier 2 sub-debt (swapped fixed to floating)	Commercial real estate loans and cash	Floating
Tier 2 sub-debt (fixed)	Investment-grade credit and cash	Fixed or floating
Surplus – tangible equity	Investment-grade credit, short-term high yield, cash and government debt securities	Fixed or floating

Asset allocation and benchmarks – U K Insurance Limited

The current strategic asset benchmarks for U K Insurance Limited are detailed in the following table:

At 31 December	Benchmark holding 2020	Actual holding 2020	Benchmark holding 2019	Actual holding 2019
Investment-grade credit	66.0%	63.8%	65.0%	62.5%
High yield	6.0%	6.0%	6.0%	6.9%
Investment-grade private placements	3.0%	1.8%	3.0%	1.8%
Credit	75.0%	71.6%	74.0%	71.2%
Sovereign	3.0%	0.4%	5.0%	1.7%
Total debt securities	78.0%	72.0%	79.0%	72.9%
Infrastructure debt	4.0%	4.5%	5.0%	4.9%
Commercial real estate loans	6.5%	3.5%	4.0%	3.7%
Cash and cash equivalents	6.0%	15.0%	7.0%	13.4%
Investment property	5.5%	5.0%	5.0%	5.1%
Total investment holdings	100.0%	100.0%	100.0%	100.0%

Investment holdings and yields – total Group

	2020			2019		
	Allocation (£m)	Income (£m)	Yield (%)	Allocation (£m)	Income (£m)	Yield (%)
Investment-grade credit ¹	3,736.6	76.3	2.1%	3,676.8	82.1	2.3%
High-yield	349.0	18.9	5.1%	390.8	21.2	5.4%
Investment-grade private placements	103.9	2.7	2.6%	104.0	2.8	2.6%
Credit	4,189.5	97.9	2.3%	4,171.6	106.1	2.3%
Sovereign ¹	25.5	0.7	1.1%	99.8	2.3	1.8%
Total debt securities	4,215.0	98.6	2.3%	4,271.4	108.4	2.5%
Infrastructure debt	264.5	5.8	2.1%	278.1	7.0	2.5%
Commercial real estate loans	206.7	6.5	3.3%	205.7	6.9	3.4%
Cash and cash equivalents ²	1,168.2	2.5	0.2%	896.3	7.9	0.8%
Investment property	292.1	13.7	4.7%	291.7	16.2	5.3%
Equity investments ³	3.2	–	0.0%	–	–	0.0%
Total Group	6,149.7	127.1	2.1%	5,943.2	146.4	2.4%

Notes:

1. Asset allocation at 31 December 2020 includes investment portfolio derivatives, which have a mark-to-market asset value of £7.7 million included in investment-grade credit and £0.3 million in sovereign debt (31 December 2019: £81.8 million and nil respectively). This excludes non-investment derivatives that have been used to hedge interest on subordinated debt and operational cash flows.
2. Net of bank overdrafts: includes cash at bank and in hand and money market funds.
3. Equity investments consist of an equity fund which is valued based on external valuation reports received from a third-party fund manager.

At 31 December 2020, total investment holdings of £6,149.7 million were 3.5% higher than at the start of the year, primarily reflecting the cash received on issue of the Tier 2 subordinated debt. Total debt securities were £4,215.0 million (31 December 2019: £4,271.4 million), of which 2.6% were rated as 'AAA' and a further 54.4% were rated as 'AA' or 'A'. The average duration at 31 December 2020 of total debt securities was 2.8 years (31 December 2019: 2.5 years).

At 31 December 2020, total unrealised gains, net of tax, on available-for-sale investments were £83.9 million (31 December 2019: £47.5 million).

Tax management

The Board recognises that the Group has an important responsibility to manage its tax position effectively. The Board has delegated day-to-day management of taxes to the Chief Financial Officer and oversight is provided by the Audit Committee.

These arrangements are intended to ensure that the Group: complies with applicable laws and regulations; meets its obligations as a contributor and a collector of taxes on behalf of the tax authorities; and manages its tax affairs efficiently, claiming reliefs and other incentives where appropriate.

Tax authorities

The Group has open and cooperative relationships with the tax authorities with whom it deals in the countries where the Group operates, namely the UK, the Republic of Ireland, South Africa and India.

Tax policy and governance

The Group's tax policy has been reviewed and approved by the Audit Committee. The Group Tax function supports the Chief Financial Officer in ensuring the policy is adhered to at an operational level.

For more information please see our published Group Tax policy on the Group's website at <https://www.directlinegroup.co.uk/en/who-we-are/governance/other-policies.html>.

Total tax contribution

The Group's direct and indirect tax contribution to the UK Exchequer is significantly higher than the UK corporation tax that the Group pays on its profits. The Group collects taxes relating to employees and customers on behalf of the UK Exchequer and other national governments. It also incurs a significant amount of irrecoverable value added tax relating to overheads and claims. Taxes borne and collected in other tax jurisdictions have not been included in this note as the amounts are minimal in the context of the wider UK Group.

During 2020 the sum of taxes either paid or collected across the Group was £888.0 million. The composition of this between the various taxes borne and collected by the Group is shown below.

At 31 December	2020 £m
Current-year corporation tax charge	95.2
Irrecoverable value added tax incurred on overheads	79.1
Irrecoverable value added tax embedded within claims spend	158.6
Employer's national insurance contributions	39.8
Other taxes	9.1
Total taxes borne	381.8

At 31 December	2020 £m
Insurance premium tax	397.0
Value added tax	11.3
Employee's pay as you earn and national insurance contributions	97.9
Total taxes collected	506.2

Total taxes borne by tax type (£m)
£381.8m

Total taxes collected by tax type (£m)
£506.2m

Corporation tax
 Irrecoverable VAT
 Employer's NIC
 Other taxes

Insurance premium tax
 VAT
 Employee's PAYE and NIC

Nell Manser
 Acting Chief Financial Officer

Motor



Own brand in-force policies increased by 0.6%, with an overall increase in in-force policies of 0.4% to 4.1 million.

Own brand gross written premium reduced by 1.5%, overall gross written premium reduced by 2.1%.

Operating profit of £363.5 million was £60.9 million higher than prior year due to lower claims frequency, mainly due to Covid-19 restrictions, partly offset by lower prior-year reserve releases.

Gross written premium by channel

Direct
Partnerships
Price comparison
websites

**In-force policies
(’000s)**

4,061
(2019: 4,043)

**Gross written
premium**

£1,616.9m
(2019: £1,651.6m)

**Operating
profit**

£363.5m
(2019: £302.6m)

**Combined
operating ratio**

87.7%
(2019: 94.8%)

	2020	2019
In-force policies (thousands)	4,061	4,043
Of which direct own brands	3,943	3,921
Gross written premium	£1,616.9m	£1,651.6m
Loss ratio	59.8%	69.3%
Commission ratio	3.2%	2.6%
Expense ratio	24.7%	22.9%
Combined operating ratio	87.7%	94.8%
Operating profit	£363.5m	£302.6m

Overview

In 2020, the motor market experienced disruption driven by Covid-19 lockdowns, with reductions in claims frequency and lower new business shopping. These trends were reflected in lower average premiums.

Against this backdrop, the Group focused on providing financial support to its customers experiencing financial difficulties while maintaining a focus on underwriting discipline and indemnity management in a highly competitive market.

During the year, the Group continued to focus on technology and business transformation. Despite the operational challenges in moving to remote working, further progress was made on the roll-out of the Group's new motor platform with roll-out completed for Privilege new business and renewal customers in the year and scheduled to be started for Churchill PCW and new phone business in Q1 2021. Motor improved its PCW competitiveness with the launch of the Darwin brand on two more PCWs helping drive strong growth during the year. In addition, the Group launched a new "Mileage Moneyback" proposition for Direct Line Motor customers.

The Group's in-house vehicle repair network continued to repair customers' vehicles and prioritised repairs for NHS workers.

The combination of market dynamics and strategic progress resulted in a current-year attritional loss ratio of 66.6% (2019: 81.2%).

Performance

Motor in-force policies grew by 0.4% to 4.1 million with own brand in-force policies up by 0.6% at 3.9 million. Strong retention was partially offset by a slow down in the new business market as new car sales fell and fewer new drivers entered the market. The Group saw good growth in the PCW channel as both Churchill and Darwin strengthened their propositions.

Note:

1. Average incepted written premium excluding IPT for Motor own brands (covering 96.5% of Motor) for year end 31 December 2020.

Mileage refunds

For our customers who were experiencing immediate financial difficulty due to the impact of Covid-19, we implemented a range of support measures. We waived cancellation fees and offered payment deferrals for people who had lost their job or seen changes to their employment. We recognised that the lockdown was changing customers' behaviour and invited every customer to contact us if their annual mileage had reduced, resulting in thousands of premium refunds and waived administration fees. We also launched a new Direct Line "Mileage MoneyBack" proposition giving customers the flexibility to update their mileage at the end of their policy and claim a refund on the miles not driven when the policy comes up for renewal.

The Group offered premium refunds to all customers where miles driven were expected to be lower than anticipated at policy inception. Furthermore, the Group launched a "Mileage MoneyBack" proposition for all Direct Line customers such that customers would be able to receive a refund at the end of the policy period where they had driven less than expected. Gross written premium reduced by 2.1% to £1,616.9 million, primarily due to lower average premium.

Motor own brand average premium¹ reduced 2.0% during 2020 due predominantly to a 4.0% impact from reducing risk mix following lower new car sales and fewer new drivers entering the market. Motor risk-adjusted prices, before taking account of lower claims frequency, increased by 1.8%. Market premium deflation accelerated through 2020 as claims frequency remained low.

The Motor result has been significantly affected by the factors surrounding Covid-19, with the current-year attritional loss ratio improving by 14.6 percentage points to 66.6% (2019: 81.2%). The majority of this reduction reflects lower levels of claims frequency as driving patterns evolved through the year. A relatively normal first quarter was followed by a halving of claims frequency during the second quarter with less significant but still lower levels of claims frequency through the rest of the year. While claims frequency was down as fewer miles were driven, claims severity was higher than the Group's medium-term expectation of 3% to 5% inflation per annum. Claims severity has been impacted by longer repair times and consequent greater credit hire costs and additional cleaning and by extending the scope of vehicle replacement as part of the customer initiatives.

Although it is not possible to entirely adjust for all of the above factors, the Group believes that it made some underlying progress in reducing the current-year loss ratio during the year.

In total, prior-year reserve releases were £79.9 million lower year on year at £100.6 million. The 2019 prior-year reserve releases included a strengthening of £15.9 million as a result of the change in the Ogden discount rate to minus 0.25% from an assumed rate of 0%.

Overall Motor's reported combined operating ratio improved by 7.1 percentage points to 87.7% (2019: 94.8%). The improvements in the current-year attritional loss ratio were offset by a 0.6 percentage point increase in the commission ratio, primarily due to increased volume related commission payments to PCWs, a 1.8 percentage point increase in the expense ratio and a 5.1 percentage point reduction in prior-year reserve releases.

Home



Total in-force policies 1.7% higher at 2.6 million. Own brand policies were 4.1% higher at 1.8 million principally due to strong growth in the PCW channel where new business sales increased by over 30%.

Total gross written premium was 1.5% lower at £577.9 million. Own brand gross written premium was 1.0% higher.

Total operating profit was £49.2 million lower than prior year due to £27.0 million of major weather costs (2019: £3.0 million) alongside a reduction in prior-year reserve releases.

Gross written premium by channel

Direct
Price comparison
websites
Partnerships

**In-force policies
('000s)**

2,638
(2019: 2,594)

**Gross written
premium**

£577.9m
(2019: £586.6m)

**Operating
profit**

£101.4m
(2019: £150.6m)

**Combined
operating ratio**

87.1%
(2019: 80.3%)

	2020	2019
In-force policies (thousands)	2,638	2,594
Of which direct own brands	1,837	1,765
Gross written premium	£577.9m	£586.6m
Loss ratio	55.6%	46.8%
Commission ratio	8.1%	9.7%
Expense ratio	23.4%	23.8%
Combined operating ratio	87.1%	80.3%
Operating profit	£101.4m	£150.6m

Overview

In 2020 the home market continued to shift towards the PCW channel and Covid-19 led to changes in claims mix with fewer claims for escape of water and theft as more people were at home.

The Home segment grew direct own brands policy count due to strong PCW performance reflecting the Group's improved focus and capability in this channel. Direct Line policies remained stable over the period. Partnership policy count continued to reduce, partly due to the continued run-off of some schemes whilst bank branch sales reduced due to lower footfall.

Home continued to focus on its transformation with the acquisition of Brolly, a small digital insurer. The team behind Brolly joined the Group and will help fast track our ability to deliver tailored products to the market. We also agreed a two year extension with NatWest Group for Home insurance.

Home operating profit of £101.4m was lower due to higher weather-related claims costs, lower prior-year reserve releases and lower investment return, partly offset by favourable claims experience across other perils.

Notes:

1. Average incepted written premium excluding IPT for Home own brands for year end 31 December 2020.
2. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation.

Performance

In-force policies for Home's own brands increased by 4.1% in 2020 to 1.8 million policies. Retention and new business were strong with particular strength in PCW new business which grew over 30%. This reflected the Group's increased focus on, and capability in, the PCW channel. Partnership volumes reduced by 3.4%; Prudential and Sainsbury's partnerships are closed to new business and continued to run off in line with expectations.

Gross written premium was 1.5% lower than 2019, primarily due to the reduction in partnership volumes. Own brands gross written premium increased by 1.0% as growth in in-force policies was offset by lower average premium.

Home own brand average premium¹ reduced by 3.8% primarily reflecting a change in mix towards lower risk and consequently lower average premium policies in the PCW channel. Risk-adjusted prices reduced by 1.2% reflecting initiatives taken to reduce claims inflation and actions taken to reduce the differential between new business and renewal prices.

The current-year attritional loss ratio, excluding major weather event claims, improved by 0.8 percentage points to 52.7%. Home has experienced a change in mix towards more accidental damage claims and fewer theft claims during 2020 with continuing positive trends in escape of water severity. Whilst the Covid-19 pandemic is believed to have contributed positively to these trends, the impact is not significant.

The commission ratio of 8.1% was 1.6 percentage points lower than 2019 due to lower profit share payments to partners.

Home's combined operating ratio increased by 6.8 percentage points to 87.1% (2019: 80.3%). This was driven primarily by a 5.3 percentage point reduction in prior-year releases and a 4.3 percentage point increase in major weather costs partly offset by an improvement in the current-year attritional loss ratio. Normalised for weather, the combined operating ratio was 3.4% percentage points higher than 2019 at 90.3%² (2019: 86.9%).

Peace of mind when it matters most

At the start of the year we supported customers affected by Storms Ciara and Dennis, which saw the Group provide in the region of £25 million in claims payments so customers could get their lives back on track.

At one point 6,500 customers got in touch to tell us their homes had been damaged by Storm Ciara's 100mph winds and torrential rain – over four times the calls we had seen the previous week. Our Claims teams coordinated our Group response, as well as colleagues on the ground in our Direct Line Defenders and Churchill branded vehicles who were there for our customers when it mattered most, so they could give them peace of mind that we were able to help at this difficult time.

Rescue and other personal lines



The Group's direct Rescue brand, Green Flag, grew in-force policies by 4.8% and gross written premiums by 5.2% in the year.

Total in-force policies and gross written premium reduced by 3.7% and 4.2% respectively, reflecting lower premium from Travel partly offset by higher premium in Green Flag.

Operating profit of £6.8 million included £51.2 million (2019: 45.2 million) profit for Rescue largely offset by loss of £44.4 million (2019: £6.1 million loss) for Other Personal Lines.

Gross written premium by product

Rescue
Travel
Pet
Other personal lines

In-force policies ('000s)

7,105
(2019: 7,377)

Gross written premium

£417.8m
(2019: £436.0m)

Operating profit

£6.8m
(2019: £39.1m)

Combined operating ratio

102.0%
(2019: 95.4%)

Meeting our customers' travel needs

We have invested in and enhanced our digital platform, which has enabled us to deliver for our travel customers. This year we significantly accelerated our digital capabilities, and quickly mobilised an online claims process after the national lockdown. This new online forms and prioritisation process has helped us handle claims up to five times faster. The Travel team have been exceptionally busy with travel claims over the pandemic; during

this period, we received 87,500 Covid-19 related travel claims and have brought home over 900 customers who were stranded overseas. To cope with the increased demand, we retrained over 500 of our colleagues to understand the changes in travel guidance as the pandemic progressed.

	2020	2019
In-force policies (thousands)	7,105	7,377
Of which direct own brands	1,114	1,063
Gross written premium	£417.8m	£436.0m
Loss ratio	61.7%	66.9%
Commission ratio	16.4%	6.4%
Expense ratio	23.9%	22.1%
Combined operating ratio	102.0%	95.4%
Operating profit	£6.8m	£39.1m

Overview

Rescue and other personal lines consists of Rescue products, including those sold through the Green Flag brand, and other personal lines insurance, including Travel, Pet and Creditor, which are sold through own brands and partnership arrangements.

Green Flag's ongoing transformation, positioning itself as the challenger brand in the rescue market, continued in 2020 with the launch of a new claims system. Throughout the pandemic in 2020 Green Flag offered free breakdown cover to NHS workers and offered free vehicle health checks to all its customers.

Green Flag's in-force policy count continued to grow, and in August it recorded its biggest sales month since 2012. Policy count growth was slower overall as there were fewer cars on the road and fewer miles driven due to lockdown restrictions. The restrictions and changes to customer behaviours also led to lower claims in the year which contributed to an increase in Rescue operating profit to £51.2 million.

Travel experienced elevated claims being registered in 2020, particularly during the first lockdown and operational capacity was strengthened to support customers. In addition, the Group has taken a cautious stance in its approach to Travel claims reserving.

Overall Rescue and other personal lines made a small operating profit of £6.8 million as the strong profit in Rescue was largely offset by a loss of £44.4 million in other personal lines due to Travel.

Transforming the way rescue service is delivered

Being able to anticipate and adapt quickly is at the heart of our strategy. This year, Green Flag expanded its service to support the NHS during lockdown, whilst updating its user-friendly "Green Flag Rescue Me" app which has seen more customers interact digitally and receive exceptional service. It has coordinated 78,931 rescues and seen a 30% increase in people accessing it during 2020.

Part of the app's success is based on the ability to introduce enhancements quickly, giving the Green Flag team greater agility to meet customer needs and service more claims digitally.

Performance

The combined operating ratio for Rescue and other personal lines increased by 6.6 percentage points to 102.0% (2019: 95.4%) due predominantly to Travel which incurred increased claims handling costs supporting customers throughout 2020 and higher commissions to partners. The Group has taken a cautious stance in its reserving for travel claims.

Rescue in-force policies reduced by 1.4% to 3.4 million and gross written premium reduced by 0.5% to £166.7 million. Green Flag Rescue continued to grow its higher average premium direct business during 2020, increasing in-force policies by 4.8% to 1.1 million and gross written premium by 5.2% to £83.1 million. Other Rescue lines, which include the linked channel, where cover can be purchased with a Group Motor policy, and Rescue partnerships, saw in-force policies and gross written premium reduce by 4.2% and 5.5% respectively.

The combined operating ratio for **Rescue** of 76.5% was 5.0 percentage points better than 2019's ratio of 81.5%. Lower claims frequency during Covid-19 lockdown alongside lower claims costs due to fewer long-distance recoveries, was partially offset by supplier network support payments and free rescue given to NHS staff. Approximately half of the improvement in the combined operating ratio is expected to be one-off.

Other personal lines (comprising Travel, Pet, Creditor and policies tailored to mid- to high-net worth customers) in-force policies reduced by 5.7% to 3.7 million primarily due to lower Travel, following the Group's suspension of sales in Q2 and Q3, as a result of the Covid-19 lockdown, and continued reductions in packaged bank volumes. Gross written premium for Other personal lines decreased by 6.5% with reductions across all lines except Pet, where premium levels were maintained.

Other personal lines combined operating ratio increased by 14.4 percentage points to 118.5%. The increase is entirely due to Travel where the Group has incurred increased claims handling costs supporting customers throughout 2020, has taken a cautious stance in its reserving and has incurred additional commission payments, particularly on packaged bank account business.

Elsewhere, Green Flag continues to record digital milestones by using advanced technology systems to reduce our mileage by sending customers the right resource first time. This leads to an efficient customer service but also helps minimise our carbon emissions in what is one of the most carbon intensive parts of our operation. Similarly our "Phone Fix" initiative means we are fixing approximately 6% of jobs over the phone with customers, an increase of 3%, across all jobs, in "Phone Fix" compared to the previous year, resulting in saving miles driven.

Note:

1. Trustpilot score of 4.4/5 (23/02/21).

Commercial



Total gross written premium increased by 7.4% with direct own brands increasing by 9.3%.

Strong performance in Direct Line for Business as it continued to focus on micro business tailored propositions.

NIG and other gross written premium grew by 6.6%, benefiting from improvements arising from the re-platforming of the products on its award-winning electronic trading platform and improvements in Van insurance pricing.

Gross written premium by channel

Direct
NIG & other

**In-force policies
(‘000s)**

811

(2019: 775)

**Gross written
premium**

£567.8m

(2019: £528.9m)

**Operating
profit**

£50.4m

(2019: £54.6m)

**Combined
operating ratio**

95.5%

(2019: 95.7%)

	2020	2019
In-force policies (thousands)	811	775
Of which direct own brands	560	541
Gross written premium	£567.8m	£528.9m
Loss ratio	51.4%	52.7%
Commission ratio	18.7%	18.5%
Expense ratio	25.4%	24.5%
Combined operating ratio	95.5%	95.7%
Operating profit	£50.4m	£54.6m

Overview

In 2020 customers continued to seek cover in the direct market that was flexibly tailored to their individual needs. Against this backdrop, Commercial maintained underwriting discipline and grew its policy count across all product lines.

Direct Line for Business continued to grow policy count through its ongoing focus on offering micro business tailored propositions, with the launch of its Van insurance product at the start of the year.

Commercial also grew policy count through more competitive pricing in the traditional broker channel as well as through the PCW channel via the Churchill brand, following investment and focus on digital, pricing and marketing of the brand.

Commercial's current-year attritional loss ratio continued to improve. Higher weather event costs were offset by fewer claims associated with the Covid-19 pandemic and UK lockdowns and underlying claims benefits from Commercial's ongoing investment in pricing and underwriting.

Performance

Commercial in-force policies of 811,000 increased by 4.6% compared with 2019, reflecting strong growth in both Commercial direct own brands and NIG and other.

Commercial direct own brands grew in-force policies by 3.5% supported by the growth in Van for Direct Line, where the product was added to the new Commercial direct platform, and for Churchill where Van is sold through the PCW channel. Gross written premium increased by 9.3% to £163.3 million with increases across all Commercial direct product lines.

NIG and other in-force policy numbers were 7.3% higher and gross written premium grew by 6.6% to £404.5 million. This reflected growth across all categories as the book continued to benefit from improvements arising from the re-platforming of the products on its award-winning electronic trading platform and improvements in Van insurance pricing.

The current-year attritional loss ratio in Commercial improved by 6.0 percentage points to 59.6%. This was driven by improvements to underwriting through pricing and risk selection as well as frequency benefits in motor lines since the end of Q1. This was partially offset by Covid-19 related business interruption claims at £6 million.

Prior-year reserve releases were £8.2 million lower at £56.8 million, primarily due to lower general liability reserve releases on older accident years. 2019's result included a £1.0 million strengthening of prior-year reserves as a result of the change in the Ogden discount rate to minus 0.25% from an assumed rate of 0%.

The combined operating ratio for Commercial improved slightly by 0.2 percentage points to 95.5% (2019: 95.7%) as an improvement in the current-year attritional loss ratio of 6.0 percentage points was largely offset by an increase in claims related to severe weather, a reduction in prior-year reserve releases and an increase of 0.9 percentage points on the expense ratio.

NIG self-help online portal

The NIG Risk Assist tool was launched to help business owners manage and respond to a broad range of risks through a comprehensive range of easy-to-use online tools.

The online portal offers a wide range of services, such as: unlimited online access to health & safety and HR professionals for support and guidance on specific issues facing their businesses; unlimited phone counselling and medical advice; a suite of online eLearning courses to help train and develop staff; assessments, guides and templates to keep up with changing rules and regulations; business continuity planning to keep our customers in business when disaster strikes; and much more. The proposition was launched during the Covid-19 pandemic and has since been a valuable support for our customers.

Building a sustainable future

Our approach to sustainability is based on a simple premise: the role we play as a business to support the stakeholders we interact with on a daily basis – customers, shareholders, suppliers, our people, communities and the planet – makes the Group stronger and can bring future rewards.

We are transforming to maintain a competitive edge, but doing it in a way that is sustainable and mindful of our impact on society and the environment.

Our established five pillar sustainability strategy, underpinned by our vision and purpose, has given the Group confidence when responding to the unforeseen circumstances of 2020. By aiming to be a force for good and giving people peace of mind we have tried at all times to deliver on our ambition of doing the right thing for all of our stakeholders.

Sustainability pillars

Customers	People	Society	Planet	Governance
Earn our customers' trust by demonstrating how we are acting in their best interests.	Encourage a culture that celebrates difference and empowers people so that they can thrive.	Use our expertise to improve outcomes for society and the communities we serve.	Protect our business from the impact of climate change and give back more to the planet than we take out.	Look to the long term for our stakeholders, build a reputation for high standards of business conduct and a sustainable business.

Training confidence from 2020

We remained focused on our sustainability strategy despite the disruption created by the Covid-19 pandemic. Far from restricting the Group, it enhanced our response. The way we supported customers in need, made remote working effective, created flexible insurance products and made ourselves accountable for reducing carbon emissions are all significant milestones. We also supported partners in our supply chain when lockdown impacted their operations.

2020 has opened up new possibilities, provided fresh insight and given the business more confidence to drive sustainable outcomes, many of which have the potential to leave a lasting impact. More detail can be found in our summary of activity for each of our sustainability pillars on pages 48 to 61.

This year we published our first Sustainability Report which you can view online at: www.directlinegroup.co.uk/2020_Sustainability_Report

Maximising our impact for all our stakeholders

In 2019, we conducted our first in-depth Materiality Assessment. It has helped shape the Group's sustainability strategy as it prioritises what our stakeholders value, alongside the impact on the business and how we can use this insight to build a sustainable business for the future.

We asked a range of business and external stakeholders to prioritise a range of sustainability issues against our business priorities through a series of in-depth interviews and surveys to create a business impact assessment of risks, impacts and opportunities for the Group.

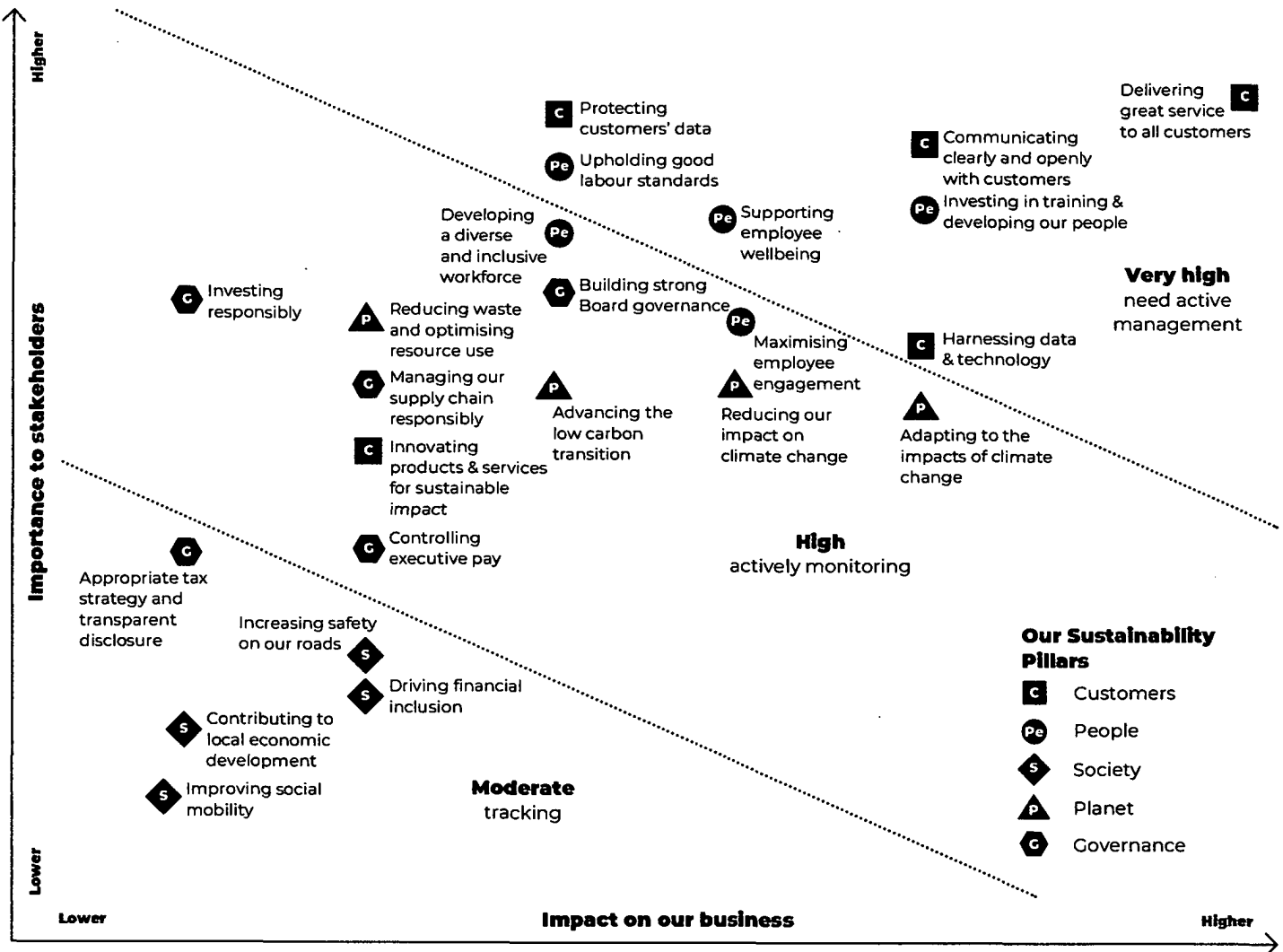
It means everything from delivering great service to all customers, investing in our people so they are supported, harnessing the latest data and technology and ensuring we manage our suppliers responsibly, including prompt payment.

Building on the four priorities outlined opposite, in 2020 we chose to actively prioritise social mobility, as well as developing a diverse and inclusive workforce and reducing our impact on climate change which our stakeholders place in the high category. We did this because each of these issues is an integral part of living up to our vision of a world where insurance is personal, inclusive and a force for good.

Priorities

- 1 Meeting customer needs each and every day
- 2 Investing in and supporting our great people
- 3 Realising the potential of data and technology
- 4 Understanding and managing the impact of climate change

Materiality matrix



United Nations SDGs

In 2015 the United Nations launched 17 Sustainable Development Goals ("SDGs") to help end poverty, fight inequality and tackle climate change by 2030. Through our sustainability work, we believe we can contribute to seven of the Goals.

	Detail	Group activity	Pillars	Sustainability priorities
Good Health and Well-being	Ensure healthy lives and promote well-being for all at all ages.	<ul style="list-style-type: none"> - Financial wellbeing - Mental health first aider network - Supporting Mind - Bereavement team 	<ul style="list-style-type: none"> C P Pe S 	2
Quality Education	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.	<ul style="list-style-type: none"> - Apprenticeships - Graduate programme - Continuous learning - Donation to Teach First 	<ul style="list-style-type: none"> Pe S P 	2
Gender Equality	Achieve gender equality and empower all women and girls.	<ul style="list-style-type: none"> - New diversity and inclusion strategy - Women in Finance Charter 	<ul style="list-style-type: none"> Pe 	2
Affordable and clean energy	Ensure access to affordable, reliable, sustainable and modern energy for all.	<ul style="list-style-type: none"> - Carbon Offsetting Project: clean cookstoves in Bangladesh 	<ul style="list-style-type: none"> P 	4
Decent Work and Economic Growth	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.	<ul style="list-style-type: none"> - Continuous learning - Social Mobility Pledge - Leadership targets for BAME and Black representation 	<ul style="list-style-type: none"> Pe S P 	2
Industry, Innovation and Infrastructure	Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation.	<ul style="list-style-type: none"> - Tech innovations at accident repair centres - Encouraging electric vehicle use - Supporting the adoption of autonomous vehicles 	<ul style="list-style-type: none"> P S 	1 3
Climate Action	Take urgent action to combat climate change and its impacts.	<ul style="list-style-type: none"> - Commitment to Science-Based Targets - Socially responsible investing 	<ul style="list-style-type: none"> P S 	4 3

External memberships and benchmarks

Direct Line Group actively supports various initiatives related to climate change, ESG and sustainability. These supplement our identification and management of climate-related risks, and include:

CDP: The Carbon Disclosure Project is a globally recognised platform measuring reporting performance and this year the Group maintained its 'B' rating based on 2019 activity.

Sustainalytics: In 2020 the Group was ranked as an ESG leader out of all companies assessed in the property and casualty insurance sector and maintained its top ten position in the broader insurance industry group of 261 companies.

MSCI: The Group maintained its 'A' rating this year highlighting our Board-level diversity, staff training and development programmes and the strengthening of ESG integration into our investment portfolio. The Group is also in the top quartile for Corporate Governance and Human Capital development.

RE100: We are in the process of applying for membership of RE100, a global initiative dedicated to accelerating a global shift in clean energy. Under this initiative, we will continue our objective of sourcing 100% renewable electricity.

PRI: The UN Principles for Responsible Investment, launched in 2006, is a major collective initiative that seeks to promote responsible investment among investors and asset managers. We expect all of our external portfolio managers to be signatories.

SBTi: The Science Based Targets Initiative helps companies to determine emission reduction targets in line with climate science. In 2020 we began the process of setting new science-based reduction targets for our Scope 1 and Scope 2 emissions and Scope 3 emissions under our direct control. These targets will be submitted for approval within the two-years' time frame set by the SBTi (August 2022).

Customers

Earn our customers' trust by demonstrating how we are acting in their best interests

Our Covid-19 response for customers

Throughout 2020 we adapted quickly to the changing world around us so that we could deliver more for customers at speed, helping them navigate the disruption to their lives. Some of the highlights included:

- free rescue cover, fast-track claims and free home emergencies for our NHS customers;
- individualised support for customers in financial difficulty;
- over 450,000 customers benefiting from support measures;
- our Travel team settled claims for over 26,000 customers with payments for those who saw their travel plans cancelled or curtailed due to Covid-19 disruption and repatriated over 900 customers stranded abroad; and
- retrained over 500 people to support travel customers to navigate the pandemic.

We seek to understand customer needs, providing real value across our brands and products. It requires a deep appreciation of customer expectations, a determination to provide an exceptional insurance experience and a consistent desire to innovate.

Our determination to deliver the best possible customer value and experience drove our response to Covid-19. We are proud that our net promoter scores have yet again demonstrated the willingness of our customers to recommend our Direct Line brand year on year.

Net promoter score¹ – Direct Line brand

Note:

1. Please see Net Promoter Score KPI on page 19 for further information.

We know that communicating clearly and openly with customers is important to our stakeholders and business. This is why our Customer Experience Pillars continue to guide the Group by using a clear framework with the aim of delivering great customer service. These principles have been invaluable this year when responding to the Covid-19 pandemic where we adapted to customer needs and changing circumstances across the business.

Customer pillars

Expectations

Manage and exceed my expectations

Ease

Make it as effortless as possible for me

Personalisation

Treat me like a real person and not like a process

Fix-it

Identify the issue, own it and fix it

Trust

Earn my trust

Empathy

Understand me and work hard to build a relationship

Taking action on pricing

The insurance sector operates in a highly competitive market which works well for most customers. We support change to improve outcomes for long-standing customers and that is why we welcome the FCA's Market Study on General Insurance Pricing Practices. These reforms, that aim to equalise customer prices whether they are renewing or looking for a new policy, should reduce unnecessary turnover and deliver fairer prices to all.

Not all insurance products are equal across the market, with varying levels of cover and service. We offer a range of propositions to protect our customers, underpinned by a high-quality claims service for all customers to give them peace of mind.

We want to earn our customers' loyalty and give them a reason to stay with our brands by taking measures such as:

- actively reviewing customers' renewal price when they reach their five-year anniversary with us, as a result of which many of our customers have seen their premiums frozen or discounted;
- introducing a facility to enable a customer to opt out of automatic renewal through our web chat service; and
- investing in a major technology upgrade to help us make it easier for our customers to manage their protection, from the moment they think about buying a policy, managing their cover 24/7, all the way through to making a claim.

Caring for customers in need

Losing a loved one is always difficult and taking care of financial matters is the last thing on people's minds. This is why we created a dedicated team with specialist skills to help customers who want everything to be made as simple as possible when they experience a bereavement.

All queries are dealt with in one place by experienced consultants trained to handle the sensitive nature of these conversations. This helps to make a difficult task, that nobody wants to face alone, just that little bit easier.

- customers seeking medical assistance abroad are offered localised care as we can recommend the nearest medical facility that can support them.

First end-to-end online Home claim

Our digital capability saw us deliver a first for the Group in 2020 by delivering an end-to-end online claims process for a Home customer – all registered, processed and settled fully online. This is the next step in our digital journey, giving customers the flexibility to handle their insurance matters how they want.

Making claims easy

When customers make a claim, they want peace of mind that it is being treated with due care, but we also know that speed matters. Whether it is fixing cars in our accident repair centres or assisting people who have suffered flooding or had their homes hit by storm damage, we want to help our customers get back to normal. This year our Travel customers' plans were turned upside down so we created a new claims prioritisation process that has handled claims up to five times faster for thousands of our travel customers. Digital developments have also enabled us to make the claims process easier for customers who wish to claim online. As a result:

- our new online travel platform gives our customers the ability to settle small value claims in four minutes or less, without any human interaction at all, and

People

Encourage a culture that celebrates difference and empowers people so that they can thrive

Our Covid-19 response for our people

The Group is nothing without its people. When lockdown happened we quickly moved 9,000 people to home working and supported our motor accident repair centres with enhanced safety measures, offering maximum flexibility to help our people manage home and work.

We aspire to create an environment where everyone feels free to be themselves and succeed in their careers. Our culture is one where we strive to care about our customers and one another. That's what our values are designed to achieve, and they underpin who we are and what we stand for.

Diversity and inclusion strategy

One of our values is "bring all of yourself to work" because as well as simply being the right thing to do, focusing on diversity and inclusion makes good business sense and delivers better outcomes.

This year we completed a comprehensive diversity and inclusion survey – to which nearly 6,500 of our people responded. It's shown us what we do well and where we need to improve, highlighting a gap between the experiences of different communities.

These findings have helped to inform a refreshed diversity and inclusion strategy, with greater ambition and reach.

Supporting race equality

Alongside our survey, we completed an in-depth analysis of our ethnicity data.

What we found:

- One in six or 17% of our colleagues is Black, Asian or Minority Ethnic ("BAME"); Black colleagues make up 3% of the total.
- BAME representation is concentrated in our lower and middle grades and reduces with seniority.
- If you are Black, mixed ethnicity, or from one of the smaller ethnic groups, it doesn't feel as positive to work for the Group as it does for other colleagues.

Our response:

We have signed Business in the Community's Race at Work charter and introduced new targets to hold ourselves to account for improving Black, Asian and Minority Ethnic representation in leadership roles by the end of 2022.

13%

Increasing BAME representation in leadership roles from 10% to 13%

1.5%

Increasing Black representation in leadership roles from 0.5% to 1.5%

Making progress

Supported by our employee networks, we have launched an awareness and education programme to build empathy and a greater understanding of issues. This includes a reverse mentoring scheme to help our senior leaders better appreciate the barriers and challenges faced by certain communities.

We have introduced new principles for senior-level recruitment to help protect from bias – including anonymised CVs and diverse shortlisting, as well as enhancing the mandatory training completed by recruiting managers.

All our leaders are completing inclusive leadership training and in 2021 we're launching a diversity and inclusion fluency programme to ensure all people managers are equipped to have better conversations and support their teams.

Diversity Network Alliance (DNA)

We have a vibrant DNA community that works together to promote and champion diversity and inclusion within our business.

Our strands

- BAME (Black, Asian & Minority Ethnic)
- Belief
- Generations, families & carers
- LGBT+
- Neurodiversity & disability
- Social mobility
- Thrive (representing gender)

The strands are led by volunteers from across the Group based in locations spanning the UK. They provide a network for colleagues and allies, as well as guiding our people policies and what we support externally.

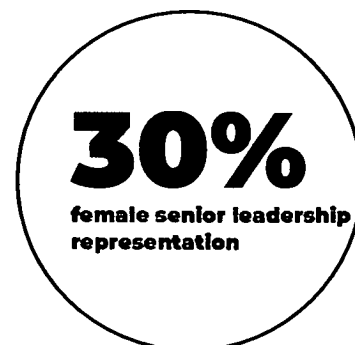
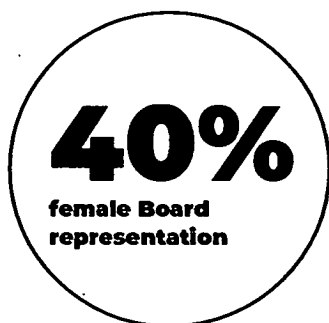
Enabling gender equality

We are proud to be one of only a few companies in the FTSE 250 with a female Chief Executive Officer and Chair. We recognise that to enable women to fulfil their potential, we need to offer them support throughout their different career stages. Women have a different set of barriers to men and these need to be navigated in a different way.

In our 21 accident repair centres we want to encourage women to think about careers in the bodyshop industry through awareness of our engineering graduate programme.

Women in Finance Charter

We are a signatory to the HM Treasury's Women in Finance Charter. At the end of 2020, 30% of our senior leadership were women. We are determined to go further and this year we took the decision to increase our target from 30% to 35% female representation in our senior leadership by the end of 2022 in order to maintain a keen focus on progression.



Gender diversity of all employees

Female
Male

Excludes an estimated 0.5% colleagues who identify as non-binary, gender-fluid or other gender due to data reporting constraints

Gender diversity of senior leadership

Female
Male

Gender diversity of senior leadership figures based on 2020 Women in Finance reporting

Ethnicity of all employees

Asian
Black
Minority Ethnic
White
Prefer not say

Excludes 13% of colleagues who have not submitted an option for ethnicity

For more information on leadership gender diversity see page 92

Hampton Alexander Review

The Hampton Alexander Review set a target for FTSE 350 companies to have at least 33% representation of women on their Board and in their Executive Committee and direct reports by the end of 2020. We are pleased to have exceeded this with 40% and 39.1% representation¹, respectively.

Tech Talent Charter

As signatories to the Tech Talent Charter, we are committed to gender diversity across our technology teams. We are proud to have a 34% female tech team versus a UK average² of 19% and a signatory average of 25%.

Gender pay gap

Our gender pay gap continues to be low compared to the broader financial services sector: we know there is more to do. After three years of reporting we feel we understand our gender pay gap well, with a large portion of this being from the under-representation of women at more senior levels across the Group.

This is why we have continued to invest in development programmes for high-potential females to support them in progressing into senior leadership roles. This helps our women to think differently and start taking risks, put themselves forward and make a plan to advance more quickly through the organisation.

Flexibility

Additionally, our My Life policies, offered to all our people, provide flexibility and support at work to do the things that matter to people outside work. We believe it's important that everyone embraces flexibility because that's the only way we'll ever achieve gender equality. We have pushed this policy further over the last 12 months to ensure those with caring or home-schooling responsibilities as a result of Covid-19 are not disadvantaged.

Supporting and developing our people

As we adjust to this new way of working remotely, we remain committed to looking after our people. This includes a programme where both financial and mental wellbeing are top priorities.

Minimum salaries

Our success is down to the hard work and commitment of our people and we want to reward them for their contribution. Whilst we look for ways to boost the reward proposition for as many of our colleagues as possible, our focus is to ensure that those in our lowest-paid roles receive a meaningful pay increase. In March 2020, for the third year running, we increased our minimum salaries for full-time colleagues working 37.5 hours from £19,000 to £19,500 which is 19% higher than the Government's National Minimum Wage and 5% higher than the Living Wage Foundation rate outside London, benefiting 5,200 of our people.

Annual incentive plan

The annual incentive plan ensures there is a strong link between pay and the Group's performance on specific metrics, such as our Customers' Experience agenda which focuses on making the customer's journey as easy as possible, and broadening our diversity impact to include BAME and Black representation targets at senior leadership positions.

Employee share incentive scheme

Despite the impact of Covid-19, we are continuing with our commitment to award free shares. The Group awarded eligible colleagues 180 shares which were worth £500 in April 2020. For employees who have been with the Group since our IPO in 2012, this was our fifth award of free shares totalling 626 shares which were worth £1,997 at 31 December 2020, plus dividends paid on those shares which amount to a further £793.

Mental health

We strongly encourage our people to be open about how they feel both in and out of work so we can best support them. Our mental health programme includes ensuring people managers receive specialist training on dealing with mental health issues. Pre-lockdown we had a network of trained mental health first aiders (MHFA) – one on each floor of each of our sites and we are proud of how quickly our approach adapted to deliver the same support remotely.

We are determined to raise the profile of mental health, supporting everyone to be open about how they feel in and out of work. Over the course of the pandemic the Group ran frequent pulse surveys to assess the sentiment and wellbeing of employees whilst many were working remotely.

Notes:

1. Board representation at 31 January 2021 and Executive Committee & direct report representation at 31 October 2020 as per Hampton-Alexander data sourcing.
2. Source: <https://www.techtalentcharter.co.uk/kolkt>

Talent pipeline

We have continued to invest in our graduate and apprenticeship programme over the years and we recognise they are key to driving our digital agenda and building a 'fit' for the future organisation. To date, we have recruited over 180 people into our graduate programme and it is designed to develop the people who will enable us to create an exciting future.

Our apprenticeship scheme has won the Top 100 Apprenticeship employer three years running, which reflects our standing in the market.

New ways of working

Earlier this year we took the decision to radically change the way we worked and transform our trading and change areas into an agile business. Agile is a way of working that began in the tech sector to improve the speed that a product went from conception to market. We decided that adopting agile values, principles, tools and most importantly mindset would allow us to deliver customer value faster. We chose to press ahead with the transformation as the sudden change to our work and home lives only served to emphasise why our people needed to be empowered to self-organise and create new ways of doing things providing solutions for customers as quickly as possible. An immense amount of work went into consultation with our Employee Representative Body ("ERB") and our people so that we could create an agile model that's true to the Group and can take advantage of the investment we have already made in our technology.

Human rights

Happy people deliver better outcomes for our customers and the business overall so we strive to ensure that our employment practices and policies exceed those in the Universal Declaration of Human Rights. Whether that's our wellbeing strategy which supports mental, physical and financial health, or our My Life policies which help our people balance work and life priorities or our policy to pay more than the Living Wage to all our people. We want to help our people thrive in and outside of work.

Employee Representative Body

We are proud to have an active and engaged ERB. They help us share and discuss proposals and initiatives that may affect our future and are consulted as part of any future change programme. During the agile transformation the ERB helped individuals understand what the changes were, helped communicate the views of colleagues and provided alternative proposals and approaches.

Society

Use our expertise to improve outcomes for society and the communities we serve

Our Covid-19 response for society

The Group wants to support communities throughout the UK which is why we prioritised social mobility in 2020 and established our Group Community Fund in response to the Covid-19 pandemic, working to deliver £3.5 million to 250 charities, helping over 200,000 people.

How we choose to give back to our communities and what to campaign on all have a bearing on society and in turn how we remain a force for good. The actions we take are all focused on making a tangible impact which leads to lasting change.

Our commitment to social mobility

Our diversity makes us stronger. We are a business employing thousands of people throughout the UK who all possess a variety of skills, experiences and, crucially, bring different perspectives to our work.

We pride ourselves on a culture that celebrates difference and authenticity, where colleagues can bring their whole self to work.

Celebrating difference, however, is more than simply catering for a multitude of voices. A person's background should never act as a barrier, but like other companies we know that people still feel held back from making progress.

The reasons can be complex and specific for each individual. That's why we have a renewed sense of purpose in supporting people throughout their career. It's not simply about attracting people into the Direct Line Group family, but also what happens once they have joined so that people can be helped to fulfil their career potential.

That's why "Getting In, Getting On, Getting Ahead" is how we think about social mobility as a Company – creating an environment where people feel confident whatever their start in life.

Some DNA strand

Our newly established Social Mobility Employee Network – known across the business as "Soko" – is a driving force behind how we talk about the issue. What started as a small group is now growing with over 100 active members.

Soko seeks to raise awareness of social mobility issues, establish role models to inspire others from similar backgrounds, and encourage more open conversations about social mobility in the workplace. It has provided an open forum for people to speak about barriers and inspire confidence, as well as driving some of the Group's outreach activity.

Social Mobility Action Plan

SoMo group

With the support of our active Social Mobility Employee Network, we have backed up our decision to sign the Social Mobility Pledge by working towards creating our own bespoke Social Mobility Action Plan. This plan provides a candid assessment of our current approach and how we can improve.

- We are exploring how to take advantage of remote working so we can open up new recruitment areas, starting with a pilot scheme of over 20 apprentice home workers.
- We are reviewing our recruitment approach to target social mobility 'cold spots' where our main offices are based.
- We have surveyed colleagues to understand what our social mobility make-up is across the business because we know that with meaningful data our interventions will have more impact.

Insight day

In 2020 we partnered with the Social Mobility Business

Partnership to run our first work insight and skills day for bright students from less advantaged backgrounds to give them the opportunity to hear from companies directly and learn what career opportunities are available. It was a pleasure to support their future career aspirations by explaining what life is like at the Group.

Auto-Raise

We're delighted to have made a corporate donation to Auto-Raise, a long-standing charity partner that supports youngsters who wish to enter the bodyshop industry and receive relevant qualifications so they become the vehicle repairers of the future.

Teach First

We've partnered with Teach First, who recruit, train and place teachers in schools in some of the most disadvantaged communities in England. Our funding will support the training and development of 17 teachers each year, who will go on to reach over 2,000 pupils. Colleagues will also be hosting work experience placements at our offices.

Achievement for All

Our Social Mobility DNA strand this year used the Group's Community Fund to partner with Achievement for All which provide wellbeing and education support for disadvantaged young people to thrive emotionally, socially and academically. Our partnership will focus on schools in Walsall, Barnsley and Doncaster where our commitment to social mobility is matched with tangible impact in communities located near to some of our main office sites, also offering the opportunity for colleagues to become mentors.

Envision

This year we supported Envision, who are long-term partners of our Bristol office to provide the Community-Apprentice Programme for school children. By setting group tasks it aims to empower young people through problem solving, building confidence, as well as testing teamwork skills, all guided by mentors from the Group. Through programmes such as this it supports participants to gain knowledge about what skills are required in the work place.

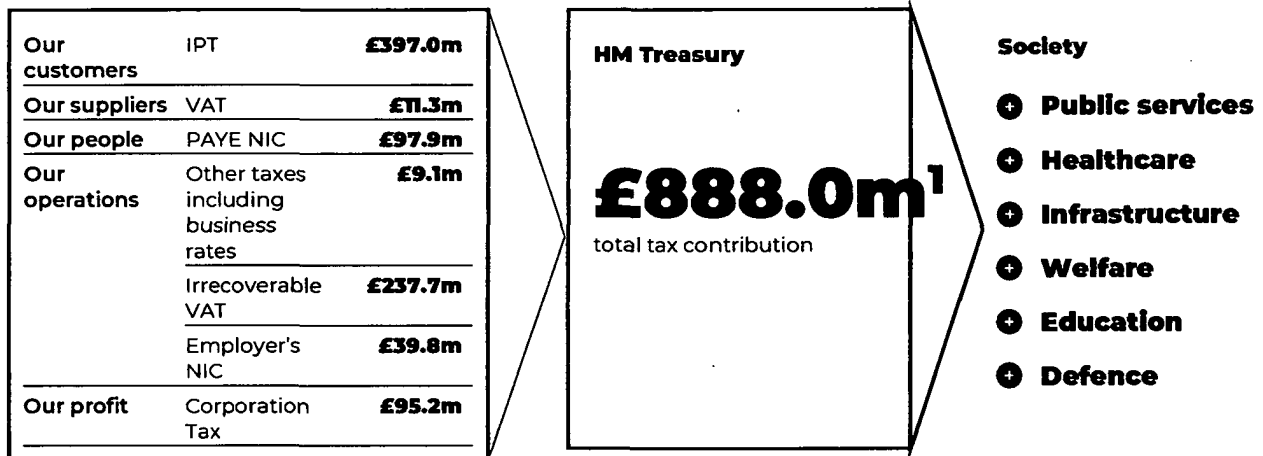
Our tax contribution

A key part of being a responsible corporate citizen is ensuring that we comply with all applicable tax laws and regulations and meet our responsibilities both as a contributor of corporate taxes and as a collector of taxes on behalf of HMRC. In 2020 the Group's total tax contribution was £888.0 million which includes the Group's direct and indirect taxation. More information can be found in the tax contribution section on page 35.

Suppliers

The Group is a long-standing signatory of the Prompt Payment Code. This year Green Flag supported our independent network of 200 local rescue businesses by offering a number of them support payments which contributed to the protection of over 4,000 key workers when lockdown started. We take our commitment to ensuring modern slavery is not present in our supply chain seriously. The Modern Slavery Act 2015 is incorporated into our risk profiling, with specific requirements incorporated in our due diligence and assurance processes.

Group's 2020 total tax contribution



Note:

1. The Group's total tax contribution in 2020, including direct and indirect tax contributions.

Road safety campaigners

As one of the UK's leading motor insurers we have a long tradition of campaigning for improved road safety. This year we worked with the Parliamentary Advisory Council on Transport Safety ("PACTS") to highlight increased numbers of road deaths and serious injury where people do not wear a seat belt. Our research discovered that almost a third (31 per cent) of those who died in vehicles on Britain's roads in 2018 were not wearing a seat belt and that 72 per cent of the British public wanted the introduction of penalty points for those caught not wearing a seat belt. We will continue to campaign with PACTS to increase the penalty for failing to wear a seat belt because it saves lives.

Our Community Fund

We immediately responded to the Covid-19 crisis by establishing our very own Community Fund targeting much needed resource to charities and local authorities where our main office sites are based. It was a small way of providing a helping hand to a variety of causes throughout the UK.

Phase 1:

£2 million of immediate support to the most vulnerable, directly assisting children and families in refuges, parents needing baby packs, food banks and community groups

£2m

of immediate support to the most vulnerable

Phase 2:

£500,000 for colleagues to nominate 180 local causes they cared passionately about with micro-donations

£500k

180 charities received donations of up to £5,000

Phase 3:

£1 million directed towards recovery efforts focused on four pressing challenges: social mobility, marginalised groups, food poverty and public health

£1m

directed towards recovery efforts

Community Fund 2021

We know that Covid-19 will continue to dominate our lives throughout 2021 and we have allocated £1.5 million to support charities across the coming year.

Computers for kids

Following our immediate crisis support to refuges, we funded 700 laptops for KidsOut to distribute to children in support of their education. Since then the first donation from our 2021 Community Fund has seen £125,000 go towards the Daily Mail's Computers for Kids campaign.

ABI Covid-19 Support Fund

We also donated £3.6 million to the ABI's Covid-19 Support Fund which has supported hundreds of charities across the UK.

Giving back to our communities

Colleagues have taken advantage of our popular Community Cashback initiative which awards £250 to chosen charities.

Planet

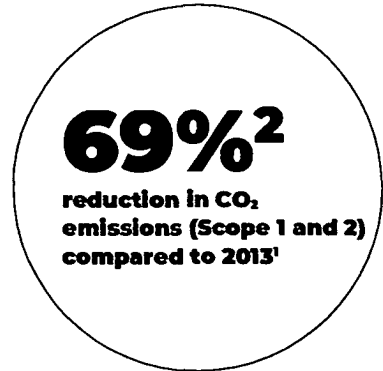
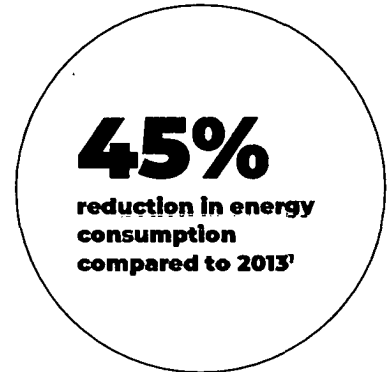
Protect our business from the impact of climate change and give back more to the planet than we take out.

The impact of climate change has far reaching implications for economies and societies around the world. We are determined to contribute to a long-term sustainable future and know that through our actions as a business we can contribute to climate risk mitigation and help to accelerate the transition to a low carbon future. There are three steps to our plan.

Greenhouse gas emissions (tCO₂e)¹

Energy consumption (kWh)

	2020
Electricity	16,669,842
Gas	21,699,765
Total	38,369,607



Enabling and encouraging flexible working

Step one:

Disclose to track progress

We have always challenged ourselves to reduce emissions and energy consumption across the business through greater transparency. We exceeded our 2020 targets set in 2017 against a 2013 baseline and now intend to hold ourselves to account against a new 2019 baseline.

We comply with the applicable greenhouse gas reporting requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and apply the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) to calculate our emissions, which includes emissions associated with electricity consumption using both the Location-based Scope 2 and Market-based Scope 2 calculation methodologies. We monitor the intensity metric of emissions per £ million of net earned premium as a measure of how efficiently we provide our insurance products (see page 61). We also engage with the Carbon Disclosure Project ("CDP") and recently maintained a 'B' rating based on 2019 activity.

We have always published our Scope 1 and 2 emissions, but this year we wanted to go further by breaking down our emissions across our offices and our accident repair centres and by publishing our first TCFD report (see page 62).

We also began the process of evaluating our Scope 3 emissions starting with those under our direct control (such as waste disposal and business travel) and purchased goods and services. Plans are underway to evaluate the final part of our Scope 3 emissions, and our investment portfolio in 2021.

**Help more and more
customers fix cars
over the phone**

100%
**carbon neutral
business in 2020***

100%
**of office waste
diverted from
landfill**

**Aiming to be the most
energy efficient repair
network in the UK**

Step two:

Commit to tangible actions

We have committed to set Science-Based Targets for Scope 1, 2 and 3 emissions within the two-years timeframe set out by the SBTi. On Scope 1 and 2 emissions, we intend to set a target that enables us to play our part in holding off some of the worst climate impacts by limiting the global temperature rise to no more than 1.5°C above pre-industrial levels.

Step three:

Offset while we reduce

We know that it will take time to reduce our emissions so in the meantime we have made a long-term commitment to be a 100% carbon neutral business by offsetting Scope 1 and 2 emissions as well as the elements of our Scope 3 emissions which are under our direct control.

This year we achieved carbon neutrality by working with ClimateCare who has over 22 years of experience in project development, carbon asset development, and delivery of corporate carbon programmes.

Over the next three years we are funding carbon offsetting projects which will also deliver high social impact benefits in three countries.

Notes:

1. See page 66 for more information on reduction targets. All emission and energy use data reported are related to UK operations.
2. Scope 1 and 2 emissions are reported here on a like-for-like basis against a 2013 baseline and exclude emissions from additional vehicles used during repairs, courtesy car fuel usage and from vehicles that are Company-funded. For our full Scope 1 and Scope 2 results inclusive of these emissions please see page 61.
3. Total scope 1 and 2 emissions. The 2019 result of 16,328 tCO₂e differs from the reported result in the 2019 Annual Report and Accounts of 13,932 tCO₂e as it now includes the additional emissions cited in footnote 2. The 2020 result is inclusive of these emissions.
4. By offsetting Scope 1 and 2 emissions as well as the elements of our Scope 3 emissions under our direct control.

Our journey to net zero

Each year we will become less reliant on carbon offsetting to achieve net zero. Through our "Greener, Cleaner Action Plan" we aim to mitigate our impact on climate change:

- **Offices:** Reimagining the way we work by investing in energy-efficient features, encouraging flexible working, improving recycling rates, continuing to use 100% renewable electricity and ensuring 100% of office waste is diverted from landfill.
- **Accident repair centres:** Aiming to be the most energy-efficient repair network in the UK by investing in our estate and repair processes.
- **Green Flag:** Reducing mileage and supporting sustainable transport through efficiency initiatives, such as optimising our roadside fix rate to reduce our mileage and tow fewer vehicles.
- **Our supply chain:** Extending our reach by calculating and disclosing our Scope 3 purchased goods and services emissions and exploring how we can work with individual suppliers to drive lower emissions.
- **Our customers:** Supporting green choices by conducting customer market research to explore attitudes to insurance.

Continuing to invest in energy reduction measures

This year the Group continued to invest in energy efficient measures with over £2 million invested in our office estate including:

- New electric air conditioning systems in our Bromley office enabling a reduction in gas usage and better maintainability
- Installation of LED lighting and new power systems in our Birmingham and Glasgow offices which could lead to a 50% reduction in electricity use

This year the Group was also awarded the ISO 14001 accreditation by the Lloyds Register Quality Assurance body for our office management – an internationally agreed standard that helps organisations improve their environmental performance.

We have also continued to invest in our auto services sites catering for their individual energy efficiency needs:

- Installing a new air conditioning system in our Peterborough site allowing for more accurate temperature control, alongside a reduction in electricity usage compared to conventional units
- Training technicians in new repair techniques which reduce the need for repair materials and reliance on paint spray booths
- New LED lighting in our Weybridge site enabling energy savings of up to 60%, a reduction in maintenance costs over a projected lifespan of 10 to 20 years
- Two new dual electric car charging points in our Birmingham site preparing for the rise in electric vehicle usage

Our investments: moving climate up the agenda

- 100% of our portfolio will be net carbon neutral by 2050
- Corporate bond portfolios are committed to a 50% reduction in weighted average greenhouse gas emission intensity by 2030
- A preference for companies with carbon reduction targets approved by the Science Based Targets initiative
- A preference for companies with at least a 2°C carbon performance alignment with the Transition Pathway Initiative
- The exclusion of any companies with a carbon transition score indicating assets could be economically stranded
- The exclusion of any mining companies that generate >5% of revenues from thermal coal production and electricity generators that derive >5% of revenues from thermal coal power generation (unless, in either case, the company has an approved Science Based Targets initiative plan)
- The exclusion of any companies that are developing new thermal coal mines or coal burning power plants
- Ensuring all of our investment-grade corporate bond portfolios maintain an average MSCI ESG rating of 'A'

Our offsetting projects

Over the next three years, we will offset those emissions we can't yet avoid through projects that cut carbon emissions whilst also delivering tangible benefits to local communities and environments in three countries:

- **Rainforest protection, Brazil:** Our funding will support efforts to prevent unplanned deforestation across 350,000 hectares of the Portel micro region, through training and educating local communities in alternative agroforestry methods. By opening up new economic opportunities, the project is reducing slash and burn agriculture, which has been one of the largest contributors to deforestation. The project is also providing access to official land titles for native families and is protecting more than 30 vulnerable species.
- **Water filters, Kenya:** Our funding will support the distribution of safe water filters for families. As well as delivering health impacts, the project also reduces the need for people to boil water to make it safe to drink, which requires the burning of unsustainable energy sources such as wood or charcoal. This reduced reliance on fuel reduces family expenditure and reduces pressure on forests, as well as cutting carbon emissions.
- **Clean cookstoves, Bangladesh:** Less than 20% of Bangladeshi households have access to clean cooking, instead using traditional "three-stone" fires, contributing to approximately 49,000 premature deaths a year. Our funding will support entrepreneurs to produce, manufacture and distribute the "bondhu chula", a clean cookstove designed for an efficient burn to reduce fuel use.

Group emissions

Our 2020 progress against our new 2019 baseline represents our most transparent emission reporting to date. In 2020 we were able, for the first time, to break out our Scope 1 and Scope 2 emissions into separate performance figures across our office sites and accident repair centres, and disclose a Scope 3 footprint with greater clarity of the activities under our direct control. Emission results reported below are all related to UK operations.

Scope 1	2020		2019 baseline	
Office sites	1,432		1,881	
Auto services ¹	6,819		7,838	
Total (tCO₂e)^{1,2}	8,251		9,719	
Scope 2	2020		2019 baseline	
	Location-based ³	Market-based ³	Location-based ³	Market-based ³
Office sites	2,176	0	4,516	0
Auto services	1,710	0	2,093	0
Total (tCO₂e)⁴	3,886		6,609	
Scope 3 emissions under our direct control	2020		2019 baseline	
Fuel and energy related activities	2,332		2,465	
Waste generated in operations	413		1,245	
Business travel – air travel	198		928	
Business travel – hotel night stays	75		469	
Business travel – rail	63		410	
Employee commuting ⁵	1,450		4,599	
Upstream leased assets ⁶	63		193	
Upstream transportation and distribution of auctioned vehicles	625		912	
Total (tCO₂e)¹	5,219		11,221	
Direct Line Group carbon footprint (operational control)	2020		2019 baseline	
Office sites (Scope 1&2 tCO ₂ e)	3,608		6,397	
Auto services (Scope 1&2 tCO ₂ e)	8,529		9,931	
Total Scope 1&2 (tCO₂e)	12,137		16,328	
Total Scope 3 under our direct control (tCO₂e)	5,219		11,221	
Total (tCO₂e)	17,356		27,549	

In addition, we monitor the intensity metric of emissions per £ million annually of net earned premium. This is a measure of how efficiently we provide our insurance products and allows us to compare our performance year-on-year and against other insurance companies.

Intensity metric

Year	Emissions per £ million of net earned premium ⁷
2020	4.1
2019	5.5
2018	5.4
2017	5.5
2016	6.4
2015	7.7
2014	9.1
2013	9.5

Notes:

- The 2019 result differs from the Group's TCFD 2020 report published in December 2020 as a result of a reclassification of 320 tCO₂e from upstream leased assets (Scope 3 under our direct control) to Scope 1 auto services.
- The 2019 Scope 1 total of 9,719 CO₂e differs from our previously reported figure of 7,365 CO₂e in the 2019 Annual Report and Accounts as it now includes emissions from additional vehicles used during repairs, courtesy car fuel usage and vehicles that are Company funded, which had not previously been tracked. The 2020 result includes these emissions.
- Figures for Scope 2 use standard location-based methodology. We follow GHG Protocol to disclose both location and market-based figures; and as we have secured our energy from 100% renewable sources since 2014, our Scope 2 market-based results are nil.
- The 2019 Scope 2 total of 6,609 CO₂e differs from our previously reported figure of 6,567 CO₂e in the 2019 Annual Report and Accounts following recalculation.
- Employee commuting is based on UK national averages, not actual individual methods of transport of Direct Line Group employees commuting. This data is not currently tracked.
- Upstream leased assets refer to leased office space locations where Direct Line Group does not directly control the energy provision as it is included in the service agreement.
- Prior to 2019, the emissions used in the calculation of the intensity metric excluded emissions from additional vehicles used during repairs, courtesy car fuel usage and vehicles that are Company funded, as these were not previously tracked. The 2019 result has been re-presented accordingly (reported as 4.7 in the 2019 Annual Report and Accounts). The 2020 result includes these emissions.

Task Force on Climate-related Financial Disclosures

This year the Group published its first comprehensive climate disclosure reporting against the Task Force on Climate-related Financial Disclosures ("TCFD") framework. TCFD has enhanced our reporting and we are confident it will continue to do so as we strengthen our strategic response to one of the biggest challenges facing the world today. A summary of the Group's 2020 TCFD Report follows.

For access to the full report, please go online at:
www.directlinegroup.co.uk/2020_TCFD_Report

Governance

The Group prides itself on good sustainability governance underpinned by our Vision and Purpose and a clear commitment from the top to align sustainability goals and ensure relevant accountability across the business.

The Sustainability Steering Group, led by our CEO, drives the sustainability agenda through our sustainability pillars, each of which is sponsored by a member of our senior management team. Our five-pillar sustainability strategy, endorsed by the Board, aims to foster the highest standard of ESG practice and deliver long-term sustainability for all of our stakeholders. The Planet pillar takes the lead on climate-related issues and is sponsored by our Chief Risk Officer ("CRO").

Board and Committees

The potential impact of climate change on the business ("inbound"), as well as the Group's impact on the environment ("outbound"), are issues that have grown in importance and sit firmly within the Group's governance approach.

The Board has oversight on two key aspects of the Group's approach:

- the Board considers and approves the Group's strategic and financial plan ("the Plan") annually and monitors progress at each of its meetings during the year. In approving the Plan, the Board reviews and approves the Group's Own Risk and Solvency Assessment ("ORSA"), which includes an analysis of the climate change-related risks to the business; and
- the Board oversees the Group's sustainability activity through its Committees which scrutinise and provide appropriate challenge on the Group's five pillar sustainability strategy. The Chair of each Committee reports to the Board after each Committee meeting, including on sustainability activities when relevant.

The Board sets and monitors the Group's performance against its risk strategy, risk appetite and risk framework and has also established a risk management model that separates responsibilities into "Three Lines of Defence".

- The First Line of Defence is the Group's management roles with responsibility for owning and managing risks to achieve business objectives on a day-to-day basis.
- The Second Line of Defence is the Risk Function which is responsible for the design and implementation of the Enterprise Risk Management Strategy and Framework, and provides proportionate oversight of, and challenge to, the business's handling of risks, events and management actions.
- The Third Line of Defence is Group Audit, providing an independent and objective view of the adequacy and effectiveness of the Group's risk management, governance and internal control framework. The Group Audit plan includes sustainability and climate change-specific reviews.

Management's role

There are three primary management roles designed to assign responsibility for the delivery of the Group's assessment and management of climate-related issues:

- the CEO has overall responsibility for climate change and environmental matters;
- the CRO is responsible for overseeing the management of climate change-related financial risk and sponsors the Planet pillar of the Group's sustainability framework. The CRO is also the senior manager with responsibility for assessing and monitoring climate change-related risk. In that capacity, the CRO oversees the work of the Risk Function in analysing and stress testing the potential future impact of climate change on the business. The results of these stress tests are submitted to the Risk Management Committee, the Board Risk Committee and the Board, including as part of the ORSA, and

- the Chief Financial Officer (“CFO”) is responsible for setting the Group’s investment strategy and is advised by the Investment Committee on the application of ESG weightings, including those related to climate change, to the relevant portfolios. The CFO is a member of the Committee and the CEO, CRO and the Director of Investment Management & Treasury are attendees.

In addition, the Climate Change Working Group has been established to help assess the potential impacts of climate change on the Group. Members of this working group represent various teams from across the business with the aim of ensuring risks are identified and managed effectively.

Strategy

Our strategy is to drive change across our underwriting activity, our operations and our investments. The specific impacts of climate change on our business are diverse, and fall into three broad categories:

- **Physical risks and opportunities** resulting from the physical effects of climate change such as weather-related events. This is important to our business as it includes the potential for increased insurance claims, driven by both the frequency and severity of natural catastrophes and other weather-related events in the UK.
- **Transition risks and opportunities** arising from efforts to mitigate climate change, which are driving the transition to a lower-carbon economy. This is significant as we navigate this transition, ensuring our insurance products and operations continue to meet our customers’ needs as a result of any changes in market dynamics and customer behaviour, for example a shift towards electric vehicle usage.
- **Liability risks** arising when parties who have suffered losses from climate change seek to recover them from those they believe may have been responsible. This is important to our business, because this includes exposure to liability risk through commercial liability insurance.

We have defined the following time horizons for these risks: Short (1-5 years), Medium (5-10 years), and Long (10+ years). In general, transition risks are likely to materialise more rapidly than physical risks, which are likely to be gradual and materialise in the longer term. The timing of liability risks is less certain due to the nature of the exposure.

Stress test

We participated in the PRA’s 2019 insurance stress test which considered the impact of climate change on our business, based on three hypothetical climate change scenarios.

- **Scenario A**, a rapid, disorderly transition to a low-carbon economy.
- **Scenario B**, a slow, more orderly transition that keeps global temperatures well within the Paris Agreement target of 2°C of warming.
- **Scenario C**, a scenario with failed future improvements in climate policy, reaching a temperature increase in excess of 4°C (relative to pre-industrial levels) by 2100 assuming no transition and a continuation of current policy trends.

Whilst the transition scenarios saw material impacts on the investment portfolio, the most notable impacts on both investments and insurance liabilities arose from the physical effects of no transition, that is no additional actions beyond those already announced. Based on the PRA specifications, Scenario C, in which physical risk dominates, resulted in the most significant impact on the Group but did not breach risk appetite despite not allowing for reinsurance. This demonstrates the resilience of the Group’s strategy to such a scenario. Furthermore, the projected time frame (2100) for this scenario is likely to allow the business to adapt.

Further disclosure on the outputs from the scenario analysis can be found in our full TCFD 2020 report, pages 11 to 13

Risk time horizons

Short (1 – 5 years)	Medium (5 – 10 years)	Long (10+ years)
Increasing frequency and severity of natural catastrophes and other weather-related events in the UK. As a general insurer we have the ability to re-price annually and transfer risk through reinsurance arrangements. This is likely to limit insurance liability impact in the short term.	Strategic and operational response to the transition towards a lower-carbon economy. This will include including changes to risk nature, opportunities and risks within our supply chain and repair processes and changes to, and opportunities in, our product offerings.	The impacts of risks and opportunities that need to be considered over the longer term include significant adjustments to weather-related modelling, a shift in dynamics within the markets we operate in and continued efforts towards net carbon neutrality in our investment portfolio.

Strategic approach

Our strategy focuses on the Group's underwriting activity, our operations and our investments where we assess the inbound and outbound risks and opportunities.

A full explanation of our strategic response can be found in our 2020 TCFD Report¹

Underwriting

Climate change is a key risk facing the insurance industry. It has the potential to affect both the frequency and severity of natural catastrophes and other weather-related events in the UK which are key drivers in the Group's solvency capital requirements.

In our Motor business, the transition to electric-powered vehicles could affect strategic and operational considerations, including changes to the profile of accidents and changes to the nature of risks, supply chain and repair processes. Understanding this transition provides an opportunity to ensure optimum risk assessments influence pricing decisions and seek to ensure an efficient repair process in our accident repair centres.

Developing further insight into electric-powered vehicles for pricing considerations, the nature of the risks involved, developing efficient repair practices and strengthening technical expertise in our accident repair centres are therefore commercial opportunities. Failing to do this could have an adverse impact on market share if the Group fails to grasp the scale of the transition in the medium term.

Climate change also creates the opportunity to enhance our risk-modelling expertise that can strengthen our pricing decisions. Remaining active participants in developing solutions to influence the debate on weather-related events gives the Group an opportunity to enhance risk modelling and ensure commercial impacts are understood, particularly how claims and fulfilment operations function, for example flooding and resilient repairs in our Home business. Changes in building codes and standards could also impact the way the Group prices property underwriting risk.

Consumers and existing customers could gravitate in greater numbers to competitors as part of a desire for environmentally friendly products. This is a risk and opportunity in equal measure. Developing products that could encourage a reduction in emissions would highlight the Group's capability to customers, opening up a potential commercial opportunity, for example mileage refund propositions for motor customers.

The Group is now conducting market research on consumer attitudes to green products in the insurance industry in order to give the Group greater insight into their commercial viability.

Note:

1. For access to the full report please go online at: www.directlinegroup.co.uk/2020_TCFD_Report

Operations

Our operations are exposed to physical and transition risks. Climate change could disrupt our direct operations as it has the potential to affect both the frequency and severity of natural catastrophes and other weather-related events in the UK. We could also face increased operating costs due to potential carbon cost increases and regulatory requirements designed to limit carbon emissions. In seeking to mitigate such potential challenges the Group is setting reduction targets, improving the way individual business areas operate and the way we leverage our relationship with suppliers.

A failure to set long-term emission reduction targets for business operations could see energy consumption and costs increase. Targets, however, allow the Group to focus on energy reduction across its estate and be transparent about progress achieved.

We continue to invest in energy-efficient features and equipment across our office estate and accident repair centres providing the opportunity to reduce energy costs, which could otherwise increase. The Group is also improving operational efficiencies in order to save energy costs and mitigate environmental impact, for example, in our roadside rescue and recovery business where we are focused on lessening our impacts by reducing our mileage through attendance efficiency. More information can be found on page 20 of the Group's 2020 TCFD Report.

Our responsibilities extend far beyond our direct operations. Therefore, another key area of focus for us is to continually enhance our understanding of the risks and impacts in our supply chain and continue to drive improvements that are designed to minimise carbon and waste.

We recognise that total Scope 3 emissions could either increase or reduce as a result of how we manage our supply chain, particularly the goods and services we purchase. Once approved, our new Science-Based Targets will enable the Group to monitor its progress and the effectiveness by reducing emissions in our supply chain.

We will use our established relationships and purchasing power through procurement to mitigate our risks by seeking to reduce the emissions in our supply chain, while we support our supply chain partners to adapt to a low-carbon world. Once approved, our new Science-Based Targets will enable us to monitor our progress and the effectiveness of this approach.

Investments

In recent years we have started to integrate more ESG considerations into our investment strategy, recognising this is a long-term process which will require assessment and challenge to inform future decision making. We know that the impacts of potential physical and transition risks arising in the wider economy can have an impact on our investment portfolio, through their influence on the value of assets.

Our largest asset portfolios are focused on corporate bonds, and in early 2019 we introduced a significant new initiative. The Group's investment-grade portfolios, representing the bulk of its fixed income investments, now include a new investment objective: to achieve a minimum MSCI ESG rating of 'A' for the portfolio. Companies with higher ESG credentials have more sustainable practices, so this new objective has enabled us to better align our investment goals with our environmental and social goals. We are proud to have achieved the objective and, by the end of 2019, 100% of the investment-grade corporate bond portfolios had an average ESG rating of 'A'.

We are also actively encouraging our investment managers to invest in green bonds. Green bonds are designated bonds intended to encourage sustainability and to support climate-related or other environmental projects. All our relevant bond mandate guidelines direct the portfolio manager to purchase a green bond where the risk/return characteristics are similar to those of a non-green bond.

We hold an investment property portfolio, and all assets in this portfolio must have an Energy Performance Certificate of 'D' or better, or a plan and funds in place for achieving that level. This is one level above the Government-mandated efficiency level of 'E'. The property portfolio also has a tailored set of 2022 ESG targets covering, amongst other things, carbon, energy, water and waste.

Looking ahead, we intend to increase our efforts to develop a more focused climate-related investment approach with a long-term goal of ensuring our entire investment portfolio is net carbon neutral by 2050.

Our first steps on this path relate to our corporate bonds portfolio, the largest part of our investment portfolio. Across these portfolios we have committed to a 50% reduction in weighted-average GHG emissions intensity by 2030, benchmarked against 2020 levels.

We recognise the importance of avoiding investing in the companies least prepared for the transition to a low-carbon economy due to the risk of stranded assets. In response, we are working to increase allocations to those companies providing the solutions and those demonstrating a serious intent to decarbonise.

We also know that to meet the aims of the Paris Agreement, energy generation from fossil fuels will have to be drastically reduced in the coming decade. From 2021, asset managers will not be authorised to buy bonds in mining companies that generate more than 5% of revenues from thermal coal production, and electricity generators that derive more than 5% of revenues from thermal coal power generation. To encourage positive climate action, an exception will be made for companies which have either made commitments for emission reduction targets through the SBTi or assigned a '2 degree' or better Carbon Performance Alignment from the Transition Pathway Initiative. We also plan to exclude companies that are developing new thermal coal plants or mines, in a time frame consistent with our application to the global corporate renewable energy initiative, RE100. We will review the above exclusions annually and may, in the future, divest completely from companies with any involvement in coal or expand the list to include other types of fossil fuels.

Alongside these actions against our investment-grade bonds, we are committed to a wider framework which encompasses all asset classes to deliver our net carbon neutral long-term goal (see page 31 of the Group's 2020 TCFD Report).

Risk management

The predominant direct physical drivers of risk to the Group's capital position are UK floods and major UK windstorms. Whilst additional risks such as freezing weather and subsidence are less material to capital requirements, these are modelled within the Group's Internal Economic Capital Model and reviewed at least biennially.

The influence of climate change is difficult to isolate from the complex oceanic and atmospheric processes driving UK weather. The Group uses catastrophe models to capture these factors, and in turn these models are regularly reviewed against specific criteria including how they have considered latest scientific thinking, to ensure they appropriately capture the Group's risk profile. Responsibility for this work sits within the Capital Modelling function.

Our most exposed policies renew annually and are priced according to risk. Pricing algorithms use sophisticated rating engines to account for recent trends and are supplemented with views of catastrophic risk to seek to ensure sufficient pricing. These prices will evolve as climate change influences manifest themselves through changing loss patterns, and views of catastrophic risk develop because of rising sea levels, changes in precipitation rates and urban resilience.

Risk pricing models are built using historical data covering a multi-decadal time period for perils most likely to be influenced by climate change. This allows us to understand and incorporate long-term signals and past trends into our modelling.

These models benefit from considerable amounts of internal and externally purchased data. External data is reviewed and updated regularly, and we maintain a relationship with data suppliers to understand the methodologies and assumptions in their work. Nevertheless, the underlying trends can be difficult to measure as they emerge through infrequent one-off catastrophe events and may have additional contributory factors (for example, deforestation increasing the pace of rainwater run-off upstream of a flood). Furthermore, future trends are likely to differ from past projections. As such, we recognise a range of uncertainty as to current and future impacts.

Increases in frequency and severity of large catastrophe weather events are mitigated by the Group's use of catastrophe excess of loss reinsurance. This reinsurance covers property (Personal Lines and Commercial) and Motor physical damage losses; in addition to significant capital benefits, it transfers the volatility of low-frequency, high-severity natural perils events away from the Group. The reinsurance purchase decision is a combination of catastrophe modelling, capital analysis, the Group's risk appetite, cost of cover and the overall income statement impact. Cover is purchased with an upper limit equivalent to a 200-year modelled loss and the retention will be based upon the amount that the Group is willing to sustain from such a loss. This cover has benefited from two substantial improvements in recent years that provide additional climate change mitigation against multiple events:

- an increase in the number of reinstatement provisions. The reinsurance limit is purchased with a reinstatement provision where, in the event of a catastrophe loss, the limit of cover available is automatically reinstated to provide cover for the next event loss. Up until recently the cover was purchased with just a single

reinstatement provision across the whole programme but this was increased to two in 2017 for a significant proportion of the reinsurance. This has resulted in more overall reinsurance cover being available for catastrophe losses; and

- an extension to the 'hours clause'. Catastrophe reinsurance covers are generally subject to an hours clause that defines a loss event by a number of hours. In practice, the Group can accumulate all losses within a number of hours to determine the reinsurance event for recovery purposes. In recent years, the amount of time available has been extended which means that the Group can capture more claims and longer duration events and have a greater level of protection for these losses.

In addition, we purchase risk covers to protect against large individual commercial losses.

For a full summary of how the Group approaches Risk management please go to page 24 of our full 2020 TCFD report

Metrics and targets

We take our environmental impact responsibilities seriously and recognise the value of target-setting and reporting in driving our emission reductions. We comply with the applicable greenhouse gas reporting requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and apply the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) to calculate our emissions, which includes emissions associated with electricity consumption using both the Scope 2 location-based and Scope 2 market-based calculation methodologies. This year we also began the process of evaluating our Scope 3 emissions under our direct control and plans are underway to evaluate the final part of our Scope 3 emissions, and our investment portfolio in 2021.

Our 2020 emissions data can be found on page 61, which reflects reduced energy usage in 2020 due to the impact of Covid-19. This data includes our intensity metric of emissions per £ million annually of net earned premium. This is a measure of how efficiently we provide our insurance products and allows us to compare our performance year-on-year and against other insurance companies.

In addition, we have two Group-wide environmental impact targets:

- a 57% reduction in emissions (Scope 1 and 2) on a like-for-like basis by the end of 2020 against a 2013 baseline. We exceeded this target with a 69% reduction in energy related emissions in 2020, which takes into account the impact of Covid-19 where home working and lockdown measures altered our energy usage. Excluding the impact of Covid-19 we estimate energy related emissions would have been approximately 63% lower than 2013; and
- a 30% reduction in energy consumption on a like-for-like basis by the end of 2020 against a 2013 baseline. This year we again exceeded our target with a 45% reduction in energy consumption, which takes into account the impact of Covid-19 where the move to home working reduced energy use across our estate. Excluding the impact of Covid-19 we estimate that energy consumption in 2020 would have been approximately 34% lower than 2013.

Having met and exceeded these targets we will now benchmark the Group's environmental performance against a 2019 baseline and will set Science-Based Targets within the two-year timeframe set out by the SBTi.

We also have the following long-term goal for our investments:

- ensuring our entire investment portfolio is net carbon neutral by 2050 in line with the aims of the Paris Agreement.

To support this aim we have now set an interim target of a 50% reduction in weighted average GHG emissions intensity by 2030 within our corporate bonds portfolio, the largest part of our investment portfolio. We will use GHG emissions intensity¹ as the key metric of measurement as follows:

$$\text{GHG emissions intensity} = \frac{\text{Metric tonnes CO}_2\text{e (CO}_2\text{ equivalent) GHG emissions}}{\text{Million \$ Sales}}$$

Normalising by sales as the denominator allows the investor to compare carbon efficiency of different sized firms within the same industry and has become the standard metric used in the investment industry. Our aim in 2021 is to be able to report the weighted average carbon intensity of our corporate bonds portfolio. Furthermore, in order to improve monitoring, management and future reporting in this area, we are working towards an improved picture of the emissions intensity of other significant portions of our investment portfolio, where appropriate data and methodologies exist.

Looking forward, we are working with the Carbon Trust to set Science-Based Targets across the full Scope 1, 2 and 3 of our operations. These targets will be submitted for approval and subject to the two-year time frame set out by the SBTi.

For a full breakdown of the Group's overall emissions, including our intensity metric and historical performance, see page 61.

Future Group activity

The Group has now set itself new priorities against the TCFD recommendations.

TCFD recommendation	Future Group activity
Governance	
Describe the Board's oversight of climate-related risks and opportunities.	The Group plans to maintain strong Board oversight, ensuring the Planet pillar, as part of its sustainability strategy, continues to take a strategic lead. Setting the Board's strategic debates in a climate change context will be supported by periodic debates on climate-related risks and opportunities, as well as inviting thought leaders to engage with Board meetings.
Describe management's role in assessing and managing climate-related risks and opportunities.	
Strategy	
Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term.	The Group intends to conduct more analysis in order to present more detailed impact assessments of climate-related risks across different time horizons.
Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.	The Group intends to strengthen how it systematically considers climate-related issues from a risk and opportunity perspective across business areas, strategic decision making and financial planning in order to be better able to describe impacts.
Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	Quantifying the impact of climate-related scenarios, including a 2°C or lower scenario, will strengthen the Group's ability to describe how resilient its strategy is, particularly placing monetary values on climate-related impacts.
Risk management	
Describe the organisation's processes for identifying and assessing climate-related risks.	The Group will continue its robust approach towards the management of physical risk and intends examining in more depth inbound and outbound impacts in order to be able to better describe transition and liability risks. The ambition is for risk management processes to support the Group in conducting detailed analysis on each risk and applying monetary values to support the Group's overall strategy.
Describe the organisation's processes for managing climate-related risks.	
Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	
Metrics and targets	
Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.	The Group plans to work towards establishing Science-Based Targets within the business to be approved by the SBTi which will strengthen our disclosures across Scope 1, Scope 2 and total Scope 3 GHG emissions.
Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 GHG emissions, and the related risks.	
Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	

Note:

1. GHG emissions intensity is used to account for greenhouse gases other than just carbon dioxide which contribute to global warming (such as methane and nitrous oxide). These other gases are converted into a CO₂ equivalent measure based on their warming potential.

Streamlined Energy and Carbon Reporting (SECR) regulations

The following table highlights where information can be found that supports the requirement to disclose how the Group manages its energy consumption and carbon emissions.

Requirement	Pages
Annual global GHG emissions (CO ₂ e)	
- from activities for which the Company is responsible	61
- from buying electricity, heat, steam or cooling by the Group for its own use	61
Annual global energy consumption in kWh, being the aggregate of:	
- energy consumed from activities for which the Company is responsible	58
- energy consumed resulting from buying electricity, heat, steam or cooling by the Group for its own use	58
The proportion of GHG emissions and energy consumed relating to the UK and offshore area ¹	59 and 61
Methodology used to calculate emissions and energy consumption	58
At least one intensity metric in relation to emissions	61
Description of energy efficiency actions taken	60

Note:

1. The offshore area is broadly defined as the sea adjacent to the UK, including the territorial sea, plus the sea in any designated area under section 1(7) of the Continental Shelf Act 1964 and section 41 (3) of the Marine and Coastal Access Act 2009.

Non-financial information statement

This Non-financial information statement highlights information necessary for an understanding of the Company's development, performance, position and impact of its activity, information relating to environmental, employee, social, respect for human rights, anti-corruption and anti-bribery matters.

Where possible, the following table states where additional information can be found that supports the requirements of sections 414CA and 414CB of the Companies Act 2006.

Reporting requirement	Information necessary to understand our business and its impact within the Annual Report & Accounts	Pages
Environmental	- Our sustainability pillars	44 to 61
	- Sustainable Development Goals	46
	- Greenhouse gas emissions	58, 61
	- Climate-related risks	66
	- TCFD Report	62
Employees	- Covid-19 response and people	50, 102
	- Diversity and inclusion	50, 92, 107, 110, 125
	- Hampton-Alexander Review	52, 93, 108
	- Gender pay gap	52
	- Performance and pay	10, 15, 52, 86, 110
Social and community matters	- Social Mobility Employee Network	54 to 55
	- Prompt Payment Code	56, 142
	- Our Community Fund	57
Human rights	- Well-being strategy	52 to 53
	- My Life policies	52, 53
	- Living wage	52, 118
	- Ethical Code for Suppliers	142
	- Modern Slavery Statement	86, 109, 142
Anti-bribery and corruption	- Ethical matters	105, 110
	- Sustainability Committee report	109 to 110
	- Code of Business Conduct	77, 85, 88, 142
Innovation	- New products, channels and propositions	2 to 3, 12, 37
	- Digital customer journey	14, 16, 40, 43, 49
Business model	- Strategic report	1 to 75
Principal risks and impact on business activity	- Managing our risk	69 to 75, 95 to 96, 104
	- Risk management	172 to 185
	- Audit, risk and internal control	95 to 96
	- Board Risk Committee report	102 to 105
Non-financial KPIs	- Change delivery	13 to 14
	- Workforce engagement	19, 117, 118
	- Net promoter score	19, 48, 124
	- Customer complaints	19, 124

Risk management

Our aim is to make risk management simple, well understood and embedded. We will provide oversight which is pragmatic and commercial to help the business make good risk-based decisions and to move quickly whilst understanding the risks.

Managing risk in line with our strategy

Our management team, with oversight from the Board and Board Risk Committee, is responsible for developing our strategy. Our strategic planning process aims to ensure we have developed clear objectives and targets, and identified the actions needed to deliver them, including the management of risk.

A key aspect of any effective strategic planning process is to understand and manage those risks appropriately. To achieve this, the Risk Function works closely with the business to help it to identify and assess risks, which is done through setting and achieving targets as well as through its review and challenge of business plans in the strategic planning process.

The Group's risk strategy is aligned with the Group strategy and supports business decision-making through the proactive identification, assessment and management of risks.

Our risk governance framework

The Risk Function continues to lead transformation and cultural change to drive ownership of risks in the business, recognising the Group's changing risk profile and the maturing control and governance environment.

To begin with, the focus was on establishing standards and governance, articulating the Group's risk appetite and ensuring we had appropriate capability across its three lines of defence. We now have an embedded Enterprise Risk Management and Strategy Framework ("Risk Management Framework") with clear accountabilities and risk ownership designed to ensure that we identify, manage, mitigate and report on all key risks and controls through the three lines of defence model:

First line: Management is responsible for embedding risk management into business as usual and change processes whilst creating transparent reporting of risks and management actions.

Second line: The Risk Function is responsible for the design and recommendation to the Board Risk Committee of the Risk Management Framework, its implementation across the Group and the provision of proportionate oversight of risks, events and management actions throughout the Group.

Third line: Group Audit is responsible and accountable for providing an independent and objective view of the adequacy and effectiveness of the Group's risk management, governance and internal control framework.

See page 69 for governance structure

Risk appetite

Our risk appetite statements are an expression of the level of risk the Group is prepared to accept to achieve its business objectives. The statements are used to drive risk-aware decision-making by key business stakeholders. Our risk appetite statements are documented in our policies and include:

- monitoring whether the business remains within risk appetite, among other information, using key risk indicators;
- deriving the key risk indicators from the risk appetite statements to drive and monitor risk-aware decision-making; and
- both qualitative and quantitative risk statements which are forward and backward-looking. We review our risk appetite statements and key risk indicators annually.

Our Risk Management Framework

The Risk Management Framework document sets out, at a high level, the Group's approach to setting risk strategy and managing risks to the strategic objectives and day-to-day operations of the business.

Aligned to the three lines of defence model, not only does the Risk Management Framework articulate the high-level principles and practices needed to achieve appropriate risk management standards, but it also demonstrates the inter-relationships between components of the Risk Management Framework.

Within this, the risk management process is a key element in the development and on-going maintenance of an accurate risk profile. The objective of the risk management process is to identify, assess, manage, monitor and report on the risks that the Group is exposed to. See page 66 for specific information on how the business identifies and assesses the risks associated with climate change.

Within the Risk Management Framework, policies address specific risk areas and are aligned to the Group's risk appetite. Policies, where appropriate, are supported by underlying minimum standards which interpret policies into a set of risk and control requirements to be implemented across the Group.

Risk appetite statement

Overarching risk objective

The Group recognises that its long-term sustainability is dependent on having sufficient economic capital to meet its liabilities as they fall due, thus protecting its reputation and the integrity of its relationship with policyholders and other stakeholders. As part of this, its appetite is for general insurance risk, focusing on

personal lines retail and small and medium-sized enterprise insurance in the United Kingdom. The Group has appetite for non-insurance risks, as appropriate, to enable and assist it to undertake its primary activity of insurance.

Three strategic risk objectives

1. Maintain capital adequacy

The Group seeks to hold capital resources in the range of 140%-180% of its solvency capital requirement.

2. Stable/efficient access to funding and liquidity

The Group aims to meet both planned and unexpected cash outflow requirements, including those requirements that arise following a 1-in-200 year insurance, market or credit risk event.

3. Maintain stakeholder confidence

The Group has no appetite for material risks resulting in reputational damage, regulatory or legal censure, poor customer outcomes, fines or prosecutions and other types of non-budgeted operational risk losses associated with the Group's conduct and activities. The Group will maintain a robust and proportionate internal control environment.

Our risk culture

Our risk culture underpins our business and decision-making, and helps us embed a robust approach to managing risk. Our Risk Function drives ownership of risks in the business and ensures that risk consideration is integral to all decision-making. It also provides expert advice and guidance to business areas, whilst also challenging the effectiveness of controls to manage risk and compliance.

The Board is committed to promoting a culture of high standards of corporate governance, business integrity, ethics and professionalism in all our activities. An annual assessment of risk behaviours and attitudes is undertaken jointly by the Risk Function and Group Audit and considers a range of factors influencing risk culture.

We also have an annual Risk Communications Plan which features activity to reinforce the message that risk is everyone's responsibility. The Plan features staff awareness campaigns, articles on the intranet and the imaginative "Risk Heroes" campaign which enabled members of staff to harness social media and mobile phone photograph filters; and enabled Risk to engage with colleagues about the importance of risk management in a unique and conversational way.

Proactive risk management through Covid-19:

The Covid-19 pandemic created an unprecedented set of circumstances in the UK, as the country moved to national lockdowns. To minimise transmission of the Covid-19 virus, people across the UK were asked to remain at home, including working from home where possible and restricting any travel.

Within the Group, Covid-19 presented a series of challenges in seeking to protect its people, maintain customer operations, and safeguard the business.

In responding to the pandemic, management demonstrated strong proactive leadership, took accountability and showed a clear understanding of risk as they transitioned the business to a home working model. We transitioned our people to working from home prior to the national lockdown being called, while maintaining service continuity for our customers.




Throughout the pandemic, the Risk Function worked closely with business areas to perform key risk and control assessments to inform this decision making; including assessments of risks introduced through mass homeworking, which enabled us to take mitigating action where necessary. The results of this exercise informed management of our critical supply chain.

Collaboration took place across the business to manage other Group responses to the pandemic; such as, the management of the surge in customer claims related to Travel; the assessment of additional scenarios relating to operational resilience; and documenting how impacts of the pandemic may evolve, in order to identify and mitigate risk.

Throughout this challenging period, business functions have continued to work together proactively to ensure that our customers receive appropriate levels of service and support, whilst still delivering business performance.

Principal risks and uncertainties

We carefully assess the principal risks facing us. Principal risks are defined as having a residual risk impact of £40 million or more on a 1-in-200 years basis, taking into account customer, financial and reputational impacts.

Principal risk	Description	Risk commentary
<p>Insurance Risk</p> <p>Strategic Alignment</p> <p>③</p> <p>Relative size of risk</p> <p>Trend - increasing</p> 	<p>The risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting.</p>	<p>Key drivers of the outlook for insurance risk across our business plan include reserve, underwriting, distribution, pricing and reinsurance risks. Issues relating to Covid-19 have been a key area of focus for the Group in 2020 and the main driver of the increasing trend in Insurance risk. Claims trends have been significantly impacted particularly during the lockdown period. This has led to uncertainty in claims reserving and pricing.</p> <p>In 2021 and beyond, Covid-19, Brexit and potential recession may have an impact on claims inflation together with market and customer behaviour.</p>
<p>Market Risk</p> <p>Strategic Alignment</p> <p>③</p> <p>Relative size of risk</p> <p>Trend - stable</p> 	<p>The risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.</p>	<p>Key drivers of market risk are the sensitivity of the values of our assets and investments to changes in credit spreads, and our exposure to losses as a result of changes in interest rate term structure or volatility.</p> <p>Concerns about the Covid-19 pandemic and Brexit fallout could impact equity and credit markets within the global economy leading to credit spread increases, foreign exchange rate volatility, interest rate changes and devaluation of UK property assets.</p>
<p>Operational Risk</p> <p>Strategic Alignment</p> <p>④ ⑤ ⑥</p> <p>Relative size of risk</p> <p>Trend - decreasing</p> 	<p>The risk of loss due to inadequate or failed internal processes or systems, human error or from external events.</p> <p>The key risks within this category are Cyber, Technology & Infrastructure, Operational Resilience, Change, People, Information Management, Outsourcing, Partnerships and Fraud.</p>	<p>Operational risks can arise within all areas of the business and can manifest themselves through inadequate or failed internal processes or systems, human error or from external events.</p> <p>Our approach is to manage our operational risks to proactively mitigate potential customer harm, regulatory or legal censure, financial and reputational impacts. The decreasing trend in operational risk is driven mainly by the good progress made by the business in delivering technology improvements.</p> <p>We have in place operational processes and systems, including prevention and detection measures. These include processes which seek to ensure we can absorb and/or adapt to internal or external events that could impact customer operations and the wider business.</p> <p>With the majority of staff now working from home, we continue to work to improve the performance of our IT systems, focusing on improving both system stability and capability.</p>
<p>Link to strategy</p> <p>① Be best at direct</p> <p>② Win on price comparison websites</p> <p>③ Extend our reach</p> <p>④ Be nimble and cost efficient</p> <p>⑤ Have technical edge</p> <p>⑥ Empower Great people</p>		

Principal Risk	Description	Risk commentary	
<p>Regulatory & Compliance Risk</p> <p>Strategic Alignment ① ② ③ ⑤</p> <p>Relative size of Risk ■</p> <p>Trend – stable ➤➤</p>	<p>The risks leading to reputational damage, regulatory or legal censure, fines or prosecutions and other types of non-budgeted operational risk losses associated with the Group's conduct and activities.</p>	<p>We maintain a constructive and open relationship with our regulators and have a strong culture of delivering on our commitments to our customers (see pages 48 to 49).</p> <p>Pricing practices within the general insurance market is a key area of focus for the FCA and for the Group. We continue to devote a lot of attention to this area as we prepare for the implementation of the FCA's pricing practices remedies, expected in Q2 2021. Our existing conduct Risk Management Framework is designed to deliver fair outcomes to customers and minimise our risk exposure. The framework is supported by a set of conduct pricing principles designed to enable the fair pricing of business across our book. We continue to develop our approach to anticipate regulatory developments and to ensure that we can continue to provide good outcomes for our customers. We carry out planned risk-based monitoring of customer processes as well as more targeted thematic reviews to help us manage the risk of unfair customer outcomes.</p>	<p>We have maintained regular and open dialogue with both the FCA and PRA on our responses to Covid-19, outlining actions taken with the aim of ensuring that good customer outcomes are achieved and that the Group remains financially and operationally resilient.</p> <p>We have worked closely with UK regulators on our Brexit preparations, and with the Central Bank of Ireland to establish an Irish Branch in preparation for the end of the Brexit transition period.</p> <p>Finally, we have put in place a strong governance and accountability framework as part of the Senior Managers and Certification Regime, and carry out an annual declaration process to ensure the ongoing fitness and propriety of the Group's Senior Managers and Certified Functions.</p>
<p>Credit Risk</p> <p>Strategic Alignment ③</p> <p>Relative size of risk ■</p> <p>Trend – stable ➤➤</p>	<p>The risk of loss resulting from default in obligations due from and/or changes in the credit standing of issuers of securities, counterparties or any debtors to which the Group is exposed.</p>	<p>To manage credit risk, we set credit limits for each counterparty and actively monitor credit exposures. In addition, we only purchase reinsurance from reinsurers with at least an A- rating and, for liabilities with a relatively long period of time to settlement, this rating is at least A+.</p>	<p>Finally, we also have well defined criteria to determine which customers are offered and granted credit.</p>
<p>Strategic Risk</p> <p>Strategic Alignment ② ③ ④ ⑤ ⑥</p> <p>Relative size of risk ■</p> <p>Trend – stable ➤➤</p>	<p>The risk of direct or indirect adverse effects resulting from strategies not being optimally chosen, implemented or adapted to changing conditions.</p>	<p>Strategic risk is influenced by internal and external developments such as the Covid-19 pandemic, Brexit and the FCA's Pricing Practices Review. In addition, the adoption of agile ways of working is designed to allow the business to more quickly identify and react to risks to the implementation of the Group's strategic goals.</p> <p>To manage our risks, we have taken the following steps:</p> <ul style="list-style-type: none"> – we agree, monitor and manage performance against the Board-approved plan and targets; 	<ul style="list-style-type: none"> – the Board leads an annual strategy and five-year planning process which considers our performance, competitor positioning and strategic opportunities; – as part of the timetable for the Strategic Plan, the Risk Function carries out a risk review of the Plan which is documented in the Group's Own Risk and Solvency Assessment and presented to the Board; and – we identify and manage emerging risks using established governance processes and forums.
<p>Link to strategy</p> <p>① Be best at direct</p> <p>② Win on price comparison websites</p> <p>③ Extend our reach</p> <p>④ Be nimble and cost efficient</p> <p>⑤ Have technical edge</p> <p>⑥ Empower Great people</p>			

UK recession and global financial instability

The risk of a further UK-wide recession and global financial instability is ongoing. The economic uncertainty is expected to remain high throughout H1 2021, as a result of the Covid-19 pandemic, and the Group continues to monitor the worst-case impact.

As a result of the Covid-19 pandemic, the UK Government has acted to support UK employees and prevent lasting damage to the economy. However, the uncertainty surrounding the pandemic makes the overall impact and recovery progress unclear.

The disruption to global trade and supply-chains caused by the pandemic could increase the risk of inflation in the long-term.

For the Group, the investment portfolio is positioned relatively defensively; however, if the UK recession were to worsen significantly, additional steps could be taken such as further shifting the portfolio towards 'defensive' sectors or increasing more allocation to cash.

Globally, the economic shock caused by the Covid-19 pandemic initially resulted in credit spreads in Europe and the US moving to levels last seen in the 2008/09 credit crisis, and equity markets posted extremely steep percentage falls. Whilst markets have recovered to a degree, there still remains uncertainty over the duration and continued impact of the pandemic.

The Group portfolio contains a proportion of short-maturity bonds which could be sold relatively quickly if necessary. Recent stress and scenario testing has highlighted that the largest impacts would be on the Group's asset portfolio. The Group believes that the risks from global financial instability are being appropriately monitored.

Potential effects of Brexit

The Brexit transition period following the UK leaving the EU ended at 11pm on 31 December 2020. A trade and co-operation agreement had been agreed, tariffs on goods entering the UK from the EU were avoided and the more severe risks identified in connection with a so-called 'no-deal' Brexit have not materialised.

Key risks identified as potentially arising in the context of disruption following the end of the transition period included financial impacts (for example, if credit spreads widened) and operational impacts (for example, if goods were delayed at the EU/UK border). Other risks identified included risks of changes to the value of sterling, inflation, recession, recruitment and retention of people, impacts on travel, and potential changes to tax and regulation.

Some of these risks could still occur to some degree and we continue to monitor developments.

The Group has a small amount of business in the Republic of Ireland, servicing a small Irish part of a UK partner's wider business. Accordingly, following approval from the Central Bank of Ireland the Group established an Irish branch in the Republic of Ireland with effect from the end of the transition period.

Emerging risks

Emerging risks are defined in the Group as newly developing risks that are often difficult to quantify but may materially affect the Group. Emerging risks are usually highly uncertain risks which are external to the Group. The Group has in place an emerging risks process which enables it to:

- have a proactive approach to emerging risk management;
- identify, manage and monitor a broad range of potential emerging risks; and
- mitigate the impact of emerging risks which could impact the delivery of the Group's Strategic Plan.

The Group records emerging risks within an Emerging Risk Register. An update on emerging risk is presented to the Board Risk Committee annually and is supplemented by deep dives into selected emerging risks. During 2020, the Group Risk function worked with first line of defence subject matter experts to enhance the quality and detail of emerging risk updates.

The Covid-19 pandemic was not included within the Emerging Risk Register as an emerging risk, as it has emerged and is impacting and is reflected in our current Group risk profile. However, 'Global Pandemic' remains on the Emerging Risk Watchlist for monitoring, which focuses on the potential for a similar type of outbreak in years to come. Many of the lessons from the Covid-19 situation can be applied to how the Group would respond to another global pandemic.

The Covid-19 pandemic continues to challenge the way the industry operates, both now and in the future. Second line of defence and first line of defence subject matter experts continue to monitor potential threats and opportunities which may impact the Group and the wider industry, as the 'new normal' becomes clearer.

The most notable emerging risks are outlined on the following page.

Climate change

The Group recognises that climate change potentially poses material long-term financial risks to the business and is receiving increased scrutiny from regulators and investors. Climate change risks can be divided into three categories: physical, transition and liability risks. All three of these categories can manifest themselves through a range of existing risks within the material risk register, including insurance, market, operational, strategic and reputational risks.

Following the issue of the PRA's Supervisory Statement SS3/19, the Group has appointed the CRO as the Senior Management Function holder for Climate Change and put an initial plan in place to address the expectations set out in the supervisory statement.

The Group has updated risk policies and minimum standards explicitly to reference the risks from climate change, and we reviewed climate-related key performance indicators for energy usage and emissions across the business throughout H2 2020, to help inform future climate-related financial disclosures.

The risks and impacts of climate change are wide ranging; the Group is focusing increasingly on climate change, with related risk management activity which includes monitoring climate change through the emerging risk process, forming a Climate Change Working Group and continuing its journey to implement the recommendations of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures ("TCFD").

As part of embedding the management of these climate-related financial risks in 2021, the Group will take part in the Bank of England's Climate Biennial Exploratory Scenarios exercise. This stress testing exercise aims to understand the impact on the Group of future climate scenarios incorporating physical and transition risks.

Ethical use of data

The Group identified the 'failure to establish an ethical way to use data' as an emerging risk in H2 2019, with activity underway to mitigate against associated risks. The industry and policymakers' view of this risk is still emerging, as legislation and regulation in this area is yet to mature; however, it is a growing area of focus for the Group's regulators and for the Group itself.

A group of stakeholders including the Chief Data Officer and the Privacy & Information Management team has been established to provide visibility of the challenge for the Group, and a working group has been established to gather external views and create visibility for the required timelines, and to provide the focus required to move development of a data ethics framework at an appropriate pace.

The Group has been outlining a proposed approach for the management and governance of data ethics. Work will continue in 2021 to confirm and embed the proposed principles-based approach. In addition, we have commenced work to determine how the Group could best incorporate emerging data ethics considerations into current customer conduct processes and forums.

Viability statement

In accordance with Provision 31 of the 2018 UK Corporate Governance Code, the Directors have assessed the prospects of the Group for a period longer than the minimum 12 months required by the going concern statement.

The Strategic report, on pages 1 to 75, sets out the Group's financial performance, business environment, outlook and financial management strategies. It covers how the Group measures its regulatory and economic capital needs and deploys capital. You can find discussion about the Group's principal risks and risk management on pages 69 to 74. Note 3 to the consolidated financial statements starts on page 172 and sets out financial disclosures relating to the Group's principal risks. This covers insurance, market and credit risk; and the Group's approach to monitoring, managing and mitigating exposures to these risks.

Every year, the Board considers the Strategic Plan and an Own Risk and Solvency Assessment ("ORSA") for the Group. The Plan makes certain assumptions in respect of the competitive markets in which the Group operates, and the delivery and implementation of the new customer systems. Appropriate aspects of the Strategic Plan are stress-tested to understand and help set capital and other requirements.

When reviewing the Strategic Plan, the Board considered the Group's prospects over the period that the plan covered and the conclusions of the ORSA, based on the Group's anticipated activities as set out in the strategic plan. This review includes reviews of solvency, liquidity, assessment of principal risks and risk management over a three-year period from 2020 to 2022 with a further two years of indicative planning from 2023 to 2024. The first year following approval of the business plan has greater certainty, so it was used to set detailed budgets across the Group. Outcomes

for the subsequent years in the plan are less certain. However, the plan provides a robust planning tool for strategic decisions. The Board recognises that, in a strategic plan, uncertainty increases over time and, therefore, future outcomes cannot be guaranteed or accurately predicted.

The Board has assessed the principal risks of the Group over the duration of the planning cycle. The assessment included considering the possible challenging market conditions due to the impact of Covid-19 on the economy and customer behaviour, the possible adverse implications of Brexit, the implementation of the FCA's Pricing Practices Review and change risk. The 2020 Plan modelled a number of different scenarios which were directly and indirectly influenced by the Covid-19 pandemic. These included delay to improvements in technological capability, the impact of Covid-19 on claims frequency levels and the impact of Brexit on the investment return. The key judgements applied were in relation to the likely time period of Covid-19 related restrictions, and the subsequent impact on customer behaviour and the economic recovery.

Covid-19 pandemic

- The Plan has been stress tested for the impact of a deep UK recession triggered by the end of furlough and extended lockdown throughout the first half of 2021. This is a severe but plausible scenario that we have used to challenge our contingent management actions.

Brexit

- Following the Brexit deal announced in December 2020 the likelihood and severity of impacts relating to a disorderly Brexit have significantly reduced. However, the Plan has been stress tested for the potential impact of adverse consequences on investment values.

FCA General Insurance Pricing Practices Review ("PPR")

- The FCA's consultation period ended in January 2021 and the final report has not yet been published. The Group's Plan includes a scenario for the impact of the PPR from 2022 onwards based upon the differential between new business and renewal prices. The Group considered a spectrum between two potential outcomes. A series of management actions have been identified to mitigate the impact of this scenario.

In addition, the Group's Risk Function has carried out an assessment of the risks to the plan and the dependencies for the success of the Strategic Plan. This included running stress tests on the Plan to consider the 1-in-8-years and 1-in-25-years loss simulations based on the internal economic capital model. In both cases, the Group remained within its risk appetite range for its solvency capital ratio and did not breach the Group's solvency capital requirement after contingent management actions in any of the years covered by the plan (2020 to 2024).

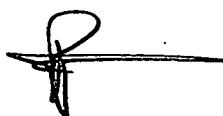
A reverse stress test was also performed to identify the most probable combination of stresses that would result in capital loss and thus threaten the viability of the Group, i.e. a reduction of own funds to below the solvency capital requirement. The test combined a number of independent events and concluded that the Group's solvency capital requirement would not be breached after management actions.

Based on the results of these reviews, the Board has a reasonable expectation that the Company and the Group can continue in operation, meet liabilities as they fall due and provide the appropriate degree of protection to those who are, or may become, policyholders or claimants in the period to 31 December 2024.

Statement of the Directors in respect of the Strategic report

The Board reviewed and approved the Strategic report on pages 1 to 75 on 5 March 2021.

By order of the Board



Penny James
Chief Executive Officer

5 March 2021

Our Governance

Danuta Gray

Chair of the Board

Dear shareholders and other stakeholders,

On behalf of the Board, I am pleased to present the Corporate Governance report for the year ended 31 December 2020.

I have been very impressed by the way the Group has responded to the challenge presented by Covid-19. I am extremely proud of our people who have played such an important part in continuing to deliver much needed services throughout the crisis. I am pleased to report that our governance operated well in a different working environment.

As Chair, it is my role to provide leadership of the Board to ensure that it operates effectively. In the light of the impact of Covid-19 and the unprecedented level of uncertainty for the business, the Board held a number of unscheduled meetings to consider significant operational matters, as well as to monitor the Group's solvency through a period of market volatility.

Your Board is committed to underpinning all of the Group's activities with the highest standards of corporate governance. This section of our Annual Report & Accounts explains how your Board seeks to ensure that we have effective corporate governance in place to help support the creation of long-term sustainable value for all our shareholders and other stakeholders.

The Board endorses the UK Corporate Governance Code 2018 (the "Code"), which applied to our 2020 financial year, and the related FRC Guidance on Board Effectiveness. We seek to ensure that our governance framework remains aligned with best practice, consistent with the Code. Throughout the year ended 31 December 2020, the Company complied with the Principles and Provisions set out in the Code.

Sustainability is at the heart of how we think about our business. We have always been conscious of our broader role in society, giving something back to our local communities and fostering social mobility. Further information on our sustainable business model can be found in the Strategic report.

There is a duty, enshrined in the Companies Act 2006, for your Directors to act in the way each of us considers, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole, having regard to various matters identified in the legislation. In this Annual Report & Accounts, we have detailed the stakeholders and issues which the Directors considered when discharging this duty throughout the year. Our formal statement in relation to Section 172(1) of the Companies Act 2006 appears on page 10.

I would like to thank you for your support and look forward to hearing your views as we prepare for our forthcoming AGM on Thursday, 13 May 2021.

Purpose, culture and values

The Board recognises the importance of its role in setting the tone of the Group's culture, aligning it with our purpose, values and strategy, and embedding it throughout the Group. The Board aims to foster an open and collaborative culture based on our vision and purpose, supporting decisions that are best for our shareholders, whilst having regard to the interests of our other stakeholders. Our vision, purpose, values and Code of Business Conduct are central to the Group's culture. We encourage our people to be curious, to be aligned on outcomes, to build trust, encourage simplicity, empower their teams and continually test, learn and adapt.

Communication with our shareholders and other stakeholders is extremely important to us. During 2020, directors attended virtual meetings with major investors to ensure their views were considered and our objectives were understood. For the safety of our shareholders and colleagues, we held a closed AGM in 2020 and encouraged shareholders to submit questions in advance of the meeting. In 2021, acknowledging that restrictions on public gatherings may remain in place, we plan to enable shareholders to participate in our AGM electronically. Shareholders are encouraged to contact us by email at ShareholderEnquiries@directlinegroup.co.uk.

For more on communication with major investors, see page 88.

“The Board recognises the importance of its role in setting the tone of the Group’s culture and embedding it throughout the Group.”

Succession planning and Board changes

There have been changes to our Board since last year’s AGM. I succeeded Mike Biggs as Chair in August 2020 and Adrian Joseph OBE joined as an independent Non-Executive Director in January 2021.

Jane Hanson has served as a Non-Executive Director for over nine years and will step down from the Board at the conclusion of the 2021 AGM.

The Board recognises the benefit of recruiting leaders who live the Group’s culture and values and represent a diversity of gender, ethnicity, cognitive strengths and socio-economic, educational and professional backgrounds. For a wider understanding of the skills and experience of our Board, see pages 78 to 80 and pages 106 to 108.

The Nomination and Governance Committee continues to review succession plans both for the Board and at executive level each year.

In early 2021, three levels of the emergency succession plan were invoked to provide cover for Tim Harris’s leave of absence while he cared for a member of his family receiving medical treatment: Neil Manser stepped up as Acting Chief Financial Officer; Jasvinder Gakhal as Acting Chief Strategy Officer and Rebecca Clapham as Interim Managing Director of Direct Line for Business.

Further information on our diversity policy, our approach to succession planning and Board appointments can be found in the Nomination and Governance Committee report on pages 106 to 108.

Effectiveness and evaluation

As Chair, one of my principal objectives is to ensure that the Board includes a body of Non-Executive Directors with the skills and experience to be able to support and challenge our Senior Management in developing and executing an ambitious strategy for the benefit of our shareholders and other stakeholders. In accordance with the Code, we conduct evaluations of the effectiveness of the Board and its Committees annually, including an externally facilitated review every third year. The 2019 review was facilitated by Robert Goffee, Professor of Organisational Behaviour at the London Business School, who had no other connection with the Company or any individual Director.

In 2020, having recently been appointed as Chair, I chose to conduct the effectiveness review myself. Building on themes identified by Professor Goffee, this year’s review focused on the value capable of being added by Non-Executive Directors from their experience, the emphasis on strategic issues on the Board’s agenda, the Board’s ability to challenge executive performance based on the quality of information provided, and the external sources of insight available.

As part of the annual evaluation process, all Non-Executive Directors were assessed as being independent and able to provide a valuable and effective contribution to the Board. Suggestions for further improving effectiveness that were raised during the review process have been taken into consideration by the Board. Further details can be found on page 94.

Remuneration

The Board has delegated responsibility to the Remuneration Committee for the remuneration arrangements for the Chair, Executive Directors and Senior Management. The Remuneration Committee also reviews workforce remuneration and related policies and the alignment of incentives and rewards with the Group’s culture.

The Group’s Remuneration Policy was approved at the 2020 AGM and the current Policy will remain in place for a further two years.

Further details on the work of the Remuneration Committee can be found in the Directors’ remuneration report which begins on page 113.

Annual General Meeting

Direct Line Insurance Group plc’s 2021 AGM will be held on Thursday 13 May 2021 at 11.00 am. Full details including the resolutions to be proposed to our shareholders can be found in the Notice of AGM which will be made available on our corporate website.

The outcome of the resolutions put to the AGM, including poll results detailing votes for, against and withheld, will be published on the London Stock Exchange’s and the Company’s websites once the AGM has concluded.

Yours sincerely,






Danuta Gray

Chair of the Board

Our Code of Business Conduct

Your Board maintains strong relationships and regular interaction with our shareholders and other stakeholders. Their continued support for our strategic aims is important. Visit www.directlinegroup.co.uk for more information.

UK Corporate Governance Code 2018

-  Board leadership and company purpose
Read more on pages 84 to 88
-  Division of responsibilities
Read more on pages 89 to 90
-  Composition, succession & evaluation
Read more on pages 91 to 94
-  Audit, risk & internal control
Read more on pages 95 to 96
-  Remuneration
Read more on pages 113 to 139

Board of Directors

Danuta Gray

Chair of the Board (N) (R)

Appointed: February 2017

Biography

Danuta is Chair of the Nomination and Governance Committee and was appointed as Chair of the Board in August 2020. The Board benefits from her previous experience as Chair, Chief Executive and NED (including two positions as Chair of Remuneration Committees), significant experience in sales, marketing, customer services and technology and in leading and changing large businesses.

Danuta was Chair of Telefónica in Ireland until 2012, having previously been its Chief Executive from 2001 to 2010. During her nine-year tenure as Chief Executive, she increased the customer base from just under 1 million to over 1.7 million. Before working at Telefónica, Danuta held various senior positions within BT Group from 1984 to 2001. Until 2018, Danuta was a NED and Chair of the Remuneration Committee at both PageGroup plc and Old Mutual plc.

Current external appointments

- Senior Independent Director of Aldermore Group plc (standing down March 2021)
- Non-Executive Chair of St Modwen Properties plc
- Non-Executive member of the Ministry of Defence Board

Penny James

Chief Executive Officer (S)

Appointed: November 2017

Biography

Penny was CFO of Direct Line Group until her appointment as CEO in May 2019. The Board benefits from Penny's deep understanding of our sector as well as her leadership skills, financial and risk expertise, strategic thinking and cultural alignment.

As CEO, Penny is leading both the delivery of the Group's short-term strategic imperatives, including technological and business transformation, and the development of the next stage of our strategy of targeting long-term sustainability.

Penny was previously Group Chief Risk Officer and Executive Director at Prudential, where she was responsible for leading risk oversight globally. Before this, she was Director of Group Finance at Prudential. Penny was previously Group CFO at Omega Insurance Holdings Limited and CFO, UK General Insurance, at Zurich Financial Services. She was a NED of Admiral Group plc from 2015 to 2017. She is an Associate of the Institute of Chartered Accountants in England and Wales.

Current external appointments

- Member of the Association of British Insurers Board
- Deputy Chair of the FCA Practitioner Panel
- Member of the Build Back Better Business Council

Tim Harris

Chief Financial Officer (I)

Appointed: October 2019

Biography

The Board benefits from Tim's many years of experience as a finance director in the insurance industry, his detailed knowledge of capital markets and his track record of successfully leading finance transformation programmes.

Tim was Deputy Chief Executive and Group Finance Director of the Royal London Group until July 2019. He joined Royal London as Group Finance Director in 2014 and was additionally appointed as Deputy Chief Executive in 2018. Before joining Royal London, Tim had been Group CFO of Torus Insurance, Deputy Group CFO and Chief Capital Officer of Aviva plc and a Partner in the Global Capital Markets practice of PricewaterhouseCoopers. Tim is also a Fellow of the Institute of Chartered Accountants in England and Wales and a Chartered Insurance Practitioner.

In January 2021, we announced that Tim would be taking a temporary leave of absence. During the interim period, Neil Manser is Acting Chief Financial Officer.

Current external appointments

- Member of the Association of British Insurers Board
- Chair of the Prudential Financial and Taxation Committee of the Association of British Insurers
- Member of the PRA Practitioner Panel

Key for Committee membership

- (A) Audit Committee
- (R) Board Risk Committee
- (I) Investment Committee
- (N) Nomination and Governance Committee
- (R) Remuneration Committee
- (S) Sustainability Committee

Mark GregoryNon-Executive Director **(A)(R)(I)**

Appointed: March 2018

Biography

Mark Gregory is Chair of the Investment Committee and interim Chair of the Remuneration Committee.

The Board benefits from his previous extensive experience and knowledge of the financial services sector, particularly in life and general insurance, gained through his roles at Legal & General. Additionally, he has a detailed understanding of the retail sector and customer service.

Mark previously held the role of Group CFO and Executive Director at Legal & General until 2017, and was CEO of Merian Global Investors from January 2019 to August 2020.

During his 19-year career at Legal & General, he held a variety of senior roles including CEO of the Savings business, Managing Director of the With-Profits business, and Resources and International Director. Before joining Legal & General, Mark held senior financial and business development roles at ASDA and Kingfisher. Mark is an Associate of the Institute of Chartered Accountants in England and Wales.

Current external appointments

- Chair of Remuneration Committee and Non-Executive Director of Entain plc

Jane HansonNon-Executive Director **(A)(I)(R)(S)**

Appointed: December 2011

Biography

Jane Hanson is Chair of the Board Risk Committee.

Jane has extensive experience of risk management, corporate governance and internal control. She also has wide experience of developing and monitoring customer and conduct risk frameworks and overseeing IT and transformation programmes.

Jane spent her early career with KPMG, working in the financial sector, becoming responsible for delivering corporate governance, internal audit and risk-management services in the north of England. Jane has also held a number of executive roles, including Director of Audit, and Risk and Governance Director at Aviva plc. She is a Fellow of the Institute of Chartered Accountants in England and Wales.

Jane has her own financial sector consulting business and is also a magistrate.

Current external appointments

- Non-Executive Director of William Hill plc
- Non-Executive Director of Rothesay Life plc
- Non-Executive Director of Welsh Water
- Honorary Treasurer of the Disasters Emergency Committee
- Chair and Non-Executive Director of Reclaim Fund Limited

Sebastian JamesNon-Executive Director **(N)(R)(S)**

Appointed: August 2014

Biography

Sebastian James is Chair of the Sustainability Committee.

The Board benefits from Sebastian's extensive experience in retail and consumer practice at large groups, his detailed understanding of the UK's consumer markets, products and brands as well as his strategic and operational experience running Dixons Carphone plc and Boots.

Until 2018, Sebastian was Group Chief Executive of Dixons Carphone plc, having previously held the role of Group Chief Executive of Dixons Retail plc from 2012. Before this, he was CEO of Synergy Insurance Services Limited, a private equity backed insurance company, and was previously Strategy Director at Mothercare plc. Sebastian has a degree in law from the University of Oxford and an MBA from INSEAD. He began his career at The Boston Consulting Group.

Current external appointments

- Managing Director of Boots UK, subsidiary of Walgreens Boots Alliance, Inc
- Senior Vice President of Walgreen Boots Alliance, Inc
- Trustee of the Museum of Modern Art Limited

Fiona McBainNon-Executive Director **(A)(R)(I)**

Appointed: September 2018

Biography

The Board benefits from Fiona's profound knowledge of the financial services industry and her previous extensive experience as both a business leader and an auditor makes her well suited to her role as a member of the Audit, Board Risk and Investment Committees.

Fiona has over 30 years' experience in retail financial services, both in the industry and as an auditor, in the UK and the USA. She is an Associate Member of the Institute of Chartered Accountants in England and Wales, qualifying as an accountant early on in her career at Arthur Young (now Ernst & Young). Until January 2019, she was Vice-Chair of Save the Children UK and a Trustee Director of the Humanitarian Leadership Academy. Previously, Fiona served as CEO of Scottish Friendly Group

for 11 years, before which she was Scottish Friendly Group's Finance Director.

Current external appointments

- Chair of Audit Committee and Non-Executive Director of Dixons Carphone plc
- Chair and Non-Executive Director of the Scottish Mortgage Investment Trust plc
- Chair of Audit Committee and Non-Executive Director of Monzo Bank Limited

Gregor Stewart

Non-Executive Director (A) (R)

Appointed: March 2018

Biography

Gregor Stewart is Chair of the Audit Committee.

The Board benefits from his wide-ranging experience of the financial services sector, and in particular, significant experience gained in the insurance and investment management sectors. His career and experiences at Ernst & Young and Lloyds, in particular, make him suitable to chair the Audit Committee.

Gregor worked at Ernst & Young for 23 years, including 10 years as a partner in the financial services practice. Following his career at Ernst & Young, he was Finance Director for the insurance division at Lloyds Banking Group plc, which included Scottish Widows, from 2009 to 2012. Gregor is a member of the Institute of Chartered Accountants of Scotland.

Current external appointments

- Chair and Non-Executive Director of Alliance Trust plc
- Chair and Non-Executive Director of FNZ (UK) Limited
- Non-Executive Director of FNZ Group

Dr Richard Ward

Non-Executive Director and Senior Independent Director (R) (R) (N)

Appointed: January 2016

Biography

Richard's previous experience as a Chief Executive, a Non-Executive Director and a Chair makes him well suited to the role of Senior Independent Director of the Company. The Board benefits from his experience in the insurance industry and his insight into prudential regulation.

Richard was Chief Executive of Lloyd's of London from 2006 to 2013. He was Non-Executive Chair of Brit Syndicates Limited and Executive Chair of Cunningham Lindsey from 2014 to 2018. He was a Non-Executive Director of Partnership Assurance Group plc, now part of Just Group plc, between 2013 and 2016. Before becoming Chief Executive of Lloyd's of London, Richard was previously Chief Executive, later Vice Chair, of the International Petroleum Exchange, rebranded ICE Futures. Before this, he held a range of senior positions at British Petroleum and was a research scientist for the Science and Engineering Council. Richard was also a Non-Executive Director of London Clearing House, a member of the PwC Advisory Board and a Board member of the Geneva Association.

Current external appointments

- Member of the Executive Committee of the Ardonagh Group

Adrian Joseph OBE

Non-Executive Director (S)

Appointed: January 2021

Biography

Adrian Joseph joined BT Group in February 2020 as Managing Director, Group Data and Artificial Intelligence. Prior to this he was a senior Partner at Ernst & Young for three years and the Head of the UK Data and Analytics practice for Financial Services. He joined Ernst & Young with over ten years' cloud, digital, platform, data science and analytics experience gained in senior leadership roles at Google, and a further 15 years in industry and consultancy. This included two years as the main Board member responsible for Sales and Marketing at Trafficmaster Plc.

Adrian was a Non-Executive Director at the Home Office from 2016 to 2020, where he sat on the Home Office Data Board and advised on data science, digital transformation, and diversity and inclusion. From January 2012-2017, Adrian was Chair of the Race Equality Board, the race campaign of Business in the Community charity. In 2014 he was appointed to the main Board of Business in the Community and he continues to serve as an Advisor. He was awarded an OBE for services to equality and diversity in business in the 2019 New Year's honours list and was announced as the most influential black, Asian and minority ethnic technology leader in the UK by the Financial Times and Inclusive Boards in 2018.

Adrian's expertise in data analytics, AI and automation, as well as his passionate advocacy for diversity and inclusion, benefit the Board as it oversees the execution of a strategy of which these issues are a fundamental part.

Current external appointments

- Member of HM Government's AI Council

Key for Committee membership

- (A) Audit Committee
- (R) Board Risk Committee
- (I) Investment Committee
- (N) Nomination and Governance Committee
- (R) Remuneration Committee
- (S) Sustainability Committee

Executive Committee

Penny James chairs the Executive Committee. In addition to Penny James and Tim Harris, the Committee comprises the following:

Mark Evans

Managing Director, Marketing & Digital

Joined: 2012

Experience and qualifications

Mark joined Direct Line Group in 2012 and is Managing Director of Marketing & Digital. He is responsible for leading the Group's Marketing and Digital functions. Before joining the Group, Mark held roles at HSBC, 118 118 (now 118 118 Money) and Mars Inc. He is Chair of the Advertising Association's Front Foot and a NED of LearnEtAl, an EdTech digital learning company. Mark is also co-founder of the School of Marketing which encourages more school children to consider a career in Marketing.

Mark is a member of Save the Children's Digital Advisory Board and also a Fellow of the Marketing Society.

Jonathan Greenwood

Managing Director, Commercial

Joined: 2000

Experience and qualifications

Jonathan joined the Group in 2000 and is Managing Director, Commercial.

Jonathan has over 30 years' experience of the insurance industry. He is responsible for delivering the Commercial strategy, developing customer propositions, enhancing the Commercial brands and delivering efficiencies within the Commercial businesses.

Jonathan was previously Managing Director of the Group's Household and Life businesses. He joined the Group as Product and Pricing Director for UK Partnerships. Before joining the Group, Jonathan held roles at HBOS, MBNA and Pinnacle.

Steve Maddock

Chief Operating Officer

Joined: 2010

Experience and qualifications

Steve joined the Group in 2010 and is Chief Operating Officer.

Steve has nearly 30 years' experience of the insurance industry. He is responsible for leading the Group's Claims, Information Technology, Information Security, Procurement and Business Services functions.

Steve's previous roles include Director of Strategic and Technical Claims at RSA, Director of Claims and Customer Service at Capita, and Director of Operations at AMP. Steve is also Chair of the Motor Insurers' Bureau and a member of the Association of British Insurers' General Insurance Committee.

Neil Manser

Chief Strategy Officer and Acting Chief Financial Officer

Joined: 2011

Experience and qualifications

Neil joined Direct Line Group in 2011 as Director of Investor Relations and was instrumental in the Group's successful IPO in 2012. He has worked in a number of roles within the Group, in Finance including Strategy and within the business, as Managing Director of NIG. Neil was appointed Deputy CFO in August 2018 before becoming Chief Strategy Officer in March 2020. He is now responsible for leading the Group's corporate strategy.

On 11 January 2021, it was announced that Neil would be Acting Chief Financial Officer during Tim Harris's leave of absence.

Neil has extensive industry and capital markets experience prior to joining the Group having previously worked at Brit Insurance and as an equity analyst at Merrill Lynch and Fox-Pitt, Kelton. He qualified as a Chartered Accountant with Ernst & Young and is an Associate of the Institute of Chartered Accountants in England and Wales.

Gus Park

Managing Director of Motor, Pricing And Underwriting

Joined: 2011

Experience and qualifications

Gus joined Direct Line Group in 2011 and is Managing Director of Motor, Pricing & Underwriting. He is responsible for leading the Group's Personal Motor business across all brands, as well as the Pricing and Underwriting function across all consumer products.

Gus joined the Direct Line Group as Strategy Director before becoming Commercial Director for the Group's Motor insurance business. Following this he was Managing Director of Motor Insurance and Business Development.

Gus has over 25 years' experience in a wide range of sectors and roles, having started his career as a civil servant for the Home Office. After this he moved into strategy consulting for the Boston Consulting Group, and then into retail banking for Bradford & Bingley.

In February 2020, Gus became a Non-Executive Director of Five AI Inc.

Kate Syred

Managing Director of Household, Partnerships And Data

Joined: 2000

Experience and qualifications

Kate joined Direct Line Group in 2000 and is Managing Director of Household, Partnerships & Data. Kate has over 20 years' experience of the insurance industry. Kate is responsible for delivering the strategy and developing products for the Group's Home, Pet, Travel, Life and Private Businesses as well as leading the Partnerships division. She is Chair of the Group's Diversity Network Alliance.

Previously, Kate was Commercial & Marketing Director for Privilege and launched Direct Line for Business in 2007. Before joining the Group, Kate held roles in Calvin Klein Cosmetics, Moore Stephens - Vladivostok and qualified as a Chartered Accountant with the National Audit Office. She is also an Associate of the Royal College of Science.

Humphrey Tomlinson

General Counsel

Joined: 2011

Experience and qualifications

Humphrey joined the Group in 2011 and is General Counsel.

Humphrey has over 30 years' experience as a solicitor. He is responsible for the Group Legal function and oversees a range of areas of legal advice and services. He has been a Non-Executive Director of The Flook Limited since July 2014.

Humphrey's experience includes advising on corporate and commercial matters, steering corporate transactions in the UK and internationally, managing legal risk and dealing with corporate governance issues. Before joining the Group, Humphrey was Group Legal Director at RSA and prior to that he was a corporate lawyer with the City law firm, Ashurst Morris Crisp.

José Vazquez

Chief Risk Officer

Joined: 2012

Experience and qualifications

José joined the Group in 2012 and is Chief Risk Officer.

José has over 25 years' experience of the insurance industry. He is responsible for the Group's Risk function and Compliance function and is a Fellow of the Institute of Actuaries.

José was previously Global Chief Risk Officer and Group Chief Actuary at HSBC Insurance. Before joining HSBC, José worked for Zurich Insurance, first in its London Market Operations, then as Chief Actuary International Business Division (Asia, Latin America and Africa) and lastly as Chief Actuary in the UK.

Vicky Wallis

Chief People Officer

Joined: 2020

Experience and qualifications

Vicky is Chief People Officer at Direct Line Group and has a wealth of experience in building HR functions, developing cultural frameworks and enhancing people capabilities.

Vicky joined the Group having worked previously at Santander where she was the HR Director for five years. Having operated in international organisations with global roles and projects in India, Romania, EMEA and the US, Vicky has experience in finance, retail and mobile telecommunications.

Vicky is accredited by the Chartered Institute of Personnel Development and holds a Master's degree in Organisational Leadership.

Jasvinder Gakhai

Acting Chief Strategy Officer

Joined: 2005

Jasvinder attends the Executive Committee meetings in her capacity as Acting Chief Strategy Officer, and as such she is leading the Group Strategy and Group Communications and Sustainability functions.

Experience and qualifications

Jasvinder joined Direct Line Group in 2005. In January 2021, it was announced that Jasvinder would be Acting Chief Strategy Officer whilst Neil Manser took on the role of Acting Chief Financial Officer.

Before stepping into the Acting Chief Strategy Officer role, she was Managing Director of Direct Line for Business, leading the growth of the direct Commercial Insurance business.

Prior to this Jasvinder has held roles leading the Pet Insurance portfolio, Head of Direct Line Home and across the Partnerships business.

Before joining Direct Line Group, Jasvinder was a maths teacher.

Corporate governance report

This report explains the Board's role and activities, and how corporate governance operates throughout the Group.

Corporate Governance Statement

This Corporate Governance Statement explains key features of Direct Line Insurance Group plc's (the "Company") governance structure and how it measures itself against the standards set out in the UK Corporate Governance Code 2018 (the "Code"). The Code set by the Financial Reporting Council (the "FRC") applied to the financial year ended 31 December 2020. For more information about the Code, visit the FRC's website at www.frc.org.uk. This Corporate Governance Statement fulfils the requirements of the FCA's Disclosure Guidance and Transparency Rule 7.2 ("DTR 7.2"). For full details refer to the Directors' report on pages 140 to 144.

The Company complied with all of the principles and provisions of the Code throughout the financial year and up to the date of this Annual Report & Accounts.

Further details of how the Company applied the Code's principles and complied with its provisions can be found in the following sections of the Annual Report & Accounts.

	Board leadership & company purpose	<ul style="list-style-type: none"> - The Board 84 - Board activities 85 - The Board and culture 88
	Division of responsibilities	<ul style="list-style-type: none"> - Governance framework and structure 89 - The structure of the Board, Board Committees and executive management 90
	Composition, succession & evaluation	<ul style="list-style-type: none"> - Board composition 91 - Development, information, support, induction, training 91 - Diversity and inclusion 92 - Board effectiveness 93
	Audit, risk & internal control	<ul style="list-style-type: none"> - Fair, balanced and understandable assessment 95 - Risk management and internal control systems 95 - Audit Committee report 97 - Board Risk Committee report 102
	Remuneration	<ul style="list-style-type: none"> - Directors' Remuneration Report 113



Board leadership and company purpose

The Board

The Board receives regular updates on the views of the Company's shareholders from the Group's brokers and directly from institutional shareholder meetings with senior executives and the Chair. The Board has regard to the interests of a range of stakeholders including customers, employees and suppliers when agreeing the Group's strategic and financial plans and in all other decision-making. Illustrations of the breadth and depth of the Board's regard to stakeholders' interests are contained in the Sustainability section of the Annual Report & Accounts on pages 44 to 68.

There is a Schedule of Matters Reserved for the Board, which contains items reserved for the Board to consider and approve, relating to strategy and management, material contracts, financial reporting and controls, internal controls and risk management, Board membership and succession planning, corporate governance, structure and capital, and delegation of authority.

In addition to the Schedule of Matters Reserved for the Board, each Board Committee has written terms of reference defining its role and responsibilities. The terms of reference of the Board Committees can be found on our corporate website. Further details regarding the role and activities of the Board and its Committees can be found below and in the Directors' remuneration report which begins on page 113.

The role of the Board

Pages 89 and 90 summarise the role of the Board, its Committees and the responsibilities of the Chair, the Senior Independent Director, the Non-Executive Directors, the Executive Directors and the Executive Committee. Whilst some of the key areas of the Board responsibility are summarised in the following paragraphs, these are not intended to be an exhaustive list.

Leadership

The Board is the main decision-making body of the Company. It provides leadership within a framework of prudent and effective controls. The Board has clear divisions of responsibility and seeks the long-term sustainable success of the Group. Information on how opportunities and risks to the future success of the business have been considered and addressed, and about the sustainability of the Company's business model, is set out in the Strategic report which begins on page 1.

Acting fairly between members and engagement methods

The Board organises and directs the Group's affairs in a way that it believes will help the Group succeed for the benefit of its members as a whole, whilst having regard to its stakeholders generally.

The Group seeks to ensure that it acts fairly between all members and considers all types of investors (including our institutional investors and private shareholders) when making decisions that impact them.

The Group ensures that it communicates the information that its investors require, using: traditional methods, such as annual report & accounts, RNS newswires and corporate and press releases; in person; and, (wherever possible) by virtual means. In 2020, virtual engagement included investor meetings attended by the Chair, CEO and CFO and broker attendance at Board meetings. Where appropriate, communication with investors is fed back to the Board.

For more information on how shareholders will be able to participate in the 2021 AGM see page 223 and for further information on communication with major investors see page 88. Additional information on how the Board has regard for the Group's wider stakeholders and other relevant matters can be found on pages 86 to 87.

Operations

The Board is responsible for overseeing the implementation of a robust control framework to allow effective management of risk. The Board supervises the Group's operations, with a view to ensuring they are effectively managed, that effective controls are in place, and that risks are assessed and managed appropriately.

Financial performance

The Board sets the financial plans, annual budgets and key performance indicators and monitors the Group's results against them. The Board is accountable to investors for financial and operational performance.

Strategy

The Board oversees the development of the Group's strategy and monitors management's performance and progress against the strategic aims and objectives.

Vision and purpose

Our vision is to create a world where insurance is personal, inclusive and a force for good. Our purpose is to help people carry on with their lives, giving them peace of mind now and in the future.

Board meetings and activity in 2020

The activities undertaken by the Board in 2020 were intended to help promote the long-term success of the Company. Scheduled Board meetings focused on four main themes, as detailed below:

Themes	Description
Strategy and execution Strategic alignment ① ② ③ ④ ⑤	<ul style="list-style-type: none"> - Approving and overseeing the Group's key strategic targets and monitoring the Group's performance against those targets; - Reviewing customer experience and trends and monitoring the Group's performance against external brand metrics; - Reviewing and approving key projects aimed at developing the business or rationalising costs; - Considering growth opportunities; and - Reviewing the individual strategy of key business lines.
Financial performance and investor relations Strategic alignment ② ⑤	<ul style="list-style-type: none"> - Setting financial plans, annual budgets and key performance indicators and monitoring the Group's results against them; - Considering the Group's reserving position, approving the Solvency II narrative reports and approving financial results for publication; - Approving reinsurance programmes and renewals; - Approving the issuance of £260 million of Tier 2 debt in June 2020; - Reviewing broker reports on the Group, alongside feedback from investor meetings; and - In March 2020, the Board considered it prudent to cancel the share buyback programme and, in April 2020, to cancel the 2019 final dividend as a result of the volatile conditions arising from Covid-19. The Board subsequently declared a 2020 interim dividend of 7.4 pence alongside a further special dividend of 14.4 pence to replace the cancelled 2019 final dividend.
Risk management, regulatory and other related governance Strategic alignment ④	<ul style="list-style-type: none"> - Reviewing and agreeing the Group's policies; - Setting risk appetites; - Approving the Own Risk and Solvency Assessment ("ORSA"); - Seeking to ensure that the Group complies with its regulatory obligations; - Reviewing the Group's solvency position and forecast; - Reviewing the Group's ESG initiatives; and - Reviewing and approving the Group's TCFD and Sustainability reports.
Board and Board Committee governance Strategic alignment ⑥	<ul style="list-style-type: none"> - Receiving reports from the Board's Committees; - Updating the Schedule of Matters Reserved for the Board; - Updating terms of reference for the Board Committees; - Receiving corporate governance updates; - Overseeing Board and executive succession planning; - Conducting the annual review of the Board and Board Committees' effectiveness; - Approving the Company's Code of Business Conduct and conducting an annual review of the Group's governance framework; and - In addition to routine business, the Board sets aside time each year outside the annual Board calendar to hold a strategy day, giving the Directors the opportunity to focus solely on strategic matters. In June 2020, the Board held a session to set and monitor progress against the Group's strategy and to discuss the Group's long-term sustainability and its future opportunities as well as the strategic implications of Covid-19.

Link to strategy

- ① Be best at direct
- ② Win on price comparison websites
- ③ Extend our reach
- ④ Be nimble and cost efficient
- ⑤ Have technical edge
- ⑥ Empower great people

Board activity and stakeholder priorities

Our stakeholders are at the root of both our strategy and our values. By engaging with our stakeholders we are able to understand who they are and what matters to them. This meant that the Group was able to react swiftly in challenging circumstances in 2020 while still planning for the long-term sustainable success of the Company.

The Group's Section 172(1) statement is part of the Chair's statement in the Strategic report on page 10 and is supported by the Group's five-pillar sustainability strategy on pages 44 to 45 and the TCFD statement on pages 62 to 63.

The table below provides an insight into decisions taken by the Board during 2020 which directly affect its stakeholders. In all cases, the Board considers the likely consequences of any decision in the long term.

Stakeholder Group	Decision of the Board	Considerations	Further information
Customers, suppliers and other business relationships (a) (c)	Customer metrics form part of Annual Incentive Plan targets. The Board approved the following: <ul style="list-style-type: none"> - Code of Business Conduct; - Group pricing approach and associated governance and control framework; - Prompt Payment Practice Report; and - Covid-19 support measures for customers and suppliers. 	<ul style="list-style-type: none"> - Urgency of settling claims - Financial difficulties of customers - Product offering (range and price) - Ease of communication - Customer service - Prompt payment - Supply chain management 	<ul style="list-style-type: none"> - Sustainability - Customers
People (a) (b)	People metrics form part of Annual Incentive Plan targets and a people update is presented at each Board meeting. The Board approved the following: <ul style="list-style-type: none"> - Covid-19 response to employees; - Agile working transformation; - Modern slavery statement; - Code of Business Conduct; - Whistleblowing procedures; - Buy As You Earn Plan; and - Free share award. 	<ul style="list-style-type: none"> - Culture - Employee wellness - Human rights - Employee satisfaction - Employee development 	<ul style="list-style-type: none"> - Sustainability - People - Directors' remuneration report
Society (a) (d)	The Board gives its full support to the Force for Good Initiative and the DLG Community Fund. The Board approved the following: <ul style="list-style-type: none"> - Code of Business Conduct; - Modern slavery statement; and - Board diversity statement. 	<ul style="list-style-type: none"> - Responsible investing - Human rights - The welfare of the communities in which we operate 	<ul style="list-style-type: none"> - Sustainability - Society
Planet (a) (d)	The Board actively supports initiatives to reduce the Group's impact on the environment and manage climate change risks. The Board approved the following: <ul style="list-style-type: none"> - New measures for the investment portfolio to help the Group to achieve net zero carbon emissions by 2050; - Publication of commitments to setting Science-Based Targets and becoming a 100% carbon-neutral business from 2020; - Approval of climate change-related stress testing; and - TCFD Report. 	<ul style="list-style-type: none"> - ESG factors - Climate change - Emissions targets - Environmental practices 	<ul style="list-style-type: none"> - Sustainability - Planet
Investors (a) (f) (e)	The Board considers feedback from investors communicated directly and through its brokers. The Board approved the following: <ul style="list-style-type: none"> - The methods by which surplus capital should be returned to shareholders; - Termination of 2020 buyback programme and cancellation of 2019 final dividend; - Subsequent approval of the interim and special interim dividend; and - Annual Report & Accounts. 	<ul style="list-style-type: none"> - Financial performance - Strategic delivery - Capital returns - FRC recommendations 	<ul style="list-style-type: none"> - Corporate governance report

Link to S172(1) Companies Act 2006

(a)	the likely consequences of any decision in the long term
(b)	the interests of the company's employees
(c)	the need to foster the company's business relationships with suppliers, customers and others
(d)	the impact of the company's operations on the community and the environment
(e)	the desirability of the company maintaining a reputation for high standards of business conduct
(f)	the need to act fairly between members of the company

Board and Committee meetings

The Board and Board Committees held a number of scheduled meetings in 2020 at which senior executives, external advisers and independent advisers were invited to attend and present on business developments and governance matters. The Company Secretary attended all Board meetings and he, or his nominated deputy, attended all Board Committee meetings.

The table below sets out attendance at the scheduled meetings in 2020¹. Additional Board and Committee meetings were convened during the year to discuss ad hoc business development, governance and regulatory matters and in response to Covid-19.

	Board	Audit Committee	Board Risk Committee	Sustainability Committee ²	Investment Committee	Nomination and Governance Committee	Remuneration Committee
Chairs							
Mike Biggs ³	6 of 6	-	-	-	-	3 of 3	2 of 2
Danuta Gray	9 of 9	-	-	-	-	4 of 4	3 of 3
Senior Independent Director							
Richard Ward	9 of 9	-	5 of 5	-	-	4 of 4	-
Non-Executive Directors							
Mark Gregory	9 of 9	5 of 5	-	-	4 of 4	-	3 of 3
Jane Hanson	9 of 9	5 of 5	5 of 5	4 of 4	4 of 4	-	-
Sebastian James	9 of 9	-	-	4 of 4	-	-	3 of 3
Fiona McBain	9 of 9	5 of 5	5 of 5	-	-	-	-
Gregor Stewart	9 of 9	5 of 5	5 of 5	-	-	-	-
Executive Directors							
Penny James	9 of 9	-	-	4 of 4	-	-	-
Tim Harris	9 of 9	-	-	-	4 of 4	-	-
Executive Committee Member							
Simon Linares ⁴				1 of 1			

Notes:

- Attendance is expressed as the number of scheduled meetings attended out of the number of such meetings possible or applicable for the Director to attend.
- Formerly the Corporate Responsibility Committee.
- Mike Biggs stepped down from the Board on 4 August 2020.
- Simon Linares stepped down from the Sustainability Committee on 21 April 2020.

The Board and culture

The Board is responsible for establishing the Company's purpose, values and strategy, promoting its culture, overseeing its conduct and affairs, and for promoting the success of the Company for the benefit of the members and all the stakeholders.

The Board recognises that culture and capability are key enablers for achieving the Group's strategic objectives and encourages an open and inclusive culture and an environment in which people can be themselves.

During the year the Board championed the Group's culture through:

- Assessing and monitoring culture and satisfying itself that the Group's purpose, values and strategy are aligned with its culture;
- Reviewing the Code of Business Conduct to ensure that it reflects the Group's purpose and sustainability strategy;
- Reviewing means, for the workforce, to raise concerns in confidence and, if they wish, anonymously ("Whistleblowing"). Further details on the Group's Whistleblowing arrangements can be found on page 105;
- Seeking feedback from our people through the 'DiaLoCue Survey', a tool to measure engagement, which this year included questions on inclusivity and culture;

Communication with major investors

The Group is committed to keeping investors informed of its strategy and progress and to ensuring appropriate channels of communication are in place. We believe that actively engaging with investors is fundamental to our business. Having an active dialogue and ongoing engagement is vital for keeping in touch with opinions and provides the opportunity to address questions and concerns. The Chief Executive Officer and Chief Financial Officer frequently meet investors and the Board is also kept up to date on investor views by the Group's corporate brokers who regularly attend Board meetings. The Chair is also available to, and has engaged with, institutional shareholders. For more information on engagement with investors, see page 86.

Despite the challenges that we saw with physical meetings in 2020, the Chief Executive Officer and/or Chief Financial Officer had the following direct engagements with investors during 2020:

- attended 15 sell-side investor events;
- met 141 investors during 2020; and
- had 53 interactions with the top 25 largest investors.

- NEDs' engagement with Employee Representative Body ("ERB") activities. The NEDs have an active interest in the workings of the ERB and in the normal course of business attend the meetings on a rotation basis so all NEDs participate and engage with the workforce. Whilst circumstances during the year have made active participation difficult, our NEDs have been kept fully informed by the Chief People Officer and Chief Executive Officer, and the Chair has attended a virtual ERB conference;
- Investing in and rewarding our workforce. During the year, the Group further built on its commitment to ensure that all of our people are rewarded fairly and have an interest in the success of the Group. See page 117 of the Remuneration Committee report for more detail;
- Supporting the Strategic Leadership Development Programme, the aim of which is to create a pipeline of diverse talent for development into future senior leaders;
- Enabling our employees to benefit from the Group's success. All eligible employees can participate in the Group's Buy As You Earn ("BAYE") Plan which provides a cost-effective way for all employees to acquire shares in the Company; and
- Supporting management's emphasis on employee wellbeing, including mental health awareness and financial wellbeing. For more information please see the People section of the Sustainability Pillars on page 50.

Conflicts of interest

The Company's Articles of Association allow the Board to authorise matters where there is, or may be, a conflict between the Group's interests and the direct or indirect interests of a Director, or between a Director's duties to the Group and another person. This is in accordance with the Companies Act 2006.

Each Director has a duty to avoid conflicts of interest. They must declare any conflict of interest that could interfere with their ability to act in the Group's best interests. The Board has authorised certain potential conflicts of interest in this way including in relation to Directors' external directorships and their interests in securities of other financial service institutions. Accordingly, the Board deals with any actual conflict of interest or duty that might arise. This usually would involve making sure a Director does not participate in a relevant Board or Committee discussion or decision. To do this, the Company Secretary maintains a register of conflicts and any conflicts that the Board has authorised. The Board reviews this register at each scheduled Board meeting to ensure that each Director applies independent judgement.



Division of responsibilities

Governance framework and structure

The Board oversees the system of governance in operation throughout the Group. This includes a robust system of internal controls and a sound Risk Management Framework. The Board has established a risk management model that separates the Group's risk management responsibilities into three lines of defence. An explanation of these responsibilities can be found on page 69.

The Group's governance framework is detailed in the Group's High Level Control and System of Governance Framework document. This document details how the Group meets Solvency II and the Prudential Regulation Authority ("PRA") requirements to identify key functions and to have and maintain a Responsibilities Map in respect of the PRA and FCA's Senior Managers and Certification Regime requirements. The Board reviews this document annually.

The core elements of the governance framework are the:

- Matters Reserved for the Board and the Board Committees' terms of reference;
- High Level Control and System of Governance Framework document;
- Risk appetite statements, which are described on page 70;
- Enterprise Risk Management Strategy and Framework, which is described on page 69;
- Group policies, which address specific risk areas, are aligned to the Group's risk appetite, and inform the business how it needs to conduct its activities to remain within risk appetite; and
- Minimum standards, which interpret the Group policies into a set of requirements that can be implemented throughout the Group.

The diagram below summarises the split of responsibilities for the different parts of the Group's governance framework.

The Board approves

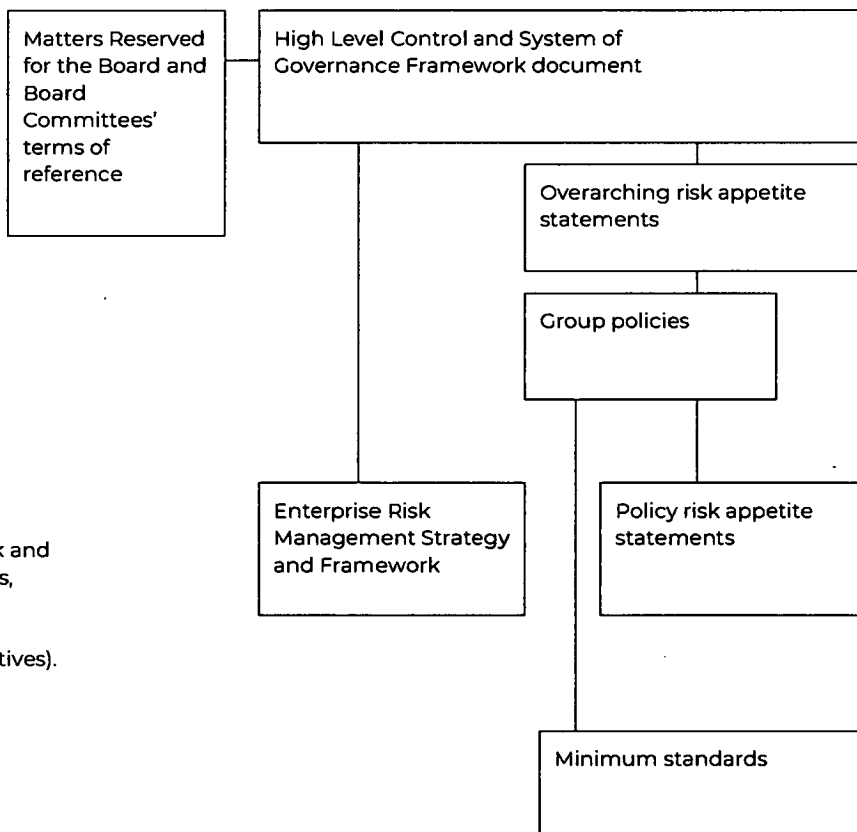
the High Level Control and System of Governance Framework, overarching risk appetite statements and Group policies following review by the Board Risk Committee.

The Board Risk Committee approves

the Risk Management Framework and the policy risk appetite statements, following review by the Risk Management Committee (a committee comprised of executives).

Policy owner approves

Minimum standards, subject to non-objection from the Risk Management Committee.



Structure of the Board, Board Committees and executive management

The following chart sets out the structure of the Board and its Committees and highlights the responsibilities of the Chair, the Senior Independent Director, the Non-Executive Directors, the Executive Directors, the Company Secretary and the Executive Committee. The role descriptions for CEO and Chair are set out in writing and the profiles clearly define their respective roles and responsibilities and ensure that no one person has unlimited powers of decision making.

The Board and Board Committees have unrestricted access to management and external advisers to help discharge their responsibilities. Each Committee plays a vital role in helping the Board to operate efficiently and consider matters appropriately.

The Board and Board Committees are satisfied that, in 2020, sufficient, reliable and timely information was received in order for them to perform their responsibilities effectively.

The reports by each Board Committee are given in this Annual Report & Accounts. The terms of reference for each Committee can be found on the corporate website at: www.directlinegroup.co.uk/en/who-we-are/governance/board-committees.

Roles and responsibilities of the Board

Board of Directors
 Each Director brings different skills, experience and knowledge to the Company, and the NEDs contribute additional independent thought and judgement. Depending on the business needs, the NEDs and the Chair commit at least two days a month and two days a week respectively to discharging their duties effectively in accordance with their letters of appointment. Biographies of the full Board can be found on pages 78 to 80.

Chair
 - Guides, develops and leads the Board
 - Plans and manages the Board's business
 - Oversees the governance framework

Board Committees
 Full details of membership, responsibilities and activity of each Committee throughout the year can be found on pages 97 to 139.

Audit Committee	Board Risk Committee
Investment Committee	Nomination and Governance Committee
Remuneration Committee	Sustainability Committee¹

Senior Independent Director
 - Acts as a sounding board for the Chair and an intermediary for the other Directors when necessary
 - Is available to shareholders if they have concerns they cannot resolve through other channels
 - Leads the Chair's performance evaluation

Non-Executive Directors
 - Challenge management in an objective and constructive manner
 - Use their wider business experience to help develop the Group's strategy

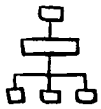
The Executive Committee
 The Executive Committee is the principal management committee that helps the CEO manage the Group's operations. It helps the CEO:
 - Set performance targets
 - Implement Group strategy
 - Monitor key objectives and commercial plans to help achieve the Group's targets
 - Evaluate new business initiatives and opportunities
 Biographies of the Executive Committee can be found on pages 81 to 82.

Executive Directors
 - The CEO and CFO are members of the Board with delegated responsibility for the day-to-day operation of the Group and delivering its strategy
 - The CEO delegates certain elements of her authority to the Executive Committee members to help ensure that senior executives are accountable and responsible for managing their business and functions

Company Secretary
 - Ensures the Directors receive accurate, timely and clear information
 - Alongside the Chair, oversees the governance framework

Note:

1. Formerly the Corporate Responsibility Committee.



Composition, succession & evaluation

Board composition

As at the date of this report, the Board comprised the Chair, who had previously served as an independent Non-Executive Director and was independent when appointed as Chair; two Executive Directors; and seven independent Non-Executive Directors, including the Senior Independent Director. The current Directors served throughout all of 2020, except for Adrian Joseph who joined the Board as an independent Non-Executive Director on 1 January 2021. The Board has previously announced that Jane Hanson will retire at the conclusion of the AGM to be held in May 2021, having completed nine years of service.

Mike Biggs, our previous Chairman, stepped down from the Board on 4 August 2020.

Biographical details of the Directors of the Company as at the date of this report are set out on pages 78 to 80.

Board succession

The Nomination and Governance Committee continues to review succession plans both for the Board and at executive level each year. Further information on our diversity policy, our approach to succession planning and Board appointments can be found in the Nomination and Governance Committee's report on pages 106 to 108.

Chair succession

In March 2020, we announced that our former Chair, Mike Biggs, had decided, after having served as Chair, to step down from the Board later in the year.

As a first step in the process of searching for and selecting a successor, Non-Executive members of the Board were asked whether they might consider submitting themselves as candidates. Danuta Gray was the only existing member of the Board who wished to be considered. Richard Ward, Senior Independent Director, was asked to lead the selection process.

A Selection Board was constituted, consisting of all Board members except Mike Biggs, the outgoing Chair, and Danuta Gray, the internal candidate. The framework for the thorough and rigorous selection process, and the terms of reference for the Selection Board, were defined with the assistance of the Company Secretary. The Selection Board authorised Richard Ward and Penny James to appoint an executive search firm to assist in ensuring that a thorough review of both internal and external candidates was carried out.

Following presentations by shortlisted firms, Russell Reynolds, which is a signatory to the Voluntary Code of Conduct for Executive Search Firms, and has no other connection with the Company or any of its Directors, was selected. Russell Reynolds' team was led by Julia Budd and Laura Sanderson.

In a series of interviews with Richard Ward and Russell Reynolds, each member of the Selection Board indicated the skills, experience and characteristics that they thought would be important in a new Chair. Based on the criteria defined as a result of consultation with Selection Board members, Russell Reynolds proposed a list of eligible external candidates, which the Selection Board refined

into a shortlist of candidates to be approached.

The Selection Board acknowledged from the outset that Danuta Gray was an extremely strong, well-qualified and highly regarded candidate. Following approaches to external candidates, interviews by members of the Selection Board and the resulting further refinement of the shortlist, the Selection Board invited Danuta Gray to present her proposed approach to the role of Chair.

In March 2020, the Selection Board resolved unanimously that Danuta was the preferred candidate, subject to regulatory approval and to confirmation of the timing of succession. In May 2020, having obtained regulatory approval for Danuta Gray's proposed appointment, the Board made its decision to appoint Danuta as Chair and we announced that she would succeed Mike Biggs as Chair with effect from 4 August 2020.

Board induction and training

All new Directors appointed to the Board undertake an induction programme aimed at ensuring they develop an understanding and awareness of our businesses, people and processes, and of their roles and responsibilities as Directors of the Company. The programmes are tailored to suit each Director and include provision of relevant current and historical information about the Company and the Group; visits to operations around the Group; induction briefings from Group functions; and one-to-one meetings with Board members, Senior Management and the Company's advisers.

The Board is committed to the training and development of Directors to improve their knowledge about the business and the regulatory environment in which it operates. The Company Secretary is responsible for helping the Chair identify and organise training for the Directors which is tailored to individual needs.

The Company Secretary maintained the training agenda for the Board and its Committees during the year. Training topics during the year included the Senior Managers and Certification Regime, the IT transformation programme, data privacy, cyber and operational resilience and the Internal Economic Capital Model.

In addition, a series of deep dives into the Group's business areas took place during the year to deepen each Director's knowledge of the business and provide oversight at Board and Committee level.

NED Independence

On behalf of the Board, the Nomination and Governance Committee assesses the NEDs' independence, skills, knowledge and experience annually. The Nomination and Governance Committee concluded that every current NED was independent, continued to contribute effectively, and demonstrated they were committed to the role. Each current Director will submit themselves for election or re-election at the 2021 AGM, except for Jane Hanson, who is retiring from the Board.

You can find out more about the activities of the Nomination and Governance Committee's work during the year on pages 106 and 108.

Information and support

The Board accesses assistance and advice from the Company Secretary. The Board may seek external independent professional advice at the Company's expense, if required, to discharge its duties.

The Board's approach to diversity and inclusion

The Board and executive management are dedicated to building a diverse and inclusive organisation, in which everyone is treated fairly, irrespective of their racial or ethnic origin, age, disability, gender, sexual orientation, belief or religion, or educational or professional background.

Supporting equality of opportunity and building a culture that values difference has a strong correlation with our values, both at Board level and within the wider workforce.

The Code encourages diversity of gender, social and ethnic backgrounds, cognitive and personal strengths. The Board understands that diversity includes but is not limited to gender and aims to increase demographic and philosophical differences at Board level and throughout the Group. The Group has a Board-approved diversity policy which is reviewed annually.

Whilst all appointments are based on merit and objective criteria, we are proud to be able to demonstrate a Board that not only boasts a female Chair and Chief Executive Officer but also a broader range of diversity characteristics.

The Board advocates the importance of cultural and ethnic diversity and aims to increase it at Board and Executive Committee level, as well as across the Group.

The charts below provide an overview of the Board independence and tenure, along with a summary of the Board and Executive Committee gender as at 31 December 2020.

Board composition

Board independence

Executive Director
Chair
Independent Non-Executive
Directors

Board and Senior Management' gender

Board gender

Female
Male

Chair and NED tenure

0-3 years
3-6 years
6-10 years

Executive Committee gender

Female
Male

Executive Committee and direct reports

Female
Male

Note:

1. Senior Management is defined as the Executive Committee and direct reports (excluding administrative and support staff) as at 31 December 2020.

The Board is pleased to have appointed Adrian Joseph as a Non-Executive Director from 1 January 2021. Adrian has deep experience of data strategy and artificial intelligence and is a respected thought leader in diversity and inclusion.

Beyond the Board and into Executive Committee and the wider workforce, we are pleased with the progress that has been made in embedding principles and practices to promote diversity and to champion the benefits of a diverse and inclusive workforce.

The Board and Executive Committee continue to support the Diversity Network Alliance which champions diversity and inclusion within our organisation through strands relating to gender, ethnicity, social mobility, disability and neurodiversity, sexual orientation, generations, families and carers and belief.

The Board has oversight of diversity and inclusion initiatives carried out through the remit of the Sustainability Committee. Further details on diversity inclusion initiatives can be found in the Strategic report, in the Sustainability Committee report and in the Nomination and Governance Committee report on pages 106 to 108.

Board skills, experience and knowledge

Our Nomination and Governance Committee has an active and dynamic process of understanding and identifying the skills, experience and knowledge of its board members. The principles of the Code are embodied in the Committee's approach to board evaluation and succession planning and the Chair of the Committee goes through a continuous process of evaluating the skill and experience required on the Board. The principles and practices set by the Board and the progress made with the diversity of the Board include:

1. Maintaining at least 33% female representation on the Board

The Board aims to maintain female representation of at least 33% and remains committed to seeking to improve further its position on gender diversity when appropriate opportunities arise. The Board will continue to appoint the most appropriate candidates based on knowledge, skills, experience and, where necessary, independence. As at the date of this report (5 March 2021), female representation on the Board was 40% which exceeds the target set in Lord Davies' Women on Boards Review Five Year Summary to be achieved by 2020 and exceeds the Hampton-Alexander Review's recommendation for a minimum of 33% of women's representation on boards by 2020. The Group ranked 44th in the FTSE 250 for female Board representation in the Hampton-Alexander review.

2. Engaging executive search firms who have signed up to the Voluntary Code of Conduct for Executive Search Firms on gender diversity and best practice

In its search for candidates, when using executive search firms, the Board will only engage those who are signatories to the Voluntary Code of Conduct for Executive Search Firms as recommended by Lord Davies.

Executive Committee gender diversity

The Board remains committed to ensuring that high-performing women from within the business and from a variety of backgrounds, who have the requisite skills, are given the opportunity to progress their career internally.

The Group is a signatory to the Women in Finance Charter which aspires to see gender balance at all levels across financial services firms. As at 31 December 2020, the Group

exceeded its target set the previous year of achieving at least 33% female representation at senior leadership team level, with 45.7% of Executive Committee and direct report positions held by women. For a breakdown of the Executive Committee, please see biographical details on pages 81 to 82.

The Board continues to support Group-wide diversity initiatives, including succession planning programmes, to broaden and strengthen female talent at middle management level. For more information on the Group's diversity and inclusion strategy please see the People section on page 50.

Board and Committee effectiveness review three-year Board evaluation cycle

The Board conducts an annual review of the effectiveness of the performance of the Board, its Committees, the Chair and individual Directors with the input of an external facilitator at least every third year. The effectiveness review in 2020 was managed internally.

The Board recognises that a continuous and constructive review of its performance is an important factor in achieving its objectives and realising its full potential.

The 2020 evaluation focused on both the preservation of the strengths identified in the 2019 and earlier evaluations and on themes for sustaining effectiveness suggested by Professor Goffee, including building Board cohesion, making space for strategic discussion, and equipping the Board to monitor the delivery of organisational transformation and to balance challenge with support.

2019	2020	2021
External	Internal	Internal

Evaluation process

Step 1: with the assistance of the Company Secretary, the Chair identified the effectiveness priorities for discussion.

Step 2: The Chair interviewed members of the Board and Senior Management team.

Step 3: Reports were prepared for the Board and for each Committee for discussion.

Step 4: An action plan was defined following discussion of the reports.

Evaluation outcome

The Chair prepared a report for discussion by the Board and each of the Board Committees.

In addition, the Senior Independent Director discussed the Chair's performance with the Non-Executive Directors (except the Chair) to enable him to provide constructive feedback. No Director was involved in the review of their own performance.

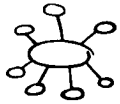
The review concluded that, during the year, the Board, its Committees and individual members of the Board had performed effectively. Progress was found to have been made on the actions suggested in the 2019 review, as summarised in the table below. Suggestions for fine-tuning the effectiveness of Committees, including strengthening the membership of the Remuneration Committee and clarifying the role and authority of the Sustainability (formerly the Corporate Responsibility) Committee, were addressed during the year.

The table below illustrates the areas of focus that resulted from the 2019 review and the actions taken in 2020 as a result.

Focus areas from the 2019 review	Action taken during 2020
Build Board solidarity around key strategic challenges facing the Group.	The Board has built on its cohesion by creating opportunities for NEDs to add value based on their experience and by focusing on strategy in post-Covid-19 markets, the impact of the FCA pricing practices review, the pace of organisational and technological change, the cost base, capital strategy and growth.
Make space for strategy	The number and length of Board meetings have been increased to allow time for deeper discussion of strategic topics including costs, capital structure, growth, technology, digitalisation, the Agile operating model, data strategy, ethics and governance, investment in, and realising the benefits of, talent management, and succession planning.
Refresh the Board	The Board has focused on strengthening its experience and diversity to enhance its ability to monitor the delivery and performance of technological and other change. Criteria for new Non-Executive Directors have reflected these priorities, resulting in the appointment of Adrian Joseph OBE as a Non-Executive Director on 1 January 2021.

The table below illustrates the areas of focus that resulted from the 2020 review and the actions that are proposed for 2021.

Focus areas from the 2020 review	Proposed action for 2021
Use of Non-Executive Directors' experience	Opportunities for the Non-Executive Directors to interact directly with the business in a remote working environment should continue to be found until site visits can be reinstated.
The Board's agenda and information flow	The sequence of strategic topics on the Board's agenda to be aligned with the executive programme, taking the opportunity of longer meetings, when necessary, to allow for deeper and more regular strategic discussion. The early sharing of thinking on key strategic topics should continue. Key topics for 2021 to include the FCA's pricing practices review, capital strategy, driving the benefits of investment in data and technology and growth.
External expertise	Regular broker updates to be obtained during a time of market volatility and increased M&A activity, as well as from thought leaders on future trends in the industry.



Audit, Risk & Internal Control

An explanation of how the Board complies with the Code in relation to audit, risk and internal control is set out below, except for the following matters, which are covered elsewhere in the Annual Report & Accounts:

- how the Board has assessed the Group's longer-term viability and the adoption of the Going Concern basis in the financial statements is on page 74 and page 143;
- The Board has delegated responsibility to the Audit Committee to oversee the management of the relationship with the Company's External Auditor. You can find details of the Audit Committee's role, activities and relationship with the External Auditor in the Committee report which starts on page 97.

Responsibility for preparing the Annual Report & Accounts

The Board's objective is to give shareholders a fair, balanced and understandable assessment of the Group's position and prospects and business model and strategy. The Board is also responsible for maintaining adequate accounting records and seeks to ensure compliance with statutory and regulatory obligations.

You can find an explanation from the Directors about their responsibility for preparing the financial statements in the Statement of Directors' responsibilities on page 143. The Group's External Auditor explains its responsibilities on page 153.

The Directors confirm that they consider that the Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provide the information that shareholders need to assess the Group's position and performance, business model and strategy. In arriving at this conclusion, the Board was supported by a number of processes, including the following:

- management drafted the Annual Report & Accounts to ensure consistency across sections, and a steering group comprising a team of cross-functional Senior Management provided overall governance and co-ordination;
- a verification process, to ensure the content was factually accurate;
- members of the Executive Committee reviewed drafts of the Annual Report & Accounts;
- the Company's Disclosure Committee reviewed an advanced draft of the Annual Report & Accounts; and
- the Audit Committee reviewed the substantially final draft of the Annual Report & Accounts, before consideration by the Board.

Assessing emerging and principal risks

The Board determines the nature and extent of the risks that it is willing to take to achieve its strategic objectives. The Directors robustly assessed the emerging and principal risks facing the Company, including risks that would threaten its business model, future performance, solvency or liquidity. You can find a description of these risks, and their management or mitigation, on pages 71 to 72.

This confirmation is based on the Board Risk Committee's review and challenge of the Group's Material Risk Assessment and the Board's review and approval of the Group's risk appetite statements. The Risk Assessment identifies risks quantified as having a residual risk impact of £40 million or more based on a 1-in-200 years likelihood. The quantifications are produced through stress and scenario analysis, and the capital model. Each directorate's bottom-up risk identification and assessment supplements the Material Risk Assessment. The Material Risk Assessment also plays a key role in developing the ORSA and assessing the Group's strategic plan.

Risk management and internal control systems

The Board oversees the Group's risk management and internal control systems. It has complied with the Code by establishing a continuous process for identifying, evaluating and managing emerging and principal risks the Group faces.

The Board has established a management structure with defined lines of responsibility and clear delegation of authority. This control framework cascades through the divisions and central functions, detailing clear responsibilities to ensure the Group's operations have appropriate controls. This includes controls relating to the financial reporting process.

The frameworks for risk management and internal control were in place for the financial year under review and up to the date of this report. They are regularly reviewed by the Board and comply with the FCA's updated guidance on Risk Management, Internal Controls and Related Financial and Business Reporting.

The Group operates a Three Lines of Defence model. You can find out more about this in the Risk management section on page 69.

The Board, with the assistance of the Board Risk Committee and the Audit Committee as appropriate, monitored the Company's risk management and internal control systems that have been in place throughout the year under review, and reviewed their effectiveness. The monitoring and review covered all material controls, including financial, operational and compliance controls. The Board and its Committees are overseeing the programme of activity to upgrade and better integrate the major IT systems within the Group's technology infrastructure, including focusing on developing future capability for both customers and our people and monitoring risks relating to IT systems' stability, cyber security and the internal control environment.



Remuneration

The Board was also supported in its review of the annual Internal Risk and Control Assessment. This process involved each function completing a self-assessment of its risks and key controls and an Executive Sponsor, responsible for the function, attesting to the status of the effectiveness of the risk management and internal control systems. The Risk function reviewed and challenged these findings and the Group Audit function provided an independent assessment of the overall effectiveness of the governance and risk and control framework of the Group. The Group then combined the overall findings into a Group-level assessment, which the CEO approved. The process included reporting on the nature and effectiveness of the controls, and other management processes that manage these risks.

The Board Risk Committee regularly reviews: significant risks and how they might affect the Group's financial position; comparisons to agreed risk appetites; and what the Group does to manage risks outside its appetite.

The Group Audit function supports the Board by providing an independent and objective assurance of the adequacy and effectiveness of the Group's controls. It brings a systematic and disciplined approach to evaluating and improving the effectiveness of the Group's risk management, control and governance frameworks and processes.

The Directors acknowledge that any internal control system can manage, but not eliminate, the risk of not achieving business objectives. It can only provide reasonable, not absolute, assurance against material misstatement or financial loss.

On behalf of the Board, the Audit Committee regularly reviews the effectiveness of the Group's internal control systems. Its monitoring covers all material controls. Principally, it reviews and challenges reports from management, the Group Audit function and the External Auditor. This enables it to consider how to manage or mitigate risk in line with the Group's risk strategy.

The Board is mindful at all times that remuneration policies and practices must be designed to support strategy and promote the long-term sustainable success of the Group. It delegates responsibility to the Remuneration Committee to ensure that there are formal and transparent procedures for developing policy on executive remuneration and determining Director and Senior Management remuneration. The Remuneration Policy was approved by the shareholders in the 2020 AGM and was drafted to include provisions and principles in the Code.

In his report on pages 113 to 139, the Remuneration Committee Chair provides an overview of the Committee's work in setting an appropriate framework for remuneration of the Executive Directors, Executive Committee and other senior managers as well as the wider workforce to ensure fair pay for all our colleagues.

For details on how the Company has applied Provision 40 of the Code in determining Executive Director remuneration policy and practices, see the summary on page 121.

Audit Committee Report

Gregor Stewart

Chair of the Audit Committee

Committee membership

- **Gregor Stewart**
Chair
- **Mark Gregory**
Independent Non-Executive Director
- **Jane Hanson**
Independent Non-Executive Director
- **Fiona McBain**
Independent Non-Executive Director

Committee meeting attendance can be found on page 87.

Key responsibilities

- Oversee the integrity of the Group's financial statements
- Oversee and challenge the effectiveness of the Group's systems of financial and other internal controls, and financial and regulatory reporting
- Oversee the actuarial reserving process
- Oversee the work and effectiveness of the Group's internal and external auditors
- Oversee the Group's financial and non-financial disclosures, including any climate-related financial disclosures

Areas of focus in the reporting period

- Financial reporting: reviewed and challenged the key accounting and actuarial estimates and judgements made by management to support the financial statements, and gave due consideration to the increased level of uncertainty in respect of Covid-19, with reference to the Financial Reporting Council's guidance issued on this matter.
- Subordinated Tier 2 Notes: oversaw certain matters in relation to the issue of £260 million Subordinated Tier 2 Notes at a 4.0% coupon in June 2020.
- Actuarial and Finance Transformation: received updates from management on: the progress of the transformation programme, including oversight of the budget; IFRS 17 accounting policies; and the general ledger migration.
- TCFD Report: reviewed and challenged the Group's first Task Force on Climate-related Financial Disclosures Report.
- Insurance reserves: reviewed the Group's insurance reserves to obtain assurance that they remained appropriate for discharging expected liabilities. In doing so, the Committee challenged the actuarial best estimate of technical provisions and the prudential margin for IFRS 4 'Insurance Contracts'.

Committee skills and experience

In line with the UK Corporate Governance Code 2018 (the "Code"), all members of the Audit Committee are independent and the Committee as a whole is deemed to have competence relevant to the insurance and financial services sectors in which the Group operates.

All Committee members are members of the Institute of Chartered Accountants in England and Wales, with the exception of the Chair, Gregor Stewart, who is a member of the Institute of Chartered Accountants of Scotland.

Each member has recent and relevant financial experience gained in a number of different financial services businesses including insurance, enabling them to contribute diverse expertise to the Committee's proceedings.

To keep their skills current and relevant, members of the Committee received training during the period on matters including IFRS 17, the Internal Economic Capital Model and Solvency II technical provisions and have a schedule of technical updates planned for 2021.

Main activities during the year

The agendas for the meetings taking place during the year are agreed by the Chair of the Committee and detail the matters to be discussed and considered at each meeting. An analysis of the activity of the Committee during the year identified that it had discussed all intended matters during the year.

At each scheduled Committee meeting, the Committee received reports on financial and non-financial reporting, insurance reserves, internal controls and Group Audit.

Having reviewed the Committee's terms of reference during the year, the Committee has included the additional responsibility of reviewing the Group's Task Force on Climate-related Financial Disclosures Report ("**TCFD Report**") on behalf of the Board on an annual basis.

Financial reporting

The Committee followed a review process before recommending the Annual Report & Accounts and Half Year report to the Board, which focused on the choice and application of significant accounting policies, emphasising those requiring a major element of estimation or judgement. Further information on the significant matters considered is provided in the table on page 99.

The Committee also considered: the Financial Reporting Council's guidance on the Strategic Report; the UK Corporate Governance Code 2018; Section 172(1) of the Companies Act 2006 (as previously defined); the Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018; the Financial Reporting Council's 2020 year-end letter to Audit Committee Chairs; and guidance issued by the Financial Reporting Council during the year on Covid-19 disclosures.

Subordinated Tier 2 Notes

In order to strengthen the Group's long-term finances further, the Committee was asked to oversee certain matters regarding the issue of £260 million Subordinated Tier 2 Notes at a 4.0% coupon to be listed on the General Exchange Market (GEM) of Euronext Dublin. The Committee reviewed the approach to the production and verification of the Listing Particulars and agreed that the listing would improve the financial flexibility and liquidity of the Group during the heightened uncertainty in the macroeconomic environment.

For more information on the Subordinated Tier 2 Notes see page 221.

Reserves

The Committee reviewed and challenged the key assumptions and judgements, emerging trends, movements and analysis of uncertainties underlying the estimate of reserves. These assumptions and judgements are informed by actuarial analysis, wider commercial and

risk management insights, and principles of consistency from period to period. After reviewing the reserves, the Committee recommended them to the Board.

The Committee also considered an appropriate balance between internal and external actuarial review. An external actuarial review of the material risk areas of the insurance reserves was carried out for the Directors of the Company by PricewaterhouseCoopers LLP ("**PWC**"). The appointment of consultants to provide actuarial reviews of reserves is subject to approval by the Committee.

Actuarial and Finance Transformation

During the year, the Committee continued to receive reports on progress against key milestones in the Actuarial and Finance Transformation programme. Updates included in respect of the migration of the general ledger, which was completed successfully in May 2020, an overview of the technology solution design for IFRS 17 and progress on accounting policy choices. The Committee also reviewed the findings of a third party assurance review and approved the budget for the programme.

TCFD Report

The Group is aware that investors, regulators and other stakeholders expect transparent and high quality disclosure on matters relevant to climate change and expect companies to provide details on their approach to the risks and opportunities associated with climate change. At the end of 2020, the Group published its first TCFD Report, which highlighted the Group's response to the issues of climate change and how the TCFD framework has been used to enhance the Group's reporting in this area. The Committee discussed how production of the report had been integrated into the existing financial reporting control framework, reviewed the report on behalf of the Board and recommended its approval to the Board. A summary of the TCFD report is included in the Sustainability section which starts on page 44, and this also includes a link to the full report which can be found on the Group's website.

Going concern and viability statement

The Committee also considered the going concern assumptions and viability statement in the 2020 Annual Report & Accounts, valuation of assets and impairment reviews, non-recurring period-specific transactions and clarity of disclosures. The Committee reviewed and concluded that the Annual Report & Accounts taken as a whole were fair, balanced and understandable and provided sufficient information to enable the reader to assess the Group's position and performance, business model and strategy.

When considering the 2020 Annual Report & Accounts, the Committee focused on the significant judgements and issues which could be material to the financial statements. These included the matters set out in the table on page 99 and also included a detailed review of the *impact of Covid-19, ensuring that the disclosure on matters relevant to the financial statements was fair, balanced and understandable in the context of the Group's operations.*

The Committee challenged the estimates and judgements being made and also discussed these matters with the External Auditor.

For more information on the Viability statement see page 74.

Significant judgements and issues

Matter considered	Description	Action
Insurance reserves valuation	The Committee reviewed the level of insurance reserves of the Group. Insurance reserves relate to outstanding claims at the balance sheet date, including claims incurred but not reported at that date. By their nature, insurance reserves require analysis of trends and risks and the application of management judgement, knowledge and experience. Further information on reserves is provided on pages 30 to 32.	In 2020, the Committee reviewed and challenged the level of insurance reserves and monitored developing trends that could materially impact them. On an ongoing basis it received updates from the Actuarial Director on how estimates of reserves compared to claims paid. The Committee also obtained insight from an independent actuarial review of the reserves.
Valuation of investments not held at fair value and investment property	The Committee considered reports on the estimates and judgements applied to the carrying value of the Group's investments that are not held at fair value and the basis for the valuation. These assets are principally comprised of infrastructure loans, commercial real estate loans and private placement bonds held within the investment portfolio. In addition the Group also holds a portfolio of investment properties. Information was provided to the Committee on a regular basis to support the value recognised in the accounts.	In 2020, the Committee considered major accounting estimates and judgements in respect of assets not held at fair value and the investment property portfolio and was satisfied with the carrying value of investments and the basis for their valuation. The Committee considered the impact of Covid-19 on the investment property portfolio and noted the year-end independent valuation reflected factors in relation to the impact of Covid-19 on certain sectors of the portfolio, primarily in relation to the retail and hospitality sectors.
Impact of Covid-19 on financial statements	Accounting estimates and judgements made in the Group's financial statements are subject to increased levels of uncertainty as a result of Covid-19. The Committee referred to the Financial Reporting Council's guidance on this matter, which encourages companies to explain the significant estimates and judgements made in accounting for the impact of Covid-19. As part of its review, the Committee: evaluated the going concern basis used to prepare the half-year 2020 and full-year 2020 results; reviewed the impact on principal risks and uncertainties; and assessed whether the pandemic could trigger an impairment of assets.	The Committee reviewed and challenged the reports presented by management and was satisfied that the financial statements of the Group presented the impact of Covid-19 in sufficient detail to enable users to understand the impact of the pandemic on the Group's position and financial performance.
Migration of general ledger system	In 2020, the Group migrated to a new general ledger system. This involved a process of key risk assessments and mitigation plans following a decision to go live whilst most staff were working remotely. Detailed plans covering areas such as testing, dry runs, data migration, reconciliation and business user training were managed and implemented remotely and the migration was successfully completed in May 2020.	The Committee received regular reports on the general ledger migration, in particular with reference to the overall progress of the project and the migration of data from the previous general ledger to the new ledger. The Committee was satisfied that the data migration had been performed in a controlled manner and that appropriate reconciliations had been performed to ensure the integrity of the Group's financial data.

Internal control and Group Audit

During the year, the Committee reviewed the adequacy and effectiveness of the Group's internal control systems. The Group's financial reporting control framework is part of the wider internal controls system and addresses financial reporting risks. The Board delegates supervision of the framework to the Committee while the CFO is responsible for the framework's operation on a day-to-day basis. During 2020, the Committee received regular reports on any control deficiencies, compensating controls and the mitigating actions taken by management.

The Committee is responsible for overseeing the work of Group Audit and for ensuring industry best practice is adopted appropriately.

In February, we welcomed Mark Stock to the Group who was appointed as Group Head of Audit. The Group Head of Audit's primary reporting line is to the Chair of the Committee. The secondary reporting line, for day-to-day administration, is to the CEO.

Group Audit has continued to build on the improvements suggested in the 2018 PwC External Quality Assessment as part of an ongoing Continuous Improvement Plan, in line with recommendations from PwC, the Chair of the Committee, along with the Group Head of Audit.

promoted the adoption of new tooling and training to enhance the insight delivered by Group Audit function reviews through the greater use of data analytics. PwC was appointed this year by Group Audit to provide insight and challenge to the function's vision and strategy, as well as taking on Quality Assurance activity. The Committee approved the Group Audit Charter, which is reviewed annually.

During the year, Group Audit provided the Committee with independent and objective reports on the adequacy and effectiveness of the Group's governance, risk management and internal controls. The Committee approved Group Audit's annual plan and received quarterly reports detailing internal audit activity, key findings, management responses, and proposed action plans. Group Audit also monitored progress so as to be able to confirm that the most significant actions were completed. There were no significant failings or weaknesses reported to the Committee in the year.

As a direct response to Covid-19, the Committee was asked to approve the rescheduling of the internal audit plan. The Committee assessed the resources available and those required to complete the Group Audit Plan. Following assessment by the Committee during the year, it concluded that the Group Audit function was effective.

Additional Information

The Committee has unrestricted access to management and external advisers to help discharge its duties. It is satisfied that in 2020 it received sufficient, reliable and timely information to perform its responsibilities effectively.

During the reporting period, the Actuarial Director, external actuarial advisers, External Auditor and Group Head of Audit met privately with the Audit Committee, in the absence of management.

The Chair of the Committee also reported on matters dealt with at each Committee meeting to the subsequent Board meeting.

Committee effectiveness review

During the year, an internal evaluation of the effectiveness of the Committee was conducted as part of the wider review of the Board and the Board Committees by the Chair of the Board. The review found that the Committee functions effectively and that issues are dealt with in a thoughtful and rigorous manner.

The activity of the Committee was reviewed during the year against the Committee's terms of reference. The Committee terms of reference can be found on the corporate website: www.directlinegroup.co.uk/en/who-we-are/governance/board-committees.

External audit

Deloitte LLP ('Deloitte') has served as the Company's Auditor since 2000. Before listing in 2012, the Group was audited by Deloitte as a division of RBS Group. The Committee is responsible for overseeing the External Auditor and agreeing the audit fee, as well as approving the scope of the External Auditor's annual plan.

The audit partner is Colin Rawlings, FCA, who was first appointed for the 2016 audit. Following conclusion of the 2020 audit, Colin will have completed five years as lead audit partner and, in compliance with the Group's minimum standard on independence of the External Auditor, will complete his engagement with the Group. During the year, the Committee confirmed the appointment of a new partner proposed by Deloitte and are satisfied that Adam Addis, ACA, can be appointed to the audit for 2021.

External Auditor tenure

During the year, the Committee again discussed the position on its external audit services contract and examined a number of options regarding the timing of tendering for the external audit, including the mandatory rotation of the Group's audit firm. This took into account the reforms of the audit market by the Competition and Markets Authority and the EU, under which Deloitte can continue as the Company's External Auditor until 31 December 2023. As Deloitte was appointed as Auditor to the Company in 2000 (when it was a subsidiary of The Royal Bank of Scotland Group plc), under the transitional provisions of the legislation, the firm may not re-engage for the audit after 17 June 2023. The Committee considered whether it was appropriate to tender the external audit contract for the year ending 31 December 2021 and concluded it was not appropriate.

When considering the timing of the external audit tender, the Committee took into account the Group's ongoing change programmes including the implementation of a new general ledger system, the use of consultants employed by auditing firms in connection with those programmes, audit partner rotation, the impact of IFRS 17 and the best interests of all stakeholders including potential investors and shareholders. The Committee will review the position on an annual basis, but currently anticipates tendering the audit contract after the implementation of IFRS 17 to ensure the broadest choice of firms. The Committee also confirmed that it will continue to comply with the regulations governing auditor rotation.

There are no contractual obligations restricting the Group's choice of External Auditor.

The Company has complied with the provisions of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Auditor independence and non-audit services

The Group has a minimum standard in relation to the independence of the External Auditor. This establishes parameters for preventing or mitigating anything that compromises the External Auditor's independence or objectivity. The minimum standard includes a formal process for the approval of certain non-audit-related services by the External Auditor. The minimum standard has been revised and updated in light of the Financial Reporting Council's review of its Ethical Standard for Auditors which was published in December 2019.

During the year, the Committee reviewed the audit-related services that could be provided by the External Auditor. It was agreed that, in order to protect the independence of the External Auditor, generally on an ongoing basis, services should not be provided unless there is a strong, clear and understandable business reason. The Committee is satisfied that the Group has adequate procedures to ensure that the External Auditor is independent and objective.

During the year, the Committee approved fees of £0.6 million to Deloitte for services unrelated to audit work. The following is a breakdown of fees paid to Deloitte for the year ended 31 December 2020.

	Fees £m	Proportion %
Audit fees	2.1	72
Audit-related assurance services	0.2	7
Non-audit services	0.6	21
Total fees for audit and other services	2.9	100

Audit-related assurance services were in respect of the Group's Solvency II reporting and the review of the Half Year Report 2020 and non-audit services primarily related to assurance activities on IT projects in relation to the development of new systems where Deloitte was chosen to provide the non-audit services because of its expertise and insight in this area. The engagement with Deloitte for this activity was compliant with the transitional rules of the Financial Reporting Council's revised Ethical Standard and this engagement is now coming to an end. To guard against any independence issues, appropriate safeguards were discussed and agreed by the Committee and Deloitte. In addition, Deloitte also undertook procedures to support the Group's issue of £260 million of Tier 2 debt in May 2020. They were considered to be an appropriate choice of service provider as their understanding of the Group was deemed relevant for the service. The Committee determined that the services provided would not affect the independence of the External Auditor. Further information in respect of audit fees paid to Deloitte is disclosed in note 10 to the consolidated financial statements.

Effectiveness of the external audit process and re-appointing Deloitte as External Auditor

In 2020, the Committee assessed the External Auditor's effectiveness. This was in addition to regularly questioning the External Auditor during its meetings. The Committee assessed the External Auditor through:

- a detailed questionnaire completed by key stakeholders;
- discussing matters with the CFO;
- formally reviewing the External Auditor's independence;
- assessing the key risks identified by the External Auditor, the quality controls put in place to deliver the audit and whether the agreed audit plan was fulfilled; and
- private meetings with the External Auditor in the absence of management.

In addition, through regular interaction with the External Auditor, the Committee was satisfied that the External Auditor continued to demonstrate professional scepticism and challenged management's assumptions.

The quality of the audit was assessed through review and discussion of the External Auditor's report to the Committee at each meeting and from the challenges and insights brought to significant areas of judgement in the Group's financial statements.

After taking into account all of the information available and considering FRC Audit Quality: Practice aid for audit committees, the Committee concluded that Deloitte had performed its obligations effectively and appropriately as External Auditor to the Group.

The Committee recommended to the Board that the Group re-appoint Deloitte as External Auditor, to which the Board agreed. A resolution regarding the reappointment of Deloitte as auditor of the Group will be put to shareholders at the 2021 AGM.

The Board reviewed and approved this report on 5 March 2021.

Gregor Stewart

Chair of the Audit Committee

Board Risk Committee Report

Jane Hanson

Chair of the Board Risk Committee

Committee membership

- **Jane Hanson**
Chair
- **Fiona McBain**
Independent Non-Executive Director
- **Gregor Stewart**
Independent Non-Executive Director
- **Dr Richard Ward**
Senior Independent Director

Committee meeting attendance can be found on page 87.

Key responsibilities

- Provide oversight and advice to the Board in relation to current and emerging risk exposures of the Group and the strategic approach to managing risk, including determination of risk appetite and tolerance
- Promote a risk-aware culture within the Group
- Review the design and implementation of the Enterprise Risk Management and Strategy Framework, risk appetite and tolerances

Areas of focus in the reporting period

- Considered the Group's approach to pricing practices, aiming to ensure that they are delivering fair and appropriate outcomes for its customers.
- Proactively monitored the impacts and risks of the Covid-19 global pandemic.
- Oversaw change risk arising from the Group's multi-year transformation programmes.
- Reviewed and understood the Group's climate-related risks.
- Monitored the progress of the Group's proactive operational resilience programme.

Further detail on these areas can be found in the body of the Committee report.

Covid-19

At the heart of the Group's strategy is the vision to become a force for good and so it has been a key focus for the Group to support its customers, people and wider society through the Covid-19 pandemic. The Committee was supportive of the Group's move to homeworking to protect the lives of its people and their families, to maintain the Group's ability to service its customers, to safeguard its business for the longer term and to support the Government in protecting the country. The Committee took a proactive approach in monitoring the impacts and risk of the Covid-19 pandemic.

The Committee received regular updates and challenged management on the actions being taken across the business to support customers during the pandemic with a particular focus on factors such as public perception, affordability and the importance of doing the right thing for the Group's financially distressed customers. The Committee also closely monitored and challenged management on the impact that Covid-19 was having on colleague morale and wellbeing, travel and business interruption claims, the supply chain of goods, operational resilience, the Group's technology and business transformation programme timelines, market risk, solvency capital requirements and risk appetite range and the Strategic Plan. Details of stress testing in relation to Covid-19 can be found in the financial risk section of the Committee report.

The Committee held an ad hoc meeting and received regular updates on cyber mitigation planning to manage cyber risk appetite which was being monitored closely by the Risk function. The Committee probed to ensure that risks were being managed appropriately and compensating controls and mitigating actions were in place to manage the Group's transition to homeworking for all of its in-house and outsourced operations, including in the UK and offshore in South Africa and India. The Committee subsequently reviewed plans for the re-opening of offices, gaining assurance from management on their plans for the return of limited numbers of staff and the measures taken to ensure social distancing was maintained.

The Committee sought assurance and was satisfied with the Risk function's review of the governance of the key Covid-19-related decisions made during the year and the management actions recommended by Group Audit following its consultative exercise of the lessons learnt from the crisis management response to the initial phases of Covid-19.

Customer and conduct

Customer and conduct risk has continued to be a principal focus of the Committee in 2020. During the period, the Committee devoted significant time to considering, challenging and supporting management on its approach to managing these risks and sought assurance that fair pricing and outcomes were being achieved for customers across all Direct Line Group products. The Committee received reports and probed management on the Group's pricing strategy and governance and control framework, the process taken to review and manage conduct thresholds and margins and pricing transparency, the methods used for pricing for vulnerable customers, protected characteristics and the approach to data ethics. In October 2020, the Committee held a risk strategy session and discussed in detail the Group's use and governance of pricing factors, key customer judgements being applied in pricing, customer outcomes illustrating the effectiveness of the Group's pricing approach as well as initial thoughts on the FCA's General Insurance Pricing Practices Market Study and its impact on the Group.

The Group has a management-level Customer Conduct Committee, which reviews, challenges and oversees customer and conduct matters for all of the Group's brands and channels with the aim of promoting customers' best interests and ensuring that the Group's business activities are consistent with the best interests of its customers. The Customer Conduct Committee's findings and any recommendations for improvement are regularly reported both to the Board and the Committee.

Compliance and regulatory risk

As part of the Chief Risk Officer's ("CRO") report submitted to each meeting, the Committee reviewed regular updates on key ongoing regulatory developments and interactions with the PRA and FCA. Areas on which the Committee focused included pricing practices, operational resilience, Brexit, the status of cyber risk and travel and business interruption claims as a result of the pandemic, the implementation of the Insurance Distribution Directive to improve customer demands and needs and the approach to assessing customer affordability.

During the year, the Committee considered the Group's compliance with regulatory requirements including those relating to conduct and financial crime. The Committee approved the annual Compliance Plan setting out the compliance activities to be undertaken in the coming year with the objectives of ensuring compliance, maintaining an open and co-operative relationship with regulators and ensuring the Board and colleagues understand their regulatory responsibilities. The Committee reviewed and challenged the outputs from conduct and compliance assurance reviews, including in relation to Solvency II compliance. The Committee received data privacy updates and a report on the Group's adherence to privacy and data protection legislation during 2020, including actions taken to respond to data information requests to comply with the General Data Protection Regulation and the Information Commissioner's Office guidelines. The Committee reviewed the actions being undertaken to ensure compliance with the regulators' Senior Managers and Certification Regime, which included a comprehensive review of the Group's High Level Control and System of Governance Framework and Management Responsibilities Map.

During the period, the Group continued to work on its proactive operational resilience programme aligned to the expectations set by the Bank of England, PRA and FCA, aiming to address business process, organisational, third-party and technological resilience as well as prioritising the prevention of, and recovery from, financial and other shocks to the business. Through receipt of regular updates, the Committee challenged and supported management on the key indicators and management information which would be used to provide the Board with oversight of the Group's operational resilience, the impact tolerances to be set and the suitable strategies, processes and systems for identifying important business services.

Operational risk

The oversight of change risk was a central focus for the Committee as the Group made good progress on its strategic transformation, continuing major technical deliveries in the remote working environment, whilst also focusing on business transformation to take advantage of the tools being built.

The Committee received updates at each of its meetings on the developing, testing and implementation of releases under the Group's technological transformation programmes, on interdependencies between programmes and on the overall management of the Group's change portfolio, reviewing and challenging the operational and financial risks and controls and the potential impact on customers, people and the Group's strategic and financial plan. Each report was accompanied by an update from the Risk function on its assurance activity, which included reviewing and challenging programme plans, testing methodology and performance, and reviewing preparations for implementation. Reasonable assurance on the Group's technology re-platforming programme, "Best for Customer", was provided to the Committee by Deloitte, who had been engaged to conduct a number of deep dive reviews of a range of programme stages and risks focusing on planning methodology and approach, testing, technical readiness for business volume increases and programme closedown.

Board Risk Committee report *continued*

The Committee reviewed updates during the year on the progress the Group had made to deliver stable desktop, telephony and mainframe platforms. The Committee challenged management on the lessons learned from other firms' IT migration programmes and sought assurance that the Group had appropriate mitigating controls and actions in place to prevent occurrence of such issues which could have a detrimental impact on the Group and its customers.

The Committee received updates on the progress of the Group's transformation of its operating model and challenged how the risk framework had been adapted to align with the new model as well as on the mitigating actions in place to address the key impact risks of the programme.

Financial risk

As an insurance company, Direct Line Group understands the importance of managing climate-related risk and recognises that climate change could pose material long-term financial impacts to the business. During the year, the Committee received regular climate-related updates as part of the CRO's report and examined and monitored management's 2020 and 2021 plans to protect the Group from climate-related financial risks and address the PRA's climate change expectations. The Committee recognised the progress that had been made, including the development of a governance framework and workstreams to manage climate-related risks and the publication of the TCFD Report in December 2020. As part of a strategy session in October 2020, the Committee also considered the potential financial risks and impacts from climate change, including an external view on regulatory expectations in the context of the sustainability agenda. Further details on the risks due to climate change faced by the Group can be found on pages 58 and 74.

At each meeting, the Committee monitored the Group's performance against its capital risk appetite through the CRO's report. Committee members considered financial risks and assessed these risks against risk appetite. Committee members also reviewed and challenged the Own Risk and Solvency Assessment ("ORSA") process and key content before the report was submitted for approval to the Board. Committee challenges on elements of the ORSA during the year included those in relation to stress testing of the strategic plan, pricing and underwriting risk, internal model validation activity and the appropriateness of contingent management actions.

The Committee reviewed and challenged the stress and scenario testing plan with a particular focus on certain scenarios including in relation to the potential financial, operational and reputational impacts of Covid-19, the potential financial risks of climate change, the potential impacts to the business following a rapid reduction of motor in-force policies and premiums as well as the impacts of a potential hard Brexit combined with economic implications resulting from the end of the furlough scheme and further lockdown periods in 2020 and 2021.

Throughout the year, the Committee received reports on the internal model, including independent validation results and the internal model owners' report. This outlined the scope of the capital model, key outputs, risk drivers, significant parameters, expert judgements and key assumptions. As a result of reviewing the internal model owners' report, the Committee challenged management on its approach to diversification risk.

During the year, the Committee also scrutinised the Group's risk appetite guidance for affirmative and non-affirmative cyber underwriting risks and challenged the actions taken to mitigate such risks.

Risk monitoring and oversight

At each scheduled meeting, the Committee received a report from the CRO which provided an overview and assessment of the Group's risk profile. It detailed the key activities undertaken by the Risk function to further embed risk management across the Group and, provided outputs of regular risk monitoring and details of specific risk issues, including in relation to Covid-19 and Brexit. The Committee also received and discussed details of the Group's current and forward-looking solvency position.

The Committee received regular reports regarding the three strategic risk appetite statements: maintain capital adequacy; stable and efficient access to funding and liquidity; and maintain stakeholder confidence. The Committee monitored the Group's exposure against these risk appetite statements and the lower level risk appetite statements, considered key risk indicators and assessed the key drivers that affected status against risk appetite. The Committee reviewed and questioned the justification of the assessment of certain risks and the robustness of management action plans to address areas close to or outside of tolerance.

Risk management and controls

The Committee monitored the Group's risk management and internal control systems, and reviewed their effectiveness. This covered all material risks, including financial, operational and compliance. The Committee reviewed the residual risk position and considered the effectiveness of any associated mitigating actions and compensating controls. The monitoring and review by the Committee involved examining an assessment of the control environment and material controls at Group level, based on divisional risk and control self-assessments. These assessments had been subject to challenge by the Risk and Group Audit functions.

Assessment of risk behaviours and attitudes

The Committee reviewed the annual Assessment of Risk Behaviours and Attitudes undertaken jointly by the Risk and Group Audit functions, which covered areas including tone from the top, decision-making and the Risk Management Framework as well as the Group's response to Covid-19 and the implementation of the Group's new ways of working as part of the business transformation programme. The Committee discussed the outputs of the assessment, as well as areas for further improvement, seeking to ensure the appropriateness of the actions identified.

Principal and emerging risks

The Committee assessed the principal risks facing the Group, which are listed on pages 71 and 72, through reviewing and challenging the matters listed in the Group's Material Risk Register in the context of the Group's risk appetite and through consideration of the risk assessment contained in the CRO's report received at each scheduled meeting.

The Committee assessed the Group's emerging risks. It challenged the assumption that management had identified all possible significant emerging risks during the year and the Risk function's role in ensuring that such risks were being monitored and managed appropriately. The most notable emerging risks identified included those relating to climate change and ethical use of data. Further details regarding such risks can be found on pages 71 to 72.

Whistleblowing

As delegated by the Board, the Committee routinely reviewed the arrangements by which employees may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters ("**whistleblowing**") during the year. The Committee also reviewed reports relating to whistleblowing, including anonymised, individual cases, to ensure arrangements were in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

The Committee probed management and was satisfied that the whistleblowing process met the necessary standards and that it was adequately designed, operated effectively and adhered to regulatory requirements. This was supported by Group Audit's review of the Group's whistleblowing arrangements during the year which concluded that whistleblowing procedures and controls were fit for purpose and operating effectively.

Financial Crime and anti-bribery and corruption

The Group has a fraud and financial crime policy, which includes the requirement that all employees of the Group comply with an anti-bribery and corruption minimum standard. The aim of the standard is to ensure compliance with applicable anti-bribery and corruption legislation and regulation and that employees act responsibly and ethically at all times when conducting and awarding business.

The Committee considered the Group's actions to prevent financial crime through its review of the annual Financial Crime Report. Annually, the Committee considers an anti-bribery and corruption report, which includes a risk assessment of the level of anti-bribery and corruption risk to the Group. The Group's annual anti-bribery and corruption risk assessment was completed, noting that no allegations or suspicions of bribery or corruption had been identified or reported in 2020. Following review and challenge, the Committee was satisfied that the Group's policies and procedures on anti-bribery and corruption were fit for purpose and that anti-bribery and corruption risks were managed appropriately.

Risk governance

During the reporting period, with the aim of balancing efficiency and appropriate ownership and oversight, the Committee reviewed the Group's most significant policies. The Committee reviewed and challenged each of these policies as part of the Group's Solvency II requirements and recommended them for approval by the Board.

The Committee also considered the results of the annual Group assessment of the effectiveness of the internal controls environment undertaken by each business division, as well as monitoring controls on an ongoing basis. The Committee considered, challenged and approved the annual risk operational plan and the adequacy and objectivity of the Risk function's resources.

The Committee has unrestricted access to management and external advisers to help discharge its duties. It is satisfied that in 2020 it received sufficient, reliable and timely information to perform its responsibilities effectively. In addition to monthly one-to-one meetings with the Chair, the Chief Risk Officer also met privately with the Committee without management being present. The Chair also reported on matters dealt with at each Committee meeting to the subsequent Board meeting.

Committee effectiveness review

During the year, an internal evaluation of the effectiveness of the Committee was conducted as part of the wider review of the Board and the Board Committees by the Chair of the Board. The review found that the Committee functions effectively and that issues are dealt with rigorously and in a considered manner.

The activity of the Committee was reviewed during the year against the Committee's terms of reference. The Committee terms of reference can be found on the corporate website: www.directlinegroup.co.uk/en/who-we-are/governance/board-committees.

The Board reviewed and approved this report on 5 March 2021.

Jane Hanson

Chair of the Board Risk Committee

Nomination and Governance Committee Report

Danuta Gray

Chair of the Nomination and Governance Committee

Committee membership¹

- **Danuta Gray – appointed as Chair
26 October 2020**
Chair
- **Sebastian James – appointed 26 October 2020**
Independent Non-Executive Director
- **Dr Richard Ward**
Independent Non-Executive Director

Committee meeting attendance can be found on page 87.

Key responsibilities

- Review Board composition
- Lead the process for Board appointments and make recommendations to the Board
- Ensure orderly succession plans are in place for the Board
- Oversee executive succession planning at a high level to ensure the development of a diverse Senior Management talent pipeline
- Oversee and monitor the corporate governance framework of the Group
- Monitor developments in governance and investor ESG expectations

Note:

1. Mike Biggs was a member of this Committee until he retired from the Board on 4 August 2020.

Areas of focus in the reporting period

- Reviewed the skills and experience of the Board with regard to the oversight of the Group's strategy and led the search for a new Non-Executive Director, which resulted in the appointment of Adrian Joseph on 1 January 2021.
- Monitored progress on executive succession planning, both for members of the Executive Committee and for new roles in the Agile operating model adopted by the Group during the year.

Main activities during the year

Board and Senior Management succession planning

The Committee regularly monitors the composition of the Board and its Committees to ensure that they have a suitable balance of skills and experience to oversee and challenge the delivery of the Group's strategy and to discharge the Committee's responsibilities effectively.

The process adopted by the Board which culminated in my selection as Mike Biggs' successor as Chair of the Board is described in detail in the Corporate Governance report on page 91.

In October 2020, the Company announced my appointment as Chair of the Nomination and Governance Committee; Mark Gregory became Interim Chair of the Remuneration Committee; and Sebastian James was appointed as a member of the Nomination and Governance Committee.

New appointments

We engaged Heidrick and Struggles, which is a signatory to the Voluntary Code of Conduct for executive search firms, to assist in the search for a new independent NED in 2020. Heidrick and Struggles has no other connection with the Company or any individual Director. Shortlisted candidates were interviewed by members of the Committee and the preferred candidate subsequently met all other members of the Board.

Following the Committee's recommendation, the Board agreed, in December 2020, that Adrian Joseph OBE would be appointed as an independent Non-Executive Director with effect from 1 January 2021.

At the Committee's recommendation, the Board also agreed that, from 1 January 2021, Adrian would join the Sustainability Committee, Richard Ward would become a member of the Remuneration Committee and Fiona McBain would become a member of the Investment Committee.

Electing and re-electing Directors

Before recommending the proposed election or re-election of Directors at the 2020 AGM, the Committee reviewed the independence of the Non-Executive Directors and concluded that all Non-Executive Directors remained independent in judgement and character and met the criteria for independence set out in the Code. The then Chair, Mike Biggs, was independent at the time of his appointment as Chair and was not involved in his own review.

Special attention was paid to the Non-Executive Directors' external responsibilities and it was concluded that all Directors had sufficient time to dedicate to their respective roles. The Board considered and approved Jane Hanson's new roles as a Non-Executive Director of Welsh Water and Rothesay Life PLC, concluding that she would continue to have sufficient time to devote to her role as a Non-Executive Director of the Company. The Committee recommended to the Board and shareholders that all serving Directors be submitted for election or re-election at the Company's 2020 AGM.

With the exception of Jane Hanson, who will be stepping down from the Board after having served as a Non-Executive Director for over nine years, all current Directors will submit themselves for election or re-election at the Company's 2021 AGM.

Diversity and inclusion

The Board believes that an effective Board with a broad strategic perspective embraces a diversity of gender, race, skills and experience, as well as of regional, socio-economic, educational and professional backgrounds, amongst other differences. The individual experience of each Director is recognised and forms a valuable part of the decision-making process at Board level. The annual evaluation of the Board considers its composition and diversity.

In its search for candidates, the Board aims only to engage with executive search firms which are signatories to the Voluntary Code of Conduct for Executive Search Firms.

The Board's diversity policy is available to view on the Company's website at www.directlinegroup.co.uk/en/who-we-are/governance/other-policies. This policy, which is annually reviewed and monitored by the Committee, is presented to any executive search firm engaged to assist with the selection and appointment process for Board positions. The objective of the diversity policy is to seek to ensure that individual differences, which contribute to the success of the Company and represent the diversity of our customers and colleagues, are reflected at Board level.

Further information on the Board diversity policy and the Group's diversity initiatives can be found in the Corporate Governance report on page 92.

The Board supports the recommendations set out in the Parker Review and was delighted to welcome Adrian Joseph as a member as of 1 January 2021. Adrian brings a wealth of experience in data strategy and analytics and has a history of commitment to diversity and inclusion initiatives. The Board looks forward to benefiting from his knowledge and experience, particularly in these fields, which are central to its strategy.

Diverse pipeline

During the year, the Committee reviewed the Group's management succession planning and talent development initiatives, with the objective of building a diverse and inclusive talent pipeline and identifying potential in the senior leadership population.

The Group has a detailed diversity and inclusion plan which is supported by the Board and overseen by the Sustainability Committee, and which includes the objectives both of encouraging diversity in our succession planning and of fostering a culture of growing inclusivity. The Group also supports the empowerment of its senior managers through its Emerge development programme.

The Committee recognises the importance of thorough contingency planning and in January 2021, it reviewed both emergency cover and longer-term succession planning for all Executive Committee roles, along with plans for developing senior leaders in new roles in the Group's Agile operating model.

Gender of Board and Senior Management

The Board supports the targets set in the Hampton-Alexander Review. As at 31 December 2020, female representation on the Board was 44.4%.

In August 2020, the Board was proud to mark a historic moment when it became one of only four FTSE 250 companies with both a female CEO and female Chair.

The Board remains committed to progressing women into senior roles and aims to increase female representation at executive level through associated development programmes for high-potential females. As at 31 December 2020, female representation at Executive Committee level and their direct reports was 45.7%.

Board effectiveness review

In accordance with our three year cycle of Board effectiveness evaluation, the review was facilitated internally in 2020.

Further information on the evaluation process, including the outcomes and actions proposed, can be found in the Corporate Governance report on page 93.

Committee effectiveness review

During the year, I conducted an internal evaluation of the effectiveness of the Committee as part of the wider review of the Board and its Committees. The review found that the Committee functions effectively and that issues are dealt with in a thoughtful and rigorous manner.

The activity of the Committee was reviewed during the year against the Committee's terms of reference and found that the Committee had discharged its responsibilities effectively in 2020. The Committee's terms of reference can be found on the corporate website: www.directlinegroup.co.uk/en/who-we-are/governance/board-committees.

Corporate governance

The Committee monitors emerging governance matters, compliance with the Corporate Governance Code and ESG standard and subsidiary governance. It will continue to monitor consultations, developments and reforms which affect the Group's corporate governance obligations.

The Board reviewed and approved this report on 5 March 2021.

Danuta Gray

Chair of the Nomination and Governance Committee

Sustainability Committee Report

Sebastian James

Chair of the Sustainability Committee

Committee membership

- **Sebastian James**
Chair
- **Penny James**
Chief Executive Officer
- **Adrian Joseph – appointed 1 January 2021**
Independent Non-Executive Director
- **Jane Hanson**
Independent Non-Executive Director

Committee meeting attendance can be found on page 87.

Key responsibilities

- Provide oversight and advice on how the Group conducts its business in a responsible and sustainable manner that reflects the Group's vision and purpose
- Monitor the progress of the Group's initiatives under its sustainability pillars

Areas of focus in the reporting period

- Oversaw the Group's efforts to be a force for good in response to the Covid-19 pandemic.
- Monitored the Group's sustainability activity through regular updates on each of the five pillars of the sustainability strategy.
- Challenged the robustness of management decision-making relating to the five pillar sustainability strategy.
- Received updates on the development of the Group's first Sustainability Report.
- Reviewed ethical matters including the Group's Modern slavery statement.
- Agreed to expand its remit to ensure alignment with the Group's sustainability strategy; and vision to be a force for good.
- Changed its name from Corporate Responsibility Committee to Sustainability Committee.

Main activities during the year

Customers

During 2020, the Committee monitored steps taken to earn customers' trust by demonstrating how the Group acts in their best interests. The Committee reviewed management's initiatives to support customers in the light of the challenges presented by the Covid-19 pandemic including supporting our customers with roles in the NHS by offering a fast track claims service, free personal possession, home emergency and rescue cover. The Committee was supportive of other initiatives to assist customers in financial difficulty as a result of Covid-19 such as providing "Mileage MoneyBack" refunds, offering to waive cancellation fees, payment deferrals, and adding flexibility to motor and rescue policies.

The Committee received updates on the work to understand the reasons behind the marginalisation of certain customer groups from various rights, opportunities and resources that are normally available to others, defined by management as social exclusion. The Committee reviewed and challenged reasons proposed by management as explanations for social inclusion which

included access, affordability and data availability. The Committee acknowledged that action to reduce social exclusion would be explored alongside the Group's response to the FCA's Market Study on General Insurance Pricing Practices.

People

The Committee considered management's mission to build a culture that celebrates difference and empowers people so that they can thrive. The Committee and Board regard diversity and inclusion as an integral aspect of ensuring that people can thrive at the Group, and the Committee was pleased to receive updates on management's progress against its diversity and inclusion priorities. The Group's first diversity and inclusion survey as well as insights from the Group's Diversity Network Alliance were incorporated into a new diversity and inclusion strategy, setting targets for progress.

The Committee received updates on measures to protect people during Covid-19 including remote working arrangements, safeguarding roles and remuneration, and on efforts to support mental health and wellbeing. The Committee noted the increased frequency of engagement with employees through regular employee pulse surveys and impactful internal communications campaigns such as #WeCare.

The Committee was supportive of management's commitment to continue building a great place to work despite the challenges of Covid-19 through the Agile transformation programme. The Committee was pleased to see management's focus on empowering employees to self-organise and provide solutions for customers as quickly as possible and noted progress updates regarding upskilling and the development of Agile behaviours.

Planet

During the year, the Committee oversaw management actions towards protecting the business from the impact of climate change and giving back to the planet more than it takes out. The Committee monitored progress against the Group's climate targets for reducing energy consumption and greenhouse gases and environmental initiatives and was pleased to see that at Half Year the Group had:

- exceeded its target to reduce Group-wide emissions on a like-for-like basis by 2020 against a 2013 baseline by 57%; and
- met its target for a 30% like-for-like reduction in the Group's energy use by 2020 against a 2013 baseline.

The Committee also received updates on the Group's work to set science-based carbon targets for Scope 1 and 2 emissions, and Scope 3 emissions under the Group's control, and submit them in line with the Science-Based Targets Initiative framework. More information regarding the Group's greenhouse gas emissions data can be found on page 61 of the Strategic report.

The Committee considered the Group's progress towards achieving its carbon neutrality ambitions in 2020. The Group agreed a three-year commitment with the Carbon Trust to offset carbon emissions by investing in high impact projects that both reduce carbon emissions and support global communities.

Society

During 2020, the Committee monitored how the Group used its expertise to improve outcomes for our society and the communities it served. The Committee received updates on the Group's Community Fund, created to support communities during Covid-19 in areas where Direct Line had a presence. The Committee was pleased to see £3.5 million of assistance given to vulnerable groups, small, local charities and charitable projects supporting public policy areas.

The redevelopment of Shotgun, the Group's initiative aimed at reducing young driver accidents, continued during 2020. Despite the delayed relaunch of Shotgun, the Committee noted management's conviction in the core aims of the mobile application to: reduce young driver accidents; and have a positive influence on young drivers' behaviours on our roads.

Additional ethical matters

The Committee recognises that respecting human rights is self-evidently the right thing to do and is committed to ensuring that the Group conducts its business in a manner which is ethical and sustainable.

In December 2020, the Committee reviewed the Group's policy on compliance with the Modern Slavery Act 2015 and how third-party suppliers complied with the Act's requirements.

The Committee challenged the Procurement function and concluded that processes and policies in connection with the Modern Slavery Act were robust, effective in being embedded in supply chain processes, and had appropriately responded to unprecedented circumstances presented by Covid-19.

Committee effectiveness review

During the year, an internal evaluation of the effectiveness of the Committee was conducted as part of the wider review of the Board and the Board Committees by the Chair of the Board. The review found that the Committee functioned effectively and that the refreshed scope of the Committee allowed sustainability issues to be addressed creatively and thoughtfully. The Committee's terms of reference were reviewed during the year against the activity of the Committee. At the time of reviewing the Committee's Terms of Reference, the Board agreed that its name should be changed from the Corporate Responsibility Committee to the Sustainability Committee.

The Committee's Terms of Reference can be found on the corporate website: www.directlinegroup.co.uk/en/who-we-are/governance/board-committees.

The Board reviewed and approved this report on 5 March 2021.

Sebastian James

Chair of the Sustainability Committee

Investment Committee Report

Mark Gregory

Chair of the Investment Committee

Committee membership

- **Mark Gregory**
Committee Chair
- **Jane Hanson**
Independent Non-Executive Director
- **Tim Harris**
Chief Financial Officer
- **Fiona McBain – appointed 1 January 2021**
Independent Non-Executive Director

Committee meeting attendance can be found on page 87.

Key responsibilities

- Provide oversight of the Group's investment strategy
- Oversee the management and performance of the Group's investment portfolio

Areas of focus in the reporting period

- Understood the potential risks and monitored the financial consequences for investment assets from the economic downturn driven by the Covid-19 global pandemic.
- Considered how the investment portfolio started to respond proactively to the global challenge to reduce greenhouse gas emissions and support the transition to a low carbon economy.
- Monitored developments and progress towards a trade agreement between the EU and the United Kingdom and any attendant impact on investment assets.
- Ensured investment activities continued always to provide sufficient access to liquidity to meet a stress insurance or market event.
- Monitored market developments in response to the planned discontinuation of the London Inter-Bank Offered Rate ("LIBOR") after 2021 and the progress made by the Group to ensure it is ready for the changes.

Main activities during the year

Covid-19

The April meeting, which took place against a background of lockdowns around the world and fiscal and monetary responses by governments and central banks being implemented at pace, considered a comprehensive paper confirming the levels of diversification within the asset portfolios, the quality of assets held and exposures to sectors most adversely affected by lockdowns and social distancing. The paper detailed exposure to those assets at the lower end of the Company's risk appetite and, therefore, more susceptible to being downgraded outside of risk appetite. At the same meeting the Committee reviewed waivers agreed by management with asset managers for fixed income holdings already outside risk appetite, the waivers allowing the asset managers a longer timeframe in which to consider when to dispose of such assets in view of improving market conditions. The Committee received regular updates on the waiver positions between scheduled meetings until all waivers were closed later in the year.

In July, the Committee considered the findings and recommendations resulting from a detailed review of the investment property portfolio. The review examined the business case for continuing to hold each property asset in the portfolio against the medium-term changes expected to impact the commercial property market as a result of the move to increased working from home and online shopping. At the meeting, the Committee also sought assurances from the asset manager that tenants were being offered flexibility, where necessary, regarding finding mutual solutions for rent payments due in situations where the tenant's cash flows had deteriorated markedly due to the pandemic.

The financial consequences of the pandemic on the Company's budgeted investment result and changes in assets valuations were reported at each meeting.

Responsible investing – climate change

In 2020, the Committee approved new measures for the corporate bond portfolios (75% of the total investment portfolio benchmark) to help achieve the Group's ambition to limit its impact on the climate and to achieve net zero carbon emissions by 2050. In summary, a commitment was given to set a target to reduce the Green House Gas ("GHG") Emissions Intensity¹ across the relevant portfolios by 50% before the end of 2030 (benchmarked against the end of 2020 GHG emissions intensity). In addition, the Committee agreed that asset managers should be encouraged to allocate capital increasingly towards companies demonstrating an intent to decarbonise through the following guideline changes and restrictions:

- A preference for companies with carbon reduction targets approved by the Science-Based Targets Initiative;
- A preference for companies with at least a 2°C carbon performance alignment with the Transition Pathway Initiative;
- The exclusion of any companies with a carbon transition score indicating assets could be economically stranded;
- The exclusion of any mining companies that generate >5% of revenues from thermal coal production and electricity generators that derive >5% of revenues from thermal coal power generation (unless, in either case, the company has an approved Science-Based Targets Initiative Plan); and
- The exclusion of any companies that are developing new thermal coal mines or coal burning power plants.

The Committee will continue to monitor the results of the responsible investing framework in place and seek updates on market developments and trends. The Committee expects management to recommend further adjustments to the framework over the next two to three years.

The Committee recognised that it was important for the Group to seek to comply with the recommendations made by the Task Force on Climate-related Financial Disclosures ("TCFD") and to carry out climate change scenario stress testing.

Further information about the Group's approach to TCFD can be found on pages 62 to 63.

Market developments

At each scheduled meeting, the Committee received a market update from the Director of Investment Management and Treasury. The updates covered: economic conditions in the UK, the US and the Eurozone; market levels for key asset classes (notably credit); the outlook for interest rates and inflation; and developing issues viewed as appropriate to be brought to the attention of the Committee. The Committee also monitored the development of interest rate policies set by the Bank of England, the US Federal Reserve and the European Central Bank and the impact of non-sterling assets held on hedged yields.

Suitability of investment strategy

The annual studies examining stressed liquidity requirements and asset and liability matching were presented to the Committee during the year. Such work informs strategic benchmark allocations and provides part of the context for the addition of new asset classes or disposing of a holding. During the year, the Committee agreed amendments to the existing strategic benchmark which entailed reductions in benchmark allocations to assets supporting liquidity and infrastructure debt and net increases in allocations to investment grade credit and Commercial Real Estate ("CRE") loans.

Monitoring investment activity and performance

The Committee received a comprehensive report at each scheduled meeting covering: the financial results of investment activity; aggregate portfolio positioning against strategic benchmarks; performance of each individual portfolio against benchmark; adherence to operational controls; performance of suppliers; and compliance with an agreed framework of risk limits. During the year the Committee invited the managers responsible for the investment property portfolio, the CRE loans portfolio and the private placements portfolio to present updates on their respective portfolios.

Committee evaluation

During the year, an internal evaluation of the effectiveness of the Committee was conducted as part of the wider review of the Board and the Board Committees by the Chair of the Board. The review found that the Committee functions effectively and that issues are dealt with in a thoughtful and rigorous manner. The Committee's terms of reference can be found on the corporate website: www.directlinegroup.co.uk/en/who-we-are/governance/board-committees.

The Board reviewed and approved this report on 5 March 2021.

Mark Gregory

Chair of the Investment Committee

Note:

1. Greenhouse gas (GHG) emissions intensity = metric tonnes CO₂e (CO₂ equivalent) GHG emissions/million \$ sales

Directors' Remuneration Report

Mark Gregory

Chair of the Remuneration Committee

Committee membership¹

- **Mark Gregory – appointed Chair on 26 October 2020**
Chair
- **Danuta Gray**
Chair of the Board
- **Sebastian James**
Independent Non-Executive Director
- **Dr Richard Ward – appointed 1 January 2021**
Senior Independent Director

Key responsibilities

- Determines the policy for rewarding Directors and senior leadership for results that are generated within the risk appetite set by the Board and oversees how the Group implements its Remuneration Policy;
- Oversees the level and structure of remuneration arrangements for senior executives, approves share incentive plans, and recommends them to the Board and shareholders; and
- Reviews workforce remuneration and related policies and the alignment of incentives and rewards with culture.

Note:

1. Mark Gregory was appointed to the Committee on 29 May 2020 and as Chair on 26 October 2020. Mike Biggs was a member of this Committee until he retired from the Board on 4 August 2020.

Dear Shareholders,

I am pleased to introduce my first Directors' Remuneration Report (the "Report") as Chair of the Remuneration Committee (the "Committee"), for the 2020 financial year. I would like to thank Danuta Gray for her stewardship of the Committee over the last few years and congratulate her on being appointed as Chair of the Board.

The Committee is immensely proud of the ways in which our people continued to provide exceptional service, value and flexibility to our customers in 2020, aligning with our desire to make insurance personal, inclusive and a force for good. We offered extra value to all our customers and further support to those in financial difficulty in response to the unexpected impact of the Covid-19 pandemic. Many measures were introduced across the business to achieve this, including payment deferrals, waiving cancellation fees, mileage refunds and free roadside assistance to key workers.

During 2020, we have sought to balance the needs of our different stakeholders, by caring for our people, looking after our customers, protecting the business for the long term, and supporting the national effort and our local communities. After reinstating our ordinary dividend as soon as possible in August (along with a 2020 special dividend, reflecting a full catch-up of the cancelled 2019 final dividend) we have also delivered to our investors. We had voluntarily withdrawn our ordinary dividend to indicate restraint and consistency with the PRA when it asked insurers to consider the protection of policyholders. As a result of the Covid-19 pandemic, and delivering on our desire to be a force for good, the Group also established our first Community Fund which distributed £3.5 million to 250 charities supporting over 200,000 people, and we have extended this by a further £1.5 million for 2021 to serve our local communities. More information on these initiatives can be found on page 57.

Through the year and into 2021, the health, safety and wellbeing of our people has never been more crucial. Despite the challenges the pandemic has presented, the Group provided stability and security of pay for our entire workforce. We did not seek or receive any government support and did not furlough any colleagues. Just before and as we moved into the initial lockdown in March 2020, we moved 9,000 people to work from home and continued to pay all of our employees their usual pay, including fixed-term contractors, regardless of whether they were fully or partially working, or temporarily not able to work. The Group also initially suspended the structural workforce changes, previously announced in February 2020, to provide further job security at this challenging time. A gradual implementation of the planned structural changes has now begun. There have been no redundancies as a result of the impact of the Covid-19 pandemic. Furthermore, through a combination of employee redeployments and alterations to the timing of planned changes, fewer than anticipated exits have occurred as part of the planned structural changes. Penny James also voluntarily donated the value of her salary increase from 1 April 2020 to FareShare, a charity that redistributes surplus food to other charities that turn it into meals for those in need. These measures demonstrate our understanding that these are challenging times for everyone and that we will continue to make the decisions needed to protect the long-term interests of the Group for the good of all of our stakeholders.

Further details of decisions which the Committee has made in respect of key components of executive remuneration as a consequence of Covid-19 are summarised on pages 115 and 116.

The Group has had a good year, in difficult circumstances, demonstrating financial resilience and making significant progress against our key strategic aims despite the challenges we faced in 2020. Our objective is to turn the Group's potential into growth through combining our customer-focused philosophy, strong brands and technology transformation to become a simpler, leaner and more agile organisation. Therefore, we are committed to being a home for capable people who celebrate difference and challenge the status quo to deliver to our customers. We can only do this by empowering and developing the best people.

We also know from regular engagement surveys that our employees have remained exceptionally engaged during the challenges that Covid-19 has brought in 2020.

With this in mind I am pleased to provide an overview of our work in relation to the remuneration of both the Executive Directors and the wider workforce for the year ended 31 December 2020.

The Committee's objectives include:

- rewarding Directors for results that are generated within the risk appetite set by the Board;
- setting an appropriate framework for remuneration for the Executive Directors, Executive Committee and other senior management with enough flexibility so that the Group can attract and retain the best people for the organisation; and
- having oversight of remuneration policies throughout the Group and ensuring all our colleagues are paid fairly.

The Report is set out in the following sections:

Section	Page
Chair's statement	113 to 118
Remuneration at a glance – summarising the remuneration arrangements for Executive Directors	119
Annual Report on Remuneration – detailing pay outcomes for 2020 and covering how the Group will implement remuneration in 2021	120 to 135
Summary of the Policy approved at the 2020 AGM	136 to 139

Remuneration Policy

In last year's report, we presented an updated Directors' Remuneration Policy (the "**Policy**") to be submitted for shareholder approval at the AGM on 14 May 2020. The updated Policy included relatively minor changes to align with regulatory and governance updates, such as the introduction of a post-cessation shareholding requirement, an increase in the shareholding requirement for the CEO, and changes aimed at simplifying the remuneration structure, such as adopting a straight-line performance schedule for the Annual Incentive Plan ("**AIP**") between threshold and maximum (consistent with the Long-Term Incentive Plan ("**LTIP**"). The updated Policy was approved by shareholders, with 97.55% of votes cast in favour, and the Committee has implemented this Policy during 2020. During the year, the Committee has taken full account of the 2018 Corporate Governance Code (the "**Code**") in our discussions and remuneration practices. The full Policy can be found on the Direct Line Group website, under the 'Results and Reports' heading of the Investors page, and on pages 128 to 138 in the 2019 Directors' Remuneration Report. In our Remuneration at a glance section on page 119, we summarise the performance outcomes against our remuneration framework, in the context of how the Policy was applied in 2020.

Covid-19 trigger factors

The Committee proactively considered the impact of Covid-19 throughout the year, beginning in late March when the Committee established a set of principles to assess its decisions. These were developed with the key overarching aim of ensuring that pay decisions for 2020 were set at a reasonable level and appropriate with reference to all our stakeholders and the external economic backdrop. They were set, and continue to be referred to, as follows:

Principle	Description	Committee end of year assessment
Dividends and shareholder experience	The Committee would consider the extent to which cash dividends have been paid over 2020, and hence the alignment of pay decisions with shareholder experience.	Following consultation with the PRA, the Group re-started dividends following the HY2020 results and also paid a catch-up dividend in respect of the cancelled 2019 final dividend. 2019 and 2020 pay outcomes are therefore aligned with the experience of our shareholders.
Regulatory factors	The Committee would be mindful of the PRA's request that insurers consider the need to protect policyholders and "maintain safety and soundness" when making decisions on variable remuneration.	The Group consulted with the PRA before re-starting dividends and concluded that the Group was financially strong. Decisions on pay outcomes for senior leadership and the wider workforce for 2020 reflect the Group's performance.
Direct government support	The Committee would consider whether the Company had used any direct government support, such as the Coronavirus Job Retention Scheme, VAT deferral, or business interruption loans.	The Group has not sought or received any direct government support during the year.
Wider workforce	The Committee would consider whether the Company has made (or intends to make) any staff redundancies as a result of Covid-19, or other impacts on the wider workforce such as salary freezes, the scaling back of salary increases or incentive opportunity reductions. The Committee would ensure that management are treated consistently with the approach for the general workforce.	<p>No staff redundancies were made as a result of Covid-19, and the Committee supported the Group's decision to delay planned redundancies as a result of the restructuring programme to provide job security for colleagues. The Committee noted that the number of redundancies was reduced as a result of re-deploying some employees.</p> <p>Management outcomes are consistent with the wider workforce – the AIP outcome is the same across the Group and senior leadership salary increases are nil for 2021 (the wider workforce received increases of between 1.5% to 2%).</p>
Non-financial impact	The Committee would consider any adverse impact in respect of customer experience, reputation or regulatory relationship during 2020.	The Group has provided exceptional service to customers during the year, as illustrated in the outturn of the Customer element of the AIP. The Committee is proud of the measures the Group took to support customers and local communities.
Shareholder expectations	The Committee would consider the expectations of institutional shareholders and proxy voting agencies.	The Committee carefully considered the expectations of shareholders and proxy agencies in determining 2020 remuneration outcomes and is satisfied that the decisions are consistent with these expectations.

Covid-19 impact on executive remuneration

The following table summarises the key components of executive remuneration and the decisions made by the Committee:

Committee decision	Rationale
2019 bonus (AIP)	
To pay the bonus in the normal manner with no adjustment.	<p>The 2019 bonus reflected the Company's good performance in a challenging year of change, before the impact of Covid-19.</p> <p>All eligible employees received their 2019 bonuses.</p> <p>At the time that 2019 bonuses were paid, it was expected that the 2019 ordinary final dividend would be paid in May 2020.</p> <p>It was agreed in April 2020 that Executive Directors would not be considered for any further bonuses until dividends for ordinary shareholders resumed (which was announced in August).</p> <p>The Company's balance sheet and liquidity remain strong.</p>
2020 salary rises	
<p>To increase the level of base salary of the CEO in line with the average rise made to all employees.</p> <p>The CEO voluntarily donated the increase to charity for the 2020 financial year.</p> <p>The CFO did not receive an increase, due to his joining date in the final quarter of 2019.</p>	<p>The Company made its commitment to all eligible employees to receive a salary increase for the 2020 financial year, prior to the impact of Covid-19, and felt it was important to meet this commitment to our hard working colleagues.</p> <p>During the year, we have made a commitment not to furlough any employees as result of Covid-19.</p>
2020 bonus (AIP)	
<p>The Committee has used the performance conditions and weightings agreed at the start of the year.</p> <p>However, in relation to the People metric, the set of indicators was refined to refocus on a few key indicators given the external circumstances and wider impact of Covid-19.</p>	<p>The Company committed publicly to the operation of a bonus plan for all eligible employees for 2020. The Company performance conditions are the same for employees and Executive Directors. A formulaic assessment of achievement against the financial and strategic elements was carried out. Profit before tax performance was above the maximum level set at the start of the financial year. However, the Committee recognises that the pandemic has had both positive and negative results on our financial performance. Examples include direct effects arising from reduced claims frequencies, refunds as a result of offering customers the opportunity to adjust their policy terms as well as the Group's charitable donations and community actions. After rigorous debate, the Committee determined that it was appropriate to apply a discretionary downward adjustment of 10% to the financial outturn of the AIP to 90% of maximum. The overall AIP outturn is 82% of maximum.</p>
2017 LTIP vesting	
The Committee approved the vesting of the March and August 2017 LTIP awards without adjustment during 2020.	<p>The 2017 LTIP measured performance over three years (up to 31 December 2019 for RoTE, and up to the vesting date for TSR).</p> <p>The value of the shares on vesting reflected the share price experience of shareholders.</p>
2020 LTIP grant	
<p>The Committee approved the grants of the 2020 LTIP awards on the normal timetable and made no changes to the performance conditions and targets agreed with shareholders.</p> <p>The Company followed its normal practice of using the three-day average share price immediately before the date of grant to determine the number of shares awarded.</p>	<p>The LTIP performance conditions are based on the long-term RoTE and TSR and therefore remain appropriate.</p> <p>Despite the initial decline experienced in our share price in March 2020, similar to the declines experienced across the market, overall the Company's share price has been less adversely affected by Covid-19 than that of many other companies and recovered well during the year.</p> <p>'Windfall gains' were considered before granting the March and August 2020 LTIPs. The Committee also took the opportunity to agree and document certain circumstances that might trigger the Committee to commence a 'windfall gains' review at vesting, including reviewing share price analysis over time versus the sector and our peers.</p> <p>The Committee will assess the value of the 2020 LTIP awards at vesting and will ensure that the final outturns reflect all relevant factors, including consideration of any 'windfall gains.'</p>

Wider workforce engagement and pay considerations for 2020

The Committee has consistently considered wider employee pay as context for the decisions it makes. Every year we review and act on the outcome of our DiaLoCue People Survey. The Chair of the Committee has attended meetings of the Group's Employee Representative Body ("ERB") since 2018, at appropriate times during the year. However, given the unprecedented activity of the ERB during 2020, it was not possible for the Remuneration Committee Chair to attend directly, but I have been kept abreast of matters by the Chief People Officer and Chief Executive Officer throughout the year. Our existing workforce engagement is strengthened through internal social networking, "town halls" and other forums. To supplement this, the Committee receives papers setting out details of all-employee pay and workforce policies across the Group at each meeting. We found that this standing agenda item gave us further valuable insight and context for framing executive pay and policies.

The Committee considers it important to monitor and assess internal pay relativities and takes these into account when determining Executive Director remuneration. Early adoption of the CEO pay ratio disclosure in 2018 emphasised the Committee's intention to do so. Option A was adopted to report the employee pay ratio last year to better reflect the diverse range of job roles across the business, (see page 129), and the Committee continues to review the annual CEO pay ratio disclosures.

During 2020, the Group further built on its commitment to ensure that all of our people are rewarded fairly and have an interest in the success of the Group, with a minimum salary increase of £500 in 2020, bringing the minimum salary across the Group to £19,500 in the UK.

We are also pleased that, through our continued focus on building an inclusive organisation, we have maintained our female representation in senior jobs in line with the Women in Finance Charter target of 30% during 2019 and 2020, and we will continue with the programmes underway to further reduce our gender pay gap. The Group's Gender Pay Gap Report can be found at www.directlinegroup.co.uk.

Performance and incentive outcomes for 2020

During 2020, the management team has worked extremely hard to launch the refocused strategy and is proud of the Group's performance in the past year.

The Group delivered good results in a challenging market with a strong capital position supported by our successful customer-focused strategy and our investment in future capabilities. This performance is reflected in the incentive outcomes for our Executive Directors. No adjustments to the performance targets set at the beginning of the year were made as a result of Covid-19. When assessing the formulaic outcome of the 2020 AIP, the Committee agreed that a discretionary downward adjustment to the financial metric was appropriate. Further details are set out in the following section. No discretion was exercised in respect of LTIP awards vesting during the year, which reflect the Group's strong performance over the last three years.

AIP

Financial resilience, whilst supporting our customers, people and local communities during this extraordinary period, has helped us to achieve strong underlying results in 2020, exceeding the financial plan for the year. This has led to a profit before tax of £451.4 million, which formulaically results in a maximum performance outturn for this element. However, the Committee recognises that the Covid-19 pandemic has acted both positively and negatively on our financial performance. Some of these influences relate to macro market trends, whereas others can be more directly linked to Covid-19 either as direct effects (for example, reduced motor claims frequencies, as a result of reduced travel during national lockdowns, and reduced motor premiums due to refunds offered to customers for reduced mileage expectations), or through choices the Group has made to manage through the pandemic (such as our charitable donations and supporting colleagues working from home). Therefore, after rigorous debate, the Committee determined that it was appropriate to apply a discretionary downward adjustment of 10% to the financial outturn of the AIP to 90% of maximum.

The Committee is pleased to report this year that performance across the Customer measures was extraordinary and awarded a maximum outturn for this element. The People measures were assessed as being between target and maximum. Although management has made significant progress on successfully landing much of the major technology transformation elements in 2020, there has been slower than expected progress on the cost reduction agenda on which the Shared objective was measured. Therefore the Committee awarded an outturn of 50% of maximum for this element. The overall AIP outcome for the Executive Directors for 2020 (after the application of downward discretion) was therefore 82% of maximum. In line with the Policy, 40% of any AIP award will be deferred for three years under the Deferred Annual Incentive Plan ("DAIP"). Full details on the outcomes for the year are included on pages 123 to 126.

LTIP

The Group grants LTIP awards in two tranches each year. RoTE performance (60% of the award) is measured over three financial years. Relative TSR performance (40% of the award) is measured over the three-year period from the date of grant. All LTIP awards granted to Executive Directors in August 2017 or later are subject to a two-year holding period after vesting. The March 2017 and August 2017 LTIP awards (which vested during 2020) were granted before the appointment of Penny James and Tim Harris; however, the outcomes of these awards are relevant to certain former Directors. The overall outcome of the March 2017 and August 2017 LTIP awards was 70.8% and 78.0% of maximum respectively. Performance under each metric was as follows:

- As disclosed last year, average RoTE performance of 20.4% over 2017, 2018 and 2019 was above the maximum target level of 18.0%, leading to a maximum payout for this element. In calculating the RoTE achievement, the reported RoTE for 2018 was adjusted downwards to exclude the favourable impact of the capital management exercises executed in the 2017 financial year on the outcome for these awards. Consistent with the regulation, the value in respect of this element was disclosed in last year's Report.

- Relative TSR performance was above the threshold performance level for both the March and August 2017 LTIP awards (based on performance over the three-year period from the date of grant of each award), leading to vesting of 26.9% and 45.1% of maximum respectively for this element.
- Penny James joined the Group in November 2017 and was granted an LTIP award at that time in respect of 2017. The RoTE performance was assessed over the same three-year period as the March and August 2017 LTIP awards. Relative TSR performance was above threshold (based on performance over the three-year period from the date of grant), leading to vesting of 51.5% of maximum for this element. The overall outcome for this award was therefore 80.6%.

The March and August 2018 LTIP awards are due to vest in 2021, subject to the Committee's satisfaction that the financial and risk underpins have been met at the end of the vesting period. These awards were granted before Tim Harris's appointment, and have the following characteristics:

- Average RoTE performance of 20.7% over 2018, 2019 and 2020, is above the maximum target level of 20.5%, and therefore this element will vest at the maximum level (subject to the above underpins). In calculating the RoTE achievement, the reported RoTE for 2018 was adjusted downwards to exclude the favourable impact of the capital management exercises executed in the 2017 financial year on the outcome for these awards.
- As performance under the relative TSR element is based on the three-year period from the date of grant, the outcomes in respect of this element are not yet known. Consistent with the regulations, as the performance period for the TSR elements of the 2018 LTIP is not yet complete, the outcome will be reported separately next year. Accordingly, we have included an estimated value of the RoTE vesting outcomes for the 2018 LTIP awards, plus the TSR vestings from the 2017 LTIP awards, in the single figure remuneration table for 2020 for the Executive Directors.

Committee decisions on outcomes

As mentioned, the Group has delivered a good performance this year in extremely challenging circumstances and the overall outcomes for the annual bonus resulted in a payout (after application of downward discretion) of £1,166,296 for the CEO and £767,725 for the CFO, which the Committee believes is appropriate in the context of the Group's performance in 2020. The Committee believes that the application of downward discretion to the profit before tax outturn of the AIP was appropriate and balanced in light of the positive and negative effects of Covid-19 on our financial performance. This demonstrates that the Policy (which provides the Committee with such discretionary powers) operated as intended during the year.

The level of vesting of the LTIP awards made in 2017 was considered appropriate in the light of the Group's performance over the three-year performance period, and therefore no discretion was exercised in relation to these awards.

Approach to pay in 2021

No change to the overall approach to pay is anticipated for 2021. Neither the CEO nor CFO will be awarded a salary increase, consistent with the approach we have taken across our senior leadership population given the challenging external economic climate. Salary increases will be awarded for the wider workforce population, in recognition of their hard work during this challenging period. The wider workforce will receive increases of between 1.5% and 2%.

No change will be made to the weightings of the metrics under the AIP. The approach to assessment will focus on performance measures agreed at the start of the year.

We are not proposing any changes to the performance conditions for the 2021 awards under the LTIP. Likewise, the target RoTE scale of 17.5% to 20.5% will remain at the same level as in 2020 and reflects an appropriate performance range in the context of the Group's planned underlying RoTE performance.

As part of the wider Committee oversight on all-employee pay matters, the Committee can confirm that the Group will maintain the minimum salary level across the Group, that is 5% above the Living Wage Foundation rate outside London, and 15% higher than the Government's current National Minimum Wage. We continue to want our employees to have direct interest in the ownership of the Group. As such, the Committee approved a grant of free shares (under the Company's Share Incentive Plan) to all employees in 2021 to recognise their invaluable contribution to the business and the desire to strengthen shareholder alignment across the Group. In addition, a £400 one-off 'thank you' bonus will be awarded in April 2021 to everyone who is not usually eligible for a bonus as part of their contract.

Committee performance

The Committee's performance was assessed as part of the annual Board evaluation. I am pleased to report that the Committee is regarded as operating effectively and the Board takes assurance from the quality of the Committee's work.

Your AGM vote

The Committee welcomes investor feedback on an ongoing basis and this Report seeks to describe and explain our remuneration decisions clearly. At this year's AGM you are being asked to vote on a resolution for the Directors' Remuneration Report. I hope that, having read the information in this Report, and considering the performance of the Group during 2020, you will vote in support of the Directors' Remuneration Report at the AGM.

Should you have any questions about my Committee's Report please email our AGM email address shareholderenquiries@directlinegroup.co.uk and I or one of my colleagues at Direct Line Group will respond to you.

Yours sincerely,



MARK GREGORY

Chair of the Remuneration Committee

Remuneration at a glance

Remuneration outcomes for 2020

Executive Directors' total pay

Base salary Pensions and benefits Annual bonus LTIP

Find out more on page 122

AIP achievement

This chart illustrates the actual amounts earned from the AIP and reflecting performance in 2020. 60% of the amount is payable in March 2021 and 40% will be deferred into shares for three years.

Actual (% of salary) Maximum (% of salary) Actual (£)

Find out more on pages 123-126

LTIP

Shareholding at 31 December 2020

This chart illustrates the number of shares held at the end of 2020 by the Executive Directors against the share ownership guidelines of 250% of salary for the CEO and 200% of salary for the CFO.

2020 Guideline

Find out more on page 133

Release of value under the LTIP

This chart illustrates the total value of the 2017 LTIP awards that vested in 2020.

Shares under award Reinvested dividends

Find out more on page 127-128

Annual Report on Remuneration

Introduction

We have prepared this Report in accordance with the requirements of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended) (the "**Regulations**"). The Report also meets the relevant requirements of the Listing Rules of the FCA and describes how the Board has complied with the principles and provisions of the Corporate Governance Code relating to remuneration matters. Remuneration tables subject to audit in accordance with the relevant statutory requirements are contained in this report and stated to be audited. Unless otherwise stated, the information within the Report is unaudited.

Committee members and governance

The following list details members of the Committee during 2020. You can find information about each member's attendance at meetings on page 87. You can find their biographies on pages 78 to 80.

Committee Chair

Mark Gregory¹

Non-Executive Directors

Mike Biggs²

Danuta Gray³

Sebastian James

Notes:

1. Mark Gregory joined the Committee on 9 May 2019 and was appointed as Chair of the Committee with effect from 26 October 2020.
2. Mike Biggs stepped down as Chair of the Board with effect from 4 August 2020.
3. Danuta Gray succeeded Mike Biggs as Chair of the Board with effect from 4 August 2020.
4. Richard Ward joined the Committee with effect from 1 January 2021.

Advisers to the Committee

The Committee consults with the Chief Executive Officer, the Chief People Officer, and senior representatives of the HR, Risk and Finance functions on matters relating to the appropriateness of all remuneration elements for Executive Directors and Executive Committee members. The Chair of the Board, Chief Executive Officer and Chief People Officer are not present when their remuneration is discussed. The Committee works closely with the Chairs of the Board Risk Committee and the Audit Committee, including receiving input from those Chairs regarding target-setting and payouts under incentive plans, and whether it is appropriate to apply malus and/or clawback. The Chair of the Board Risk Committee attended Committee meetings on three occasions in 2020. The Remuneration and Board Risk Committees can also hold joint meetings to consider matters of common interest.

The Committee appointed PricewaterhouseCoopers LLP ("**PwC**") as its independent adviser from 1 January 2019 following a competitive tender process. PwC is a signatory to the Remuneration Consultants Group's Code of Conduct.

During the year, PwC advised on market practice, corporate governance and regulations, incentive plan design and target-setting, recruitment, investor engagement and other matters that the Committee was considering. PwC supported the Group in several ways, including the provision of IFRS 17, tax, technology consulting and immigration services during 2020. The Committee is satisfied that the advice PwC provided was objective and independent.

PwC's total fees for remuneration-related advice in 2020 were £78,500 excluding VAT. PwC charged its fees based on its standard hourly rates for providing advice.

Allen & Overy LLP, one of the Group's legal advisers, also provided legal advice relating to the Group's executive remuneration arrangements. It also provided the Group with other legal services.

Alignment to Provision 40 of the Corporate Governance Code

The following table summarises how the Remuneration Committee has addressed the factors set out in Provision 40 of the 2018 UK Corporate Governance Code.

<p>Clarity Remuneration arrangements should be transparent and promote effective engagement with shareholders and the workforce.</p>	<ul style="list-style-type: none"> - The remuneration arrangements for the Executive Directors are set out in a clear and simple way in the Directors' Remuneration Policy ("Policy") and in the plan rules for each incentive plan. - Guides are accessible explaining how each incentive plan operates via the employee portal to ensure full understanding. - The Committee is committed to transparent disclosure – full details of incentive targets and outcomes are published in detail in the Annual Report on Remuneration each year. - Queries on remuneration practices from shareholders or the workforce are welcomed by the Committee throughout the year and encouraged at the AGM and at the Group's regular Employee Representative Body ("ERB") meetings.
<p>Simplicity Remuneration structures should avoid complexity and their rationale and operation should be easy to understand.</p>	<ul style="list-style-type: none"> - The Group's remuneration arrangements are intentionally simple in nature and well understood. Executive Directors (and senior leadership) receive fixed pay (salary, benefits, pension), and participate in a single short-term incentive (the "AIP") and a single long-term incentive (the "LTIP"). - The Committee reviews the appropriateness of targets annually, being mindful of alignment with strategy and keeping them simple.
<p>Risk Remuneration arrangements should ensure reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated.</p>	<ul style="list-style-type: none"> - The ability to mitigate potential risk associated with remuneration is built into the Policy. Examples include: <ul style="list-style-type: none"> - the Committee's discretionary powers to amend the formulaic outcome from incentive awards (for example, where not consistent with performance); - the inclusion of malus and clawback provisions under a wide range of potential scenarios; and - in-employment and post-employment shareholding requirements. - The Committee considers that the incentive arrangements do not encourage inappropriate risk-taking, due to the Committee's rigorous process for reviewing incentive outcomes, which includes seeking the view of the Chair of the Board Risk Committee before making its final variable pay determinations. - The Committee also considers that the Policy provides wide-ranging flexibility to adjust payments where outcomes are not considered to reflect underlying business performance and individual contributions, or where behaviours are inconsistent with the risk appetite of the Group.
<p>Predictability The range of possible values of rewards to individual directors should be identified and explained at the time of approving the Policy.</p>	<ul style="list-style-type: none"> - Full information on the potential values of the AIP and LTIP are provided, with strict maximum opportunities and minimum, target and maximum performance scenarios provided when the Policy was approved. - An indication of the potential impact of a 50% share price appreciation on the value of LTIP awards is also included.
<p>Proportionality The link between individual awards, the delivery of strategy and the long-term performance of the Company should be clear. Outcomes should not reward poor performance.</p>	<ul style="list-style-type: none"> - Payments under variable incentive schemes require robust performance against challenging conditions over the short and longer term. The Committee considers the formulaic outcome, as well as other relevant factors, when making decisions on remuneration outcomes. - Outcomes do not reward poor performance due to the Committee's overriding discretion to depart from formulaic outcomes which do not reflect underlying business performance. - Performance conditions consist of both financial and non-financial metrics to support Group strategy, including measures focused on delivering for our customers (for example, Net Promoter Score and complaints), our people (diversity and engagement) and our shareholders (profit before tax and TSR).
<p>Alignment to culture Incentive schemes should drive behaviours consistent with company purpose, values and strategy.</p>	<ul style="list-style-type: none"> - The Committee oversees consistent workforce reward principles and is satisfied that these policies drive the right behaviours and reinforce the Group's values, which in turn promote an appropriate culture. - Our values are reflected in the measures used in our incentive schemes. In particular, our incentive arrangements link to the following values: <ul style="list-style-type: none"> - Do the right thing – AIP and LTIP performance measures incentivise participants to choose the right path for our customers, our people and shareholders by using measures which directly assess outcomes for these stakeholders. - Work together – the Shared element of the AIP requires our Executive Directors and senior leadership to work together to deliver key results to our stakeholders. - Take ownership – financial targets under the AIP are the same for all participants, regardless of seniority, linking everyone's individual contribution to AIP reward outcomes. - The use of annual bonus deferral, LTIP holding periods and our shareholding requirements strengthen the focus on our strategic aims, and ensure alignment with the interests and experiences of shareholders, both during and after employment.

Implementing policy and pay outcomes relating to 2020 performance
Single figure table (Audited)

		Salary ¹	Benefits ²	Annual bonus ³	Long-term Incentives ^{4,5}	Other ⁶	Pension	Fixed pay and benefits sub-total	Variable remuneration sub-total	Total
£'000										
Penny James	2020	813	26	1,166	1,110	–	73	912	2,276	3,188
	2019	755	35	1,005	871	–	107	897	1,876	2,773
Tim Harris	2020	535	14	768	–	–	48	597	768	1,365
	2019	134	3	178	–	198	12	149	376	525

Notes:

1. Salary – the Company operates a flexible benefits policy, and salary is reported before any personal elections are made.
2. Benefits – include a company car or allowance, private medical insurance, life assurance, income protection, health screening and discounted insurance. The CEO uses a car service for travelling on journeys between home and office; the Group also pays for any associated tax liability that arises on this benefit.
3. Annual bonus – includes amounts earned for performance during the year but deferred for three years under the DAIP. For more information, see page 133. These deferred awards are normally subject to continuous employment. However, awards remain subject to malus and clawback.
4. The 2019 LTIP figure for Penny James disclosed in the 2019 Report should have included the value of the RoTE element of her LTIP award granted in November 2017, which was based on average RoTE over 2017, 2018 and 2019. As disclosed in last year's Report, the performance outcome for this element was 100% of maximum. The 2019 LTIP figure has been restated this year to include that value, based on the share price at the date of vesting (28 November 2020) of £2.97. The 10-year CEO history and 2019 CEO pay ratios have been updated accordingly.
5. The 2020 LTIP figure for Penny James reflects the relative TSR element of her November 2017 LTIP award and the RoTE element of her 2018 awards. The value is calculated based on the share price at date of vesting for the November 2017 LTIP award, of £2.97, and a three-month average share price to 31 December 2020 of £2.91 for the 2018 awards. Further information on LTIP awards can be found on pages 127-128.
6. The 2019 "Other" figure for Tim Harris relates to the amount in respect of his buyout awards, disclosed in the 2019 Report. The award is not subject to any performance conditions, and the value of this award is based on a share price at the date of grant (1 October 2019) of £2.99.

Each Executive Director has confirmed they have not received any other form of remuneration, other than that already disclosed in the single figure table.

Annual Incentive Plan outcomes for 2020 (Audited)

The chart illustrates the final assessment of the level of achievement under the AIP and total outcome approved by the Committee.

Performance measure and weighting	Performance achievement 2020	Outcome 2020
20% Shared	55% Financial	49.5%
10% People		15.0%
15% Customer		7.5%
		10.0%
		Total 82%

Executive Director	Achievement under the 2020 AIP	2020 AIP payment
Penny James	82% of maximum	£1,166,296
Tim Harris	82% of maximum	£767,725

40% of any AIP award is deferred into shares under the DAIP, vesting three years after grant.

Financial element (55% weighting)

The financial performance measure is profit before tax. The Committee established threshold and maximum performance levels at the start of the year and did not adjust the targets during the year. In the table below, we have disclosed the target set for profit before tax performance.

The approach taken to assessing financial performance against this measure was based on a straight-line outcome between 10% for threshold performance and 100% for achievement of maximum performance.

A formulaic assessment of achievement against the financial and strategic elements was carried out. Whilst the financial plan for the year did not reflect any impact of the Covid-19 pandemic, the Committee sought quantitative data and qualitative information summarising losses and gains from the impacts of the pandemic. After a rigorous assessment, the Committee agreed to make a discretionary downward adjustment of 10% against the financial target component of the 2020 bonus. The outcome from 2020 performance against the financial measure was 90%, giving a total of 50% out of 55% attributable to this element. A summary of the assessment is provided in the following table.

Measure	Threshold 10%	Maximum 100%	2020 Actual	Formulaic 2020 Achievement ¹	Adjusted 2020 Achievement ²
Profit before tax	£356m	£428m	£451m	100%	90%

Notes:

1. Formulaic outcome
2. Outcome including discretionary downward adjustment

Customer element (15% weighting)

We put our customers at the heart of everything we do. Our long-term sustainability is driven by understanding customers' needs and acting in their best interests. As part of our customer strategy, and to ensure that the business strives to achieve a sustained and competitive level of service, the Board sets challenging customer-centric KPIs. These are intended to ensure that remuneration is aligned with and supports continuous improvement.

Throughout the changing world around us in 2020 we adapted quickly so that we could deliver more for our customers at speed and help them navigate disruption in their lives. Our determination to deliver the best possible customer value and experience drove our response to Covid-19. This drove best-ever and long-term improving performance in 2020. Our brands performed well (mainly top quartile) across the majority of insurance customer experience benchmarking studies.

Having considered performance against targets and an assessment of the quality of performance achieved, the Committee determined that a maximum outturn for the Customer measures was appropriate, giving a total of 15% out of 15% attributable to this element. A detailed assessment of the Customer measures is set out below.

Measure	Assessment
Net promoter score ("NPS") Improvement of customer advocacy across the Group	<ul style="list-style-type: none"> - We are proud that our NPS scores have yet again demonstrated the willingness of our customers to recommend our brands year on year, especially with Direct Line. - Our NPS scores measure the likelihood of our customers to recommend one of our brands and showed strong year-on-year performance, exceeding target and achieving top-quartile performance in a range of independent benchmarking studies. - Strong brand NPS scores on Direct Line and Churchill continue with motor claims and renewals journeys showing particularly positive performance. - Rescue claims NPS performance ended the year well ahead of target. Record performance levels have been sustained across the year including during summer holidays as 'staycation boom' put pressure on our recovery network and migrating our systems to a new operating platform. - We continued to enhance digital capabilities for customers needing to claim, amend and renew policies to meet even more customer needs.
Complaints Reduction in complaints volume and process improvements	<ul style="list-style-type: none"> - The volume of complaints reduced significantly in 2020 to lowest ever levels. However, focus on continual improvement and taking learnings from dissatisfaction helped ensure that our customer outcomes continue to be positive. - A large spike of travel claims post 'lockdown' in Q2 led to significantly increased workloads and to mitigate this with the minimum impact to our customers, large numbers of staff were cross-trained to handle the increased volume of claims customer queries.
MyCustomer Transaction customer experience performance measuring our people/calls	<ul style="list-style-type: none"> - Over 1.2 million responses from customers across the Group have provided feedback on the experience delivered by our people. 84% (Claims) and 90% (Customer Operations) of customers rated our people as 9 or 10 out of 10. - MyCustomer performance in Customer Operations and Claims Operations achieved record levels during 2020 despite the challenges we faced in migrating a workforce from office to home working in an extremely short period. - Customers recognised the extraordinary levels of service provided and this was frequently acknowledged with many comments referring to our peoples excellence and the Group's approach to adjusting products, processes and pricing in this period.

Measure	2020 Achievement
Customer	100%

People element (10% weighting)

For the People element of the AIP, the Board set a range of people measures specifically around leadership, diversity and inclusion and employee engagement, reflecting the importance of these agendas to the success of the Group. Early into H2, the set of indicators was refined to refocus on a few key measures given that leadership effectiveness and engagement became most critical in our response to the Covid-19 pandemic. At year end, the Committee considered that performance across these measures had continued to improve on an already strong H1 performance against stretching targets. This was particularly laudable given the ongoing uncertainty caused by the pandemic, balanced with the re-initiation of a number of transformation activities in line with our strategic objectives. The Committee judged the performance against the People element to be above target, giving a total of 7.5% out of 10% attributable to this element. A detailed assessment of the People measures is set out below.

Measure	Assessment
Leadership effectiveness & succession Enable the transformation of the Group by bringing about a shift in leadership style. Ensure there is good succession cover and that we are building high-quality talent pipelines of future leaders	<ul style="list-style-type: none"> - To support our leadership community through the challenges of Covid-19, we invested in improving their ability to lead a more dispersed, digital and agile organisation through various leadership development initiatives including storytelling training, agile coaching and developing and launching a new Leadership Discovery programme. This is a six-month blended learning experience combining masterclasses, 360-degree insights and ongoing peer coaching to accelerate adoption of our behaviours. - We have measured progress in leadership effectiveness by creating a leadership index that was measured regularly throughout 2020 indicating the extent to which colleagues felt positive about our leaders and the decisions they were making. This has shown that there is a high level of trust in our leaders with 84% positivity at the end of 2020. - To prepare future successors we made a number of internal talent moves in 2020 and provided broadening experiences as well as promotional moves to some of those who feature in our talent pools. The gender diversity of our succession pipeline is now extremely strong, something we have improved again in 2020. - Finally, we maintained our commitment to recruiting graduates into our future leaders' programme and have continued to rotate those already on the programme to provide a broad set of early-career experiences. We successfully recruited a further 12 graduates and 51 apprentices in 2020.
Diversity Ensure the Group is a diverse and inclusive place to work where differences are respected, valued and celebrated	<ul style="list-style-type: none"> - Since becoming a signatory to the Women in Finance Charter, we have recruited, developed and promoted more women into senior roles. Women now account for 30% of our senior leadership (2019: 31%, 2018: 28%, 2017: 25%, 2016: 22%) and we are looking forward to working towards our next milestone of 35% female representation in our senior leadership by the end of 2022. We have continued to invest in supporting the development of our female leaders through external programmes and coaching mentoring support. - We gathered deeper insights via an employee survey where around two thirds of our people shared their perceptions and experiences on diversity and inclusion, which has informed an updated strategy, with greater ambition and reach. - We established BAME and Black representation targets within the organisation for the first time and signed Business in the Community's Race at Work charter to demonstrate our commitment to race inclusion. - Our #WeCare campaign celebrated the diversity of our people by sharing stories to build a greater understanding of difference and reinforce a culture where our people can 'bring all of themselves to work'. - We have strengthened senior leadership sponsorship for our Diversity Network Alliance, which promotes, champions and supports diversity and inclusion within our business.
Engagement Ensure we are fully engaged with our employees via the DiaLoGue programme, including throughout the business transformation process, with leaders setting the tone demonstrating the Group's Values and Behaviours in all aspects of their role	<ul style="list-style-type: none"> - At the start of the pandemic we adopted lighter touch and more regular employee pulse surveys in contrast to our usual bi-annual in-depth process. Short pulse surveys were initially run on a weekly basis and as pandemic conditions gradually stabilised they extended to fortnightly and eventually monthly frequency. - Throughout the year, we continued to achieve high participation levels (64% average), gathering a mix of quantitative and qualitative data across a range of topics including some key themes like sentiment, mental health, leadership, engagement and productivity. - Our ability to check in and monitor engagement, sentiment and wellbeing in a more adaptive way was critical during 2020, allowing leaders to benefit from rapid access to results and to design for relevant, targeted actions to address themes, share ideas or build solutions. - In addition, we re-designed many of our Group-wide high-profile engagement activities such as our coveted Chief Executive Awards programme to be delivered virtually. Our teams and leaders have creatively risen to the challenge of keeping motivation, support and engagement as high as possible through such a testing period. - In 2020, our mid-year engagement score was 1% off our highest ever score at 80%, having improved by 2pts from the preceding survey and 4pts year on year. However, towards the end of 2020 as the new wave of lockdowns hit, this dipped by 6% to 74%. This is in line with the shape other organisations are reporting. Although we are consistent with upper quartile high-performing companies, we were slightly below the threshold target of maintaining 2019 engagement levels at 78%.
Measure	2020 Achievement
People	75%

Shared element (20% weighting)

For the Shared element of the AIP, the Board set a range of strategic measures specifically around technology and business transformation and cost savings, with the aim of ensuring the Group has the capabilities and cost base to ensure its sustained success. The Committee considered the delivery of the major technology transformation programmes, for which specific measures and milestones were set; and for the cost objective the Committee focused on the progress to achieve a reduced cost base. The Committee therefore agreed an outturn of 50% for the Shared measures, giving a total of 10% out of 20% attributable to this element. A detailed assessment of the technology transformation and costs measures is set out below.

Measure	Assessment	2020 Achievement
<p>Technology transformation Progress and delivery of several technology investment programmes on time and on budget, to deliver new capability benefits</p>	<ul style="list-style-type: none"> - In the first half of the year, we transitioned to full-scale home working, whilst carrying out major system changes. Where appropriate we deferred certain elements of programmes, primarily to mitigate potential risks arising from system stability and programme complexity, and to reprioritise resources to Covid-19-related work. These actions have been well managed and controlled. - Our major programmes successfully navigated the impacts of Covid-19 and mitigated delays to the extent possible, delivering a significant amount of change in a highly challenging environment. - We launched a number of customer-facing systems, including: <ul style="list-style-type: none"> - a Green Flag claims engine delivering significant uplift in platform flexibility and customer service; - retooling of NIC 'complex' business including improving pricing sophistication; - the main product builds of the new Direct Line for Business platform, including Tradesperson and Van and the full-cycle end-to-end delivery model established for ongoing change; - major Finance transformation which has moved core finance systems to the cloud; and - deployed a new telephony system and migrated our mainframe. - Alongside launching new systems, we have made good progress on setting the foundations for changes to come in 2021. - We continued to make significant steps to put Churchill and Direct Line onto our new motor system meeting key technical deployment milestones; whilst overall operational deployment has been slower due to the build of additional scope and impact of Covid-19 on delivery. 	
<p>Costs Development and execution of activities to deliver a sustainably lower cost base to support future quality of earnings</p>	<ul style="list-style-type: none"> - Despite a strategic ambition to progress towards our target of reducing operating expenses, they increased during 2020 by £30.7 million to £724.4 million. The increase in costs was entirely due to investment in initiatives to protect our customers, people and society from the impact of Covid-19. - In total these initiatives are estimated to have increased operating expenses by £34 million and in some cases had the effect of delaying cost-saving programmes which were planned for 2020. Adjusting for these initiatives, operating expenses were broadly flat year on year. - Despite the impact of Covid-19, we have made good progress in building the capability to reduce our cost base in the future and have reiterated our 20% expense ratio target in 2023. 	
Measure		2020 Achievement
Shared		50%

LTIP outcomes for 2020 (Audited)

LTIP awards are granted in March and August of each year. Each grant is subject to the following performance conditions:

- RoTE (60% weighting) – performance is measured over three financial years starting from the 1 January preceding the March and August grants; and
- relative TSR (40% weighting) – performance is measured over a three-year period from the date of grant.

2017 LTIP awards (vesting in 2020)

Awards under the LTIP granted in March, August and November 2017 vested during 2020. They were subject to relative TSR performance over the three-year period from the date of grant, and RoTE performance in 2017, 2018 and 2019.

Consistent with the Regulations, the expected RoTE vesting outcomes for the year ended 31 December 2019 (together with the TSR elements from the 2016 awards) are included in the 2019 LTIP column of the single figure table. The performance outcomes of these elements are included in the table below.

The 2020 single remuneration figure includes the value of the 2017 TSR elements (for which the performance period ended in November 2020 for Penny James) and the awards vested shortly after. Details of the targets and performance achieved are set out in the table below (with the March and August 2017 outcomes only relating to former Directors).

The Committee was satisfied that the financial and risk underpins were met at the end of the vesting period and therefore the performance achieved against the targets and the vesting of the awards is as follows.

Award	Performance measure	Weighting	Threshold (20% of maximum)	Maximum (100% of maximum)	Actual performance	Achievement	Outcome
March 2017	RoTE (2019 single figure)	60%	15.0%	18.0%	20.4%	100.0%	60.0%
	Relative TSR (2020 single figure)	40%	Median	Upper quintile	Between median and upper quintile	26.9%	10.8%
August 2017	RoTE (2019 single figure)	60%	15.0%	18.0%	20.4%	100.0%	60.0%
	Relative TSR (2020 single figure)	40%	Median	Upper quintile	Between median and upper quintile	45.1%	18.0%
November 2017 (Penny James only)	RoTE (2019 single figure)	60%	15.0%	18.0%	20.4%	100.0%	60%
	Relative TSR (2020 single figure)	40%	Median	Upper quintile	Between median and upper quintile	51.5%	20.6%

2018 LTIP awards (vesting in 2021)

Awards under the LTIP granted in March and August 2018 will vest during 2021. They are subject to relative TSR performance over the three-year vesting period, and RoTE performance in 2018, 2019 and 2020. The RoTE performance period for these awards ended on 31 December 2020 and performance in respect of this element is set out in the table below. Performance under the relative TSR measure will be assessed at the end of the vesting periods in March 2021 and August 2021 respectively and will be disclosed in the 2021 Directors' Remuneration Report. This is subject to the Committee's satisfaction that the financial and risk underpins have been met at the end of the vesting period.

Consistent with the Regulations, the expected RoTE vesting outcomes for the 2018 LTIP awards (together with the TSR elements from the 2017 awards) are included in the 2020 single remuneration figures for the Executive Directors based on the three-month average share price to 31 December 2020. As the awards were granted before Tim Harris joined the Group, figures are for Penny James only. You can find details of this on page 122.

Award	Performance measure	Weighting	Threshold (20% of maximum)	Maximum (100% of maximum)	Actual performance	Achievement	Outcome
March 2018	RoTE (2020 single figure)	60%	17.5%	20.5%	20.7%	100%	60%
	Relative TSR (2021 single figure)	40%	Median	Upper quintile	Performance period not yet complete		
August 2018	RoTE (2020 single figure)	60%	17.5%	20.5%	20.7%	100%	60%
	Relative TSR (2021 single figure)	40%	Median	Upper quintile	Performance period not yet complete		

Directors' Remuneration report *continued*

Summary of the 2020 LTIP single remuneration figure outcomes

		Number of shares awarded (inc. dividends) subject to this performance condition	Percentage vested by reference to performance achieved	Number of shares vested	Total value of shares (inc. dividends) vested £'000
March 2018 LTIP – RoTE ¹	Penny James	136,943	100%	136,943	399
August 2018 LTIP – RoTE ¹	Penny James	141,711	100%	141,711	412
November 2017 LTIP – TSR ²	Penny James	195,421	51.5%	100,642	299
Total single figure LTIP	Penny James				1,110

Notes:

- 2018 RoTE elements are based on the three-month average share price to 31 December 2020 of £2.91.
- 2017 TSR element is based on share price on the date of vesting on 28 November 2020 of £2.97.

Using shares (Audited)

In receiving a share award, Executive Directors commit not to hedge their exposure to outstanding awards under these plans or in respect of shares they are reporting to the Company within their ownership for the purposes of any share ownership guidelines. They also agree not to pledge as collateral their participation under any of the plans or any shares which they are required to hold in the Company for any purposes, including for share ownership guidelines. There have been no changes to the share interests below since 31 December 2020.

	At 31 December 2020			Share plan interests exercised during the year to 31 December 2020		
	Share plan awards subject to performance conditions ^{2,3}	Share plan awards subject to continued service ¹	Share plan interests vested but unexercised ¹	Shares held outright	Number of options exercised ¹	Share price on date of exercise ⁴
Penny James	1,430,485	350,847	393,773	665,464	–	–
Tim Harris	741,647	87,927	–	5,785	5,388	3.24

Notes:

- These awards take the form of nil-cost options over the Company's shares. Awards accrue dividend entitlement from the grant date to the date on which an award vests. Dividends added post-vesting are shown to 31 December 2020 but are not realised until exercise.
- LTIP awards include an additional two-year holding period before awards may be released.
- Unvested awards subject to performance conditions represent LTIP awards for which 60% is based on RoTE performance and 40% on relative TSR performance. The exact targets for each award were disclosed in the relevant Annual Report on Remuneration.
- Tim Harris exercised options on 4 August 2020.

The table below shows the Non-Executive Directors' beneficial interests in the Company's shares¹.

Director	Shares held at 31/12/2020	Shares held at 31/12/2019
Mike Biggs ²	–	–
Danuta Gray	10,000	10,000
Mark Gregory	–	–
Jane Hanson	11,083	11,083
Sebastian James	5,000	5,000
Fiona McBain	–	–
Gregor Stewart	2,925	2,925
Richard Ward	–	–

Notes:

- This information includes holdings of any connected persons, as defined in section 253 of the Companies Act 2006.
- Mike Biggs stepped down from the Board on 4 August 2020.

Non-Executive Directors (Audited)

Fees were the only remuneration paid to Non-Executive Directors in 2019 and 2020. Non-Executive Directors may also claim for reasonable travel and subsistence expenses, in accordance with the Group's travel and expenses policy, and, where these are classified as taxable by HMRC, they are shown under 'Taxable benefits' below. The Non-Executive Directors receive no other benefits.

Director ¹	Fees		Taxable benefits ²		Total	
	2020 £'000	2019 £'000	2020 £'000	2019 £'000	2020 £'000	2019 £'000
Mike Biggs ³	235	400	1	5	236	405
Danuta Gray	209	110	–	7	209	117
Mark Gregory	109	101	–	0.1	109	101
Jane Hanson	120	120	3	11	123	131
Sebastian James	96	95	–	–	96	95
Fiona McBain	95	83	3	16	98	99
Gregor Stewart	115	115	2	19	117	134
Richard Ward	120	120	0.1	0.1	120	120

Notes:

1. Non-Executive Directors are not eligible to participate in any of the Group's bonus or share incentive schemes or to join any Group pension scheme.
2. The values shown under 'Taxable benefits' above comprise the value of taxable travel and subsistence expenses reimbursed by the Company (including any gross-up for tax and national insurance contributions due).
3. Mike Biggs stepped down from the Board on 4 August 2020, on which date Danuta Gray became Chair.

CEO pay ratio

In 2018, the Committee chose to adopt early the CEO pay ratio disclosure requirements. Since 2019, the Committee has determined that the appropriate methodology to be used in future years is Option A, as the Committee believes this is the most robust approach to use going forward.

The table below compares the 2020 single total figure of remuneration for the CEO with that of the Group employees who are paid at the 25th percentile (lower quartile), 50th percentile (median) and 75th percentile (upper quartile) of its employee population. The 2019 figures are also shown for comparison purposes.

Year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2020	Option A	128:1	105:1	71:1
2019 ¹	Option A	123:1	101:1	67:1

Note:

1. As required by the regulations, the CEO single figure used to determine the 2019 pay ratios is based on the sum of the total single figures of remuneration for Paul Geddes and Penny James, but with remuneration in respect of Penny's service as CFO excluded. The 2019 figures have been updated for Penny's updated 2019 single figure value (see page 122 note 4).

The UK employees included are those employed on 31 December 2020 and remuneration figures are determined with reference to the financial year ending on 31 December 2020.

Option A, as set out under the reporting regulations, was used to calculate remuneration for 2020 as we believe that it is the most robust methodology for calculating these figures. The value of each employee's total pay and benefits was calculated using the single figure methodology consistent with the CEO. No elements of pay have been omitted. Where required, remuneration was approximately adjusted to be full-time and full-year equivalent basis based on the employee's average full-time equivalent hours for the year and the proportion of the year they were employed.

Each employee's pay and benefits were calculated using each element of the employee remuneration, on a full-time equivalent basis. No adjustments (other than to achieve a full-time equivalent rate) were made and no components of pay have been omitted.

	25th percentile (P25)	Median (P50)	75th percentile (P75)
Salary	£21,487	£25,842	£39,325
Total pay and benefits	£24,885	£30,401	£44,905

Base salaries of all employees, including our Executive Directors, are set with reference to a range of factors including market practice, experience and performance in role. For reference, the CEO base salary median pay ratio is 33:1 (2019: 32:1). In reviewing the ratios the Committee also noted that the CEO's remuneration package is weighted more heavily towards variable pay (including the AIP and LTIP) than of the wider workforce due to the nature of the role, and this means the ratio is likely to fluctuate depending on the performance of the business and associated outcomes of incentive plans in each year.

As there was a change of CEO in 2019, the 2019 pay ratios were calculated based on a "hybrid" single figure of remuneration for the two CEOs during the year, as required by the Regulations. This means that the 2019 and 2020 ratios are not directly comparable. Nevertheless, the small increase in the pay ratios from 2019 to 2020 is partly attributable to the increase in the CEO's AIP and LTIP outcomes for 2020. This increase is partially offset by an increase in the total pay and benefits of employees, primarily as a result of the increase in the Group's minimum salary level in April 2020 and broader annual salary increases, as well as an increase in bonus outcomes (consistent with the CEO's AIP outcome).

Directors' Remuneration report *continued*

The Group's employees are fundamental to the Group's strategy and to ensuring a high level of service to our customers. We are proud that the high number of consultants in our customer service centres are employed by the Group (rather than being outsourced) and note that the impact of these lower-paid roles is reflected in the ratios above. Further details on the differences between the remuneration of Executive Directors and the wider workforce are set out on page 117. The Committee is satisfied that these policies drive the right behaviours and reinforces the Group's values which in turn drives the correct culture, and, for the reasons given above, it believes that the ratios are consistent with the Group's reward policies.

Percentage change in Executive Directors' and Non-Executive Directors' pay for 2019 to 2020

The table below shows the year-on-year percentage change in salary, taxable benefits and bonus (where applicable) of the Executive Directors and Non-Executive Directors, compared to the average pay for all other employees.

	Salary/Fees ¹	Benefits ²	Bonus (including deferred amount) ³
Executive Directors			
Chief Executive Officer	7.6%	(24.6)%	16.1%
Chief Finance Officer ⁴	0.0%	0.5%	7.9%
Non-Executive Directors⁵			
Mike Biggs	0.0%	(82.3)%	-%
Danuta Gray	90.1%	(100.0)%	-%
Mark Gregory	7.2%	(100.0)%	-%
Jane Hanson	0.0%	(73.1)%	-%
Sebastian James	1.0%	0.0%	-%
Fiona McBain	14.6%	(79.9)%	-%
Gregor Stewart	0.0%	(87.2)%	-%
Richard Ward	0.0%	(5.7)%	-%
All employees (average)	3.5%	(1.4)%	3.9%

Notes:

- Based on the change in average pay for employees employed in the year ended 31 December 2020 and the year ended 31 December 2019. The CEO's salary in 2019 reflected part year as CFO before promotion to CEO, therefore the increase appears larger. Actual pay increase in 2020 was 2.1%. The increase to the CEO salary from 1 April 2020 was voluntarily paid to FareShare, a charity that redistributes surplus food to other charities that turn it into meals for those in need.
- For all employees, there were no changes in benefits provision between 2019 and 2020. For the CEO the decreased value of benefits relate to the car service not used by the CEO for travelling on journeys between home and office since March, in respect of which the Group also pays for any associated tax liability that arises on this benefit. For Non-Executive Directors, benefits comprise taxable travel and subsistence expenses reimbursed by the Company (including any gross-up for tax and national insurance contributions due).
- For employees other than the CEO, this includes average amounts earned under the AIP, and other variable incentive schemes, including monthly and quarterly incentive schemes operated in certain parts of the Group. Non-Executive Directors are not eligible to participate in any of the Group's bonus or incentive schemes.
- The figure for the CFO is based on an annualised amount for 2019, as he joined in the final quarter of the year.
- For Non-Executive Directors, increased fees relate to Board changes. The decreased value of benefits relates to a decrease in travel expenses due to the Covid-19 pandemic.

Chief Executive Officer's pay between 2012 and 2020 and historical performance of TSR

The table below shows historical levels of the CEO's pay between 2012 and 2020. It also shows vesting of annual and long-term incentive pay awards as a percentage of the maximum available opportunity. This is presented against the Company's TSR since its shares began trading on the London Stock Exchange in October 2012, against the FTSE 350 Index (excluding Investment Trusts) over the same period. This peer group is the same used for measuring relative TSR under the LTIP.

Total Shareholder Return

	DLG		FTSE 350 (excluding Investment Trusts)							
	2012 ¹	2013 ¹	2014 ¹	2015	2016 ²	2017	2018	2019 ³	2019 ^{3,4}	2020 ⁵
	Paul Geddes							Penny James		
CEO single figure of remuneration (£'000s)	1,908	2,536	5,356	4,795	4,071	4,039	3,250	774	2,773	3,188
Annual bonus payment (% of maximum)	65%	63%	75%	83%	43%	88%	68%	76%	76%	82%
LTIP vesting (% of maximum) ¹	30%	55%	88%	96%	86%	99%	71%	0%	100%	80%

Notes:

1. Based on actual vesting under the 2010, 2011 and 2012 RBS Group LTIP. The value included in the single figures in respect of these awards is £205,000 in 2012, £728,000 in 2013 and £2,437,428 in 2014.
2. The 2016 single figure and annual bonus payment reflect an adjustment, made in 2019, to the original award of 20% of maximum opportunity related to the Ogden discount rate change.
3. The 2019 single figure reflects part of the year for the outgoing CEO, Paul Geddes, and the entire year for the newly appointed CEO, Penny James.
4. The 2019 single figure has been revised to reflect the actual vesting of the 2017 awards under the LTIP.
5. The 2020 single figure reflects the estimated vesting of the RoTE portion of the LTIP granted in March and August 2018. Any shares under the LTIP granted in 2018 will not be delivered until the end of the applicable vesting periods in March and August 2021. However, they have been included in the single figure, as the performance period in respect of the RoTE portion has now been completed.

Payments to Past Directors (Audited)

March and August 2017 LTIP

The table below sets out the awards which vested during the year to John Reizenstein (former CFO), Paul Geddes (former CEO) and Mike Holliday-Williams (former MD, Personal Lines), who exited the Group on 7 September 2018, 31 July 2019 and 30 September 2019 respectively:

Award	Executive Director	Number of share options awarded (inc. dividends)	Vesting proportion (inc. performance and pro-rata)	Number of share options vested	Total value of share options (including dividends) vested (£)
March 2017	John Reizenstein	167,925	35.7%	59,952	171,343 ¹
	Paul Geddes	288,554	55.6%	160,439	458,535 ¹
	Mike Holliday-Williams	196,416	59.3%	116,391	332,645 ¹
August 2017	John Reizenstein	148,752	29.4%	43,733	128,969 ²
	Paul Geddes	262,956	51.6%	135,567	399,787 ²
	Mike Holliday-Williams	180,197	55.4%	99,794	294,293 ²

Notes:

1. Based on closing share price of £2.86 on the vesting date (27 March 2020).
2. Based on closing share price of £2.95 on the vesting date (29 August 2020). LTIP awards for Executive Directors are subject to an additional two-year holding period following the three-year vesting period, during which time awards may not normally be exercised or released.

The March 2017 LTIP award vested overall at 70.8%, with the RoTE element achieving 100%, and TSR at 26.9%. The August 2017 LTIP award vested at 78.0%, with the RoTE element achieving 100% and TSR at 45.1%. All former Directors confirmed that they complied with the requirements of their individual exit agreements, which enabled the Committee to approve the vesting of these awards.

March and August 2018 LTIP

The performance period in respect of the RoTE elements of these awards ended on 31 December 2020; however, the performance periods in respect of the TSR elements of these awards end on 25 March 2021 and 27 August 2021 and the awards will vest on these dates. The value of the 2018 LTIP awards vesting for Paul Geddes and Mike Holliday-Williams will therefore be disclosed in the 2021 report.

No payments were made to any Director for loss of office during 2020.

Distribution statement

This chart shows the overall pay expenditure across all Group employees compared with the total dividend value paid to shareholders in 2019 and 2020.

Dividend (£m)

% change
(26.8)%
 Special
 Ordinary

Overall expenditure on pay (£m)

% change
1.9%

Notes:

1. On 3 March 2020, the Group announced that the Board had approved a share buyback of up to £150 million. On 19 March 2020, the Board cancelled that share buyback programme given the uncertainty in the capital markets at the time, driven by the rapidly emerging Covid-19 pandemic.
2. Following the cancellation of the dividend as announced on 8 April 2020, the final dividend for 2019 was not paid. However, a special interim dividend was subsequently paid in September 2020 reflecting a full catch-up of the cancelled 2019 final dividend.
3. The dividends paid information has been taken from note 14 to the consolidated financial statements. The overall expenditure on pay has been taken from note 10 and therefore, consistent with market practice, it has not been calculated in a manner consistent with the single figure in this report.

AGM voting outcomes

The table below shows the percentage of shareholders' votes which were for or against, and the percentage of votes withheld, relating to the resolutions to approve the 2019 Directors' Remuneration Report and Remuneration Policy, both of which were put to shareholders at the 2020 AGM.

The resolutions approving the Directors' Remuneration Report and Remuneration Policy were passed by 94.88% and 97.55% of the votes cast in favour of the resolutions, respectively.

	For		Against		Number of votes withheld (abstentions)	Percentage of votes withheld (abstentions)
	Number	Percentage	Number	Percentage		
Approval of Directors' Remuneration Report (2020 AGM)	1,023,165,733	94.88%	55,176,087	5.12%	63,462	–
Approval of Directors' Remuneration Policy (2020 AGM)	1,051,904,620	97.55%	26,440,027	2.45%	60,251	–

Shareholdings (Audited)

This table sets out the Executive Directors' share ownership guidelines and actual share ownership levels:

Name	Position	Share ownership guideline ¹ (% of salary)	Value of shares held at 31 December 2020 ^{2,3} (% of salary)
Penny James	Chief Executive Officer	250%	426%
Tim Harris	Chief Financial Officer	200%	33%

Notes:

- Executive Directors are expected to retain all the 'after tax' Ordinary Shares they obtain from any of the Company's share incentive plans until they achieve a shareholding level that is equal to 250% of base salary for the CEO and 200% of base salary for the CFO respectively.
- For these purposes, holdings of Ordinary Shares will be treated as including all vested but unexercised awards, or awards unvested but after the performance period in the holding period, valued on a basis that is net of applicable personal taxes payable on acquiring such Ordinary Shares.
- Shareholding as a percentage of salary has been calculated based on the 31 December 2020 share price of £3.19.

LTIP awards granted during 2020 (Audited)

The table below shows awards granted under the LTIP to Executive Directors in 2020 in the form of nil-cost options.

Director	Position	Awards granted in 2020 under the LTIP ¹		
		Award as % of salary	Number of shares granted	Face value of Awards (£)
Penny James	Chief Executive Officer	200%	581,357	1,617,000
Tim Harris	Chief Financial Officer	200%	384,941	1,070,000

Note:

- The number of shares awarded was based on the average share price in the three-day period prior to grant, which was £2.62 in March 2020 and £2.96 in September 2020.

The performance conditions that apply to the LTIP awards granted in 2020 are set out below:

Performance Measure	Performance conditions for awards granted in 2020 under the LTIP		
	Proportion of award	Performance for threshold vesting (20%)	Performance for maximum vesting
RoTE	60%	17.5%	20.5%
TSR	40%	Median	Upper quintile

The RoTE targets for awards granted in 2020, applying to 60% of the award, were an average annual RoTE of 17.5% for 20% vesting and 20.5% for full vesting. A straight-line interpolation occurs from threshold to maximum performance.

The remaining 40% of each award is based on TSR performance against the FTSE 350 (excluding Investment Trusts), for which there is a straight-line interpolation between threshold and maximum performance on a ranked basis.

The performance period for the awards granted on 27 March 2020 will end on 31 December 2022 for the RoTE element and 26 March 2023 for the TSR element. The performance period for the awards granted on 1 September 2020 will also end on 31 December 2022 for the RoTE element and 31 August 2023 for the TSR element.

DAIP awards granted during 2020 (Audited)

The table below shows the deferred share awards granted under the DAIP to Executive Directors on 27 March 2020 in respect of the 2019 AIP. Awards will vest after three years, normally subject to continued service, and were granted in the form of nil-cost options.

Director	Position	Awards granted in 2020 under the DAIP	
		Value of deferred bonus (£)	Number of shares granted ¹
Penny James	Chief Executive Officer	401,899	153,397
Tim Harris	Chief Financial Officer	71,155	27,158

Note:

- The number of shares awarded was based on the average share price in the three-day period prior to grant, which was £2.62. In accordance with the DAIP rules, dividends in respect of the deferred shares are reinvested in additional shares, which vest when the deferred shares vest.

Directors' Remuneration report *continued*

Dilution

The Company complies with the dilution levels that the Investment Association guidelines recommend. These levels are 10% in 10 years for all share plans and 5% in 10 years for discretionary plans. This is consistent with the rules of the Company's share plans.

Non-Executive Directors' fees

The fees for the Chair and Non-Executive Directors for 2021 are set out below and were reviewed in 2020.

Position	Fees for 2021 £'000
Board Chair fee	350
Basic Non-Executive Director fee	75
Additional fees	
Senior Independent Director fee	30
Chair of Audit, Board Risk and Remuneration Committees	30
Chair of Sustainability and Investment Committees	10
Member of Board Committee (Audit, Board Risk or Remuneration)	10
Member of Board Committee (Sustainability or Nomination)	5

No additional fees are paid for membership of the Investment Committee.

Service contracts

Subject to the discretion set out in the recruitment remuneration policy, it is the Group's policy to set notice periods for Executive Directors of no more than 12 months (by the Director or by the Company). The Executive Directors' service agreements summary is as follows:

Director	Effective date of contract	Notice period (by Director or Company)	Exit payment policy
Penny James	01-Nov-17	12 months	Base salary, benefits and pension only for unexpired portion of notice period to be paid in a lump sum or monthly instalments in which case, instalments are subject to mitigation if an alternative role is found.
Tim Harris	01-Oct-19	12 months	Base salary, benefits and pension only for unexpired portion of notice period to be paid in a lump sum or monthly instalments, in which case, instalments are subject to mitigation if an alternative role is found.

There are no further obligations which could give rise to a remuneration or loss of office payment other than those set out in the Remuneration Policy table and the termination policy.

Implementing the Policy in 2021

Key feature	Implementation in 2021
Base salary	
<ul style="list-style-type: none"> – Reviewed annually with any increases taking effect on 1 April – The Committee considers a range of factors when determining salaries, including pay increases throughout the Group, individual performance and market data 	<ul style="list-style-type: none"> – The CEO's salary remains appropriate (at £817,000) – The CFO's salary remains appropriate (at £535,000)
Pensions	
<ul style="list-style-type: none"> – Pension contributions are paid only in respect of base salary – The Executive Directors' pension is set in line with the pension level received by the majority of the employee population 	<ul style="list-style-type: none"> – CEO and CFO pension contribution remains at 9% (in line with the workforce)
Annual Incentive Plan	
<ul style="list-style-type: none"> – Maximum opportunity of 175% of salary for the CEO and the CFO – At least 50% of the AIP is based on financial measures. <i>The Committee considers various non-financial performance measures such as strategic measures</i> – It bases its judgement for the payment outcome at the end of the performance period on its assessment of the level of performance achieved with reference to performance targets agreed at the start of the year – Any payment is subject to an additional gateway assessment, including assessing risk factors – Malus and clawback provisions apply 	<ul style="list-style-type: none"> – No change to the maximum opportunity – No change from the weightings or measures used for 2020 – There will be a straight-line vesting between AIP threshold and maximum performance – Financial measures (55%): Profit before tax – Non-financial measures (45%): People, Customer and Shared – The performance targets will be set following the usual process, considering internal and consensus forecasts and the key strategic priorities for the Group in 2021 – The performance targets are considered commercially sensitive and will therefore be disclosed in next year's Report
Deferred Annual Incentive Plan	
<ul style="list-style-type: none"> – 40% of the AIP is deferred into shares – Typically vesting after three years, normally subject to continued employment – Malus and clawback provisions apply 	<ul style="list-style-type: none"> – No further performance conditions apply
Long Term Incentive Plan	
<ul style="list-style-type: none"> – Awards typically granted as nil-cost options – Awards typically granted twice a year – The LTIP allows for awards with a maximum value of 200% of base salary per financial year – Performance is measured over three years – Awards vest subject to financial underpin and payment gateway – Malus and clawback provisions apply – Awards are subject to an additional two-year holding period following the end of the three-year performance period 	<ul style="list-style-type: none"> – No change to the maximum annual award levels – Nil-cost options will continue to be used for the grants – The current 60% RoTE and 40% TSR mix will continue to apply for 2021 – A RoTE target range of 17.5% (threshold) to 20.5% (maximum) is required for the 2021 awards to vest – Vesting at threshold is 20% and maximum is 100% with straight-line vesting in between – Relative TSR will be measured against the FTSE 350 (excluding investment trusts) peer group. Vesting for median TSR performance (threshold) is 20% and for upper quintile TSR performance (maximum) is 100% with straight-line vesting in between these points

Directors' Remuneration Policy

The following is a copy of the main table from the Policy approved by shareholders at the 2020 AGM. The full Policy is available in the Directors' Remuneration Report of the 2019 Annual Report and Accounts, which is available on the Direct Line Group website under the 'Results and reports' heading in the Investors page. You can find further details regarding the Policy's operation for 2021 on page 135.

Policy table

Element and purpose in supporting the Group's strategic objective	Operation
<p>Base salary</p> <ul style="list-style-type: none"> - This is the core element of pay that reflects the individual's role and position within the Group - Staying competitive in the market allows us to attract, retain and motivate high-calibre executives with the skills to achieve our key aims while managing costs 	<ul style="list-style-type: none"> - Base salaries are typically reviewed annually and set in April of each year, although the Committee may undertake an out-of-cycle review if it determines this to be appropriate - When reviewing base salaries, the Committee typically takes the following into account: <ul style="list-style-type: none"> - level of skill, experience and scope of responsibilities, individual and business performance, economic climate, and market conditions; - the appropriate benchmarking peer group(s) that reflects the Group's size and industry focus, the corresponding market pay range(s) and the relevant positioning within the market pay range(s); and - general base salary movements across the Group - The Committee does not follow market data strictly. However, it uses it as a reference point in considering, in its judgement, the appropriate salary level, while regarding other relevant factors, including corporate and individual performance, and any changes in an individual's role and responsibilities - The principles for setting base salary are like those applied to other employees in the Group. However, the specific benchmarking groups used to review external market relativities may differ across employee groups - Base salary is typically paid monthly
<p>Pension</p> <ul style="list-style-type: none"> - To remain competitive within the marketplace - To encourage retirement planning and retain flexibility for individuals 	<ul style="list-style-type: none"> - Pension contributions are paid only in respect of base salary - Executive Directors are eligible to participate in the defined contribution pension arrangement or alternatively they may choose to receive a cash allowance in lieu of pension - The Executive Directors' pension will be set in line with the pension level received by the majority of the employee population
<p>Benefits</p> <ul style="list-style-type: none"> - A comprehensive and flexible benefits package is offered, emphasising individuals being able to choose the combination of cash and benefits that suits them 	<ul style="list-style-type: none"> - Executive Directors receive a benefits package generally set by reference to market practice in companies of a similar size and complexity. Benefits currently provided include a Company car, use of a car or car allowance, private medical insurance, life insurance, health screening, and income protection - The Committee may periodically amend the benefits available to some or all employees. The Executive Directors are eligible to receive such additional benefits as the Committee considers appropriate having regard to market norms - In line with our approach to all employees, certain Group products are offered to Executive Directors at a discount - Executive Directors are eligible to participate in any of the employee share plans operated by the Company, in line with HMRC guidelines (where relevant) and on the same basis as other eligible employees. Currently, this includes our HMRC-approved SIP, which has been used to provide an award of free shares to all employees (including Executive Directors) and permits employees to purchase shares with a corresponding matching award - Where an Executive Director is required to relocate to perform their role, they may be offered appropriate relocation benefits. The level of such benefits would be determined based on the circumstances of the individual and typical market practice and be consistent with the relocation arrangements available to the workforce generally. In normal circumstances, relocation benefits will only be paid for a period of up to 12 months

Maximum opportunity

Performance measures

- When determining salary increases, the Committee will consider the factors outlined in this table under 'Operation'

- Not applicable

- The maximum pension percentage contributions are set at a level that is consistent with that applied to the majority of employees

- Not applicable

- The costs of benefits provided may fluctuate from year to year, even if the level of provision has remained unchanged
- The Committee will monitor the costs in practice and ensure the overall costs do not increase by more than the Committee considers to be appropriate in all the circumstances
- Additionally, the limit for any employee share plans in which the Executive Directors participate will be in line with the caps permitted by HMRC from time to time
- The Executive Directors may be entitled to retain fees received for any directorships held outside the Group
- Similarly, while not benefits in the normal usage of that term, certain other items such as hospitality or retirement gifts may also be provided

- Not applicable

Element and purpose in supporting the Group's strategic objective	Operation
<p>AIP</p> <ul style="list-style-type: none"> - To motivate executives and incentivise delivery of performance over a one-year operating cycle 	<ul style="list-style-type: none"> - The AIP is measured based on performance over the financial year against performance targets which the Committee considers to be appropriate - Clawback provisions apply to the AIP. Further explanatory notes can be found on the Direct Line Group website, under the 'Results and reports' heading on the Investors page, and on pages 128 to 138 in the 2019 Directors' Remuneration Report
<p>DAIP</p> <ul style="list-style-type: none"> - To enable a stronger focus and alignment with the short to medium-term elements of our strategic aims 	<ul style="list-style-type: none"> - For Executive Directors, at least 40% of the AIP is deferred into shares under the DAIP - This typically vests three years after grant (with deferred awards also capable of being settled in cash at the discretion of the Committee, for example, when it gives rise to legal difficulties to settle in shares). The remainder of the award is paid in cash following the year end - The Committee will keep the percentage deferred and terms of deferral under review. This will ensure levels are in line with regulatory requirements and best practice and may be changed in future years but will not, in the Committee's view, be changed to be less onerous overall - Dividends will accrue during the deferral period - Malus and clawback provisions apply to the cash and deferred elements. Further explanatory notes can be found on the Direct Line Group website, under the 'Results and reports' heading on the Investors page, and on pages 128 to 138 in the 2019 Directors' Remuneration Report.
<p>LTIP</p> <ul style="list-style-type: none"> - Aligning executives' interests with those of shareholders to motivate and incentivise delivering sustained business performance over the long term - To aid retaining key executive talent long term 	<ul style="list-style-type: none"> - Awards will typically be made in the form of nil-cost options or conditional share awards, which vest to the extent performance conditions are satisfied over a period of at least three years. Under the Plan rules, awards may also be settled in cash at the discretion of the Committee. This may be appropriate, for example, if legal difficulties arise with settling in shares - Vested options will remain exercisable for up to the tenth anniversary of grant - Malus and clawback provisions apply to the LTIP. Further explanatory notes can be found on the Direct Line Group website, under the 'Results and reports' heading on the Investors page, and on pages 128 to 138 in the 2019 Directors' Remuneration Report. - Awards under the LTIP may be made at various times during the financial year - Executive Directors will be subject to an additional two-year holding period following the three-year vesting period, during which time awards may not normally be exercised or released - During the additional holding period the awards will continue to accrue dividends. Following the holding period awards will cease to accrue dividends if not exercised
<p>Share ownership guidelines</p> <ul style="list-style-type: none"> - To align the interests of Executive Directors with those of shareholders 	<ul style="list-style-type: none"> - Executive Directors are expected to retain all the Ordinary Shares vesting under any of the Company's share incentive plans, after any disposals for paying applicable taxes, until they have achieved the required shareholding level; unless such earlier sale, in exceptional circumstances, is permitted by the Chair - Shares considered will include those held by the director and their connected persons, vested awards subject to holding requirements and unvested awards not subject to performance conditions (on a net of tax basis) - Executive Directors are also expected to retain an equivalent level of shareholding post their employment for a period of two years - In exceptional circumstances, earlier sale is permitted subject to the Chair's discretion

Maximum opportunity	Performance measures
<ul style="list-style-type: none"> - Threshold and maximum bonus levels for Executive Directors are set by considering annual bonus practice throughout the organisation and referring to practice at other insurance and general market comparators - Outcomes for performance between threshold and maximum will be determined on a straight-line basis - The maximum bonus opportunity under the AIP is 175% of base salary per year. The current maximum bonus opportunity applying for each individual Executive Director is shown in the statement of implementation of policy - No more than 10% of the bonus is paid for threshold performance - However, the Committee retains flexibility to amend the pay-out level at different levels of performance for future bonus cycles. This is based on its assessment of the level of stretch inherent in the set targets, and the Committee will disclose any such determinations appropriately 	<ul style="list-style-type: none"> - Performance measures may be financial and non-financial (Group, divisional, business line or individual) - Each year, at least 50% of the bonus is based on financial measures. The remainder of the bonus may be based on a combination of, for example, strategic, operational, shared or individual performance measures - The Committee sets targets at the beginning of each financial year - Before any payment can be made, the Committee will perform an additional gateway assessment (including in respect of any risk concerns). This will determine whether the amount of any bonus is appropriate in view of facts or circumstances which the Committee considers relevant. This assessment may result in moderating (positively or negatively) each AIP performance measure, subject to the individual maximum bonus levels - The AIP remains a discretionary arrangement. In line with the Code requirements, the Committee maintains discretion to override formulaic outcomes where those outcomes are not reflective of the overall Group performance - Subject to continued employment
<ul style="list-style-type: none"> - The maximum LTIP award in normal circumstances is 200% of salary - Awards of up to 300% of base salary are permitted in exceptional circumstances, relating to recruiting or retaining an employee, as determined by the Committee 	<ul style="list-style-type: none"> - The Committee will determine the performance conditions for each award made under the LTIP, measuring performance over a period of at least three years with no provision to retest - Performance is measured against targets set at the beginning of the performance period, which may be set by referring to the time of grant or financial year - Awards vest based on performance against financial and/or such other (including share return) measures, as set by the Committee, to be aligned with the Group's long-term strategic objectives. The Committee may alter the precise targets used for future awards - Not less than 50% of the award shall be subject to one or more financial measures, and not less than 25% shall be subject to a relative TSR measure - Awards will be subject to a payment gateway, such that the Committee must be satisfied that there are no material risk failings, reputational concerns or regulatory issues - 20% of the award vests for threshold performance, with 100% vesting for maximum performance. The Committee reserves the right in respect of future awards to lengthen (but not reduce) any performance period and/or amend the terms of any holding period; however, there is no intention to reduce the length of the holding period - In line with the Code requirements, the Committee maintains discretion to override formulaic outcomes where those outcomes are not reflective of the overall Group performance
<ul style="list-style-type: none"> - 250% of salary for the CEO and 200% for the CFO. - The Committee reserves the discretion to amend these levels in future years 	<ul style="list-style-type: none"> - Not applicable

Directors' report

The Board of Directors present their report for the financial year ended 31 December 2020 as required by the Companies Act 2006.

The Board would like to draw your attention to the forward-looking statements disclaimer which can be found on page 231.

Directors' report disclosures

The Board takes the view that some of the matters required to be disclosed in the Directors' report are of strategic importance and these are, therefore, included in the Company's Strategic report which is on pages 1 to 75 as permitted by the Companies Act 2006. These matters, and all matters referenced in the table below, are incorporated into this Directors' report:

Subject	Pages
Use of financial instruments	26, 33, 34
Important events since the financial year-end	8 to 17
Likely future developments in the business	17
Employee engagement	19, 50, 53, 125, 142
Engagement with suppliers, customers and other business relationships	48 to 49
Research and development	6, 12, 16, 56, 60, 64
Greenhouse gas emissions, energy consumption and energy-efficient action	61 to 63

Disclosure of information required by Disclosure Guidance and Transparency Rule 7.2

The FCA's Disclosure Guidance and Transparency Rule 7.2 require a corporate governance statement in the Directors' report to include certain information. You can find information that fulfils the corporate governance statement's requirements in this Directors' report, the Corporate Governance report, the Committee reports and the Directors' Remuneration Report, all of which is incorporated in the Directors' report by reference.

Disclosure of information under Listing Rule 9.8.4(C)

In accordance with Listing Rule 9.8.4C, the table below sets out the location of the information required to be disclosed under LR 9.8.4(R), where applicable.

Subject	Page
Interest capitalised by the Group	None
Unaudited financial information	Note 3.5
Branches outside the UK	219
Long-term incentive plan involving one Director only	Not applicable
Directors' waivers of emoluments	Not applicable
Directors' waivers of future emoluments	Not applicable
Non pro-rata allotments for cash (issuer)	Not applicable
Non pro-rata allotments for cash (major subsidiaries)	None
Listed company is a subsidiary of another company	Not applicable
Contracts of significance involving a Director	Not applicable
Contracts of significance involving a controlling shareholder	Not applicable
Details of shareholder dividend waivers	141
Controlling shareholder agreements	Not applicable

Dividends

The Board recommends a final dividend of 14.7 pence per share to shareholders. Subject to shareholder approval at the Company's 2021 AGM, this will become payable on 20 May 2021 to all holders of Ordinary Shares on the Register of members at close of business on 9 April 2021.

The final dividend resolution provides that the Board may cancel the dividend and, therefore, payment of the dividend at any time before payment, if it considers it necessary to do so for regulatory capital purposes. You can find detailed explanations about this in the Notice of AGM 2021.

You can find information on dividend and capital management, including the share buyback programme, in the Finance review, on pages 20 to 35.

Directors

You can find the names of all current Directors and their biographies on pages 78 to 80. All Directors will retire and those wishing to continue to serve will be submitted for election or re-election at the 2021 AGM (with the exception of Jane Hanson who will be stepping down from the Board with effect from the end of the AGM, as previously announced.) This is in accordance with the Code and the Articles of Association of the Company, which govern appointing and replacing Directors.

The Directors listed on pages 78 to 80 were the Directors of the Company throughout the year under review, except for Adrian Joseph, who joined the Board on 1 January 2021. Mike Biggs also served during the year, stepping down as Chair of the Board and as a Director in August 2020. Mike was succeeded as Chair by Danuta Gray.

The Company's Articles of Association set out the Directors' powers. You can view these on the Company's website at www.directlinegroup.co.uk. The Directors' powers are also subject to relevant legislation and, in certain circumstances, including in relation to the issuing or buying back of shares, authority from the Company's shareholders. You can find details of the Directors' remuneration, service contracts, employment contracts and interests in the shares of the Company in the Directors' Remuneration Report on pages 113 to 139.

The Articles of Association of the Company permit it to indemnify the Company's officers, and officers of any associated company, against liabilities arising from conducting Company business, to the extent permitted by law. As such, the Company has executed deeds of indemnity for each Director's benefit, regarding liabilities that may attach to them in their capacity as Directors of the Company or associated companies.

These indemnities are qualifying third-party indemnities as defined by section 234 of the Companies Act 2006. No amount was paid under any of these indemnities during the year. The Company maintains directors' and officers' liability insurance. This provides appropriate cover for legal actions brought against its Directors. The Company has also provided the Directors of DLG Pension Trustee Limited with qualifying pension scheme indemnities. This is in accordance with section 235 of the Companies Act 2006. DLG Pension Trustee Limited acts as trustee for two of the Company's occupational pension schemes.

Secretary

Roger Clifton is the Company Secretary of Direct Line Insurance Group plc. He can be contacted at the Company's Registered Office, details of which are on page 232.

Share capital

The Company has a premium listing on the London Stock Exchange. As at 31 December 2020, the Company's share capital comprised 1,364,551,605 fully paid Ordinary Shares of 10% pence each.

At the Company's 2020 AGM, the Directors were authorised to:

- allot shares in the Company or grant rights to subscribe for or convert any security into shares, up to an aggregate nominal amount of £49,620,058, and to allot further shares up to an aggregate nominal amount of £49,620,058 for the purpose of a rights issue;
- allot shares having a nominal amount not exceeding in aggregate £7,443,009 for cash, without offering the shares first to existing shareholders in proportion to their holdings;
- allot additional shares having a nominal amount not exceeding in aggregate £7,443,009 for the purposes of financing a transaction which the Board of the Company determines to be an acquisition or other capital investment, without offering the shares first to existing shareholders in proportion to their holdings;
- make market purchases of up to 136,455,160 shares in the Company, representing 10% of the Company's issued share capital at the time; and
- allot shares (with the disapplication of pre-emption rights) up to an aggregate nominal amount of £23,250,000 in relation to the issue of Restricted Tier 1 ("RT1") Instruments.

To date, the Directors have not used these authorities granted in 2020 (although the authority to make market purchases of shares granted at the AGM in 2019 was used during the year, as described below.)

At the 2021 AGM, shareholders will be asked to renew these authorities. The Company has not held any shares in treasury during the period under review. You can find out more about the Company's share capital and shares under option as at 31 December 2020 in notes 30 and 36 of the consolidated financial statements.

Under the Company's Share Incentive Plan, Trustees hold shares on behalf of employee participants. The Trustees will only vote on those shares and receive dividends that a participant beneficially owns, in accordance with the participant's wishes. An Employee Benefit Trust also operates. The Trustee of this has discretion to vote on any shares it holds as it sees fit, except any shares participants own beneficially, in which case the Trustee will only vote on such shares as per a participant's instructions.

The Trustee of the Employee Benefit Trust has waived its right to dividends on all shares within the Trust. You can find out more about the number of shares held by the employee share plan trusts in note 36 on page 208. The Company is only aware of the dividend waivers and voting restrictions mentioned above.

On 3 March 2020, the Company announced the launch of a share buyback programme, which was then terminated on 19 March 2020 as a result of the volatile conditions arising from the Covid-19 pandemic. The share buyback programme had been designed to return surplus capital

to shareholders and move the Group's solvency capital coverage ratio towards the middle of its solvency risk appetite range. A total number of 10,448,395 ordinary shares of 10% pence each were repurchased under the share buyback programme. The aggregate consideration paid was £28,783,407.42.

Shareholder voting rights and restrictions on transfer of shares

All the Company's issued Ordinary Shares rank equally in all respects. The Company's Articles of Association set out the rights and obligations attaching to the Company's Ordinary Shares.

Employees of the Company and Directors must comply with the UK Market Abuse Regulation and the Company's share dealing rules. These rules restrict particular employees' and Directors' ability to deal in the Company's shares at certain times, and require the employee or Director to obtain permission to deal before doing so. Some of the Company's employee share plans also include restrictions on transferring shares while the shares are held within the plans.

Each general meeting notice will specify a time, not more than 48 hours before the time fixed for the meeting (which may exclude non-working days), for determining a shareholder's entitlement to attend and vote at the meeting. To be valid, all proxy appointments must be filed at least 48 hours before the time of the general meeting.

Where the Company has issued a notice under section 793 of the Companies Act 2006, which is in default for at least 14 days, the person(s) interested in those shares shall not be entitled to attend or vote at any general meeting until the default has been corrected or the shares sold.

There is no arrangement or understanding with any shareholder, customer or supplier, or any other external party, which provides the right to appoint a Director or a member of the Executive Committee, or any other special rights regarding control of the Company.

Articles of Association

Unless expressly specified to the contrary in the Articles of Association, they may only be amended by a special resolution of the Company's shareholders at a general meeting.

Significant agreements affected by a change of control

A number of agreements may take effect, alter or terminate upon a change of control of the Company. None of these agreements is considered significant in terms of its impact on the Group's business as a whole. All the Company's employee share incentive plans contain provisions relating to a change of control. Outstanding awards would typically vest and become exercisable. This is subject to satisfying any performance conditions, and normally with an additional time-based pro-rata reduction where performance conditions apply, and approval from the Remuneration Committee.

Substantial shareholdings

The table below shows the direct and indirect holdings of major shareholders in the Company's ordinary issued share capital, as at 31 December 2020 and as at 5 March 2021, as notified in accordance with the provisions of Chapter 5 of the FCA's Disclosure Guidance and Transparency Rules. It should be noted that these holdings may have changed since the Company was notified. However, notification of any change is not required until the next notifiable threshold is crossed. Information provided by the Company pursuant to the FCA's Disclosure Guidance and Transparency Rules is publicly available via the regulatory information services and on the Company's website.

	31 December 2020	5 March 2021	Nature of Holding
BlackRock, Inc.	9.97%	10.08%	Indirect
Artemis Investment Management LLP	5.07%	5.07%	Indirect
Norges Bank	5.05%	4.91%	Direct
Majedie Asset Management Limited	4.99%	4.99%	Indirect
T.Rowe Price Associates, Inc	4.94%	4.94%	Indirect
Standard Life Aberdeen plc	4.57%	4.57%	Indirect
APG Asset Management N.V	2.99%	2.99%	Direct

Political donations

The Group made no political donations during the year (2019: nil).

Business relationships

The Board understands and has regard to the need to foster the Company's business relationships with suppliers, customers, and others.

The Group is a leading motor, home and commercial insurer which depends on the trust and confidence of its stakeholders to operate sustainably in the long term. Direct Line Group seeks to put its customers' best interests first, invests in its employees, supports the communities in which it operates and strives to generate sustainable profits for shareholders.

The Board aims to maintain the highest possible standards of integrity in business relationships with suppliers and partners. The Group is a long-standing signatory of the Prompt Payment Code. There are mechanisms in place for the Board to be alerted to problems with payment expectations.

The Group relies on certain key strategic suppliers and a large number of other suppliers to conduct its business. The Board receives in-depth updates on its relationship with strategic suppliers in the context of reports on the Group's technology programme. The Board has, in 2020, received updates on the generic approach to suppliers' robustness in the context of Brexit preparations.

The Board reviews and approves the Code of Business Conduct, Ethical Code for Suppliers and Modern Slavery statement on an annual basis to ensure that these reflect the Group's purpose and sustainability strategy.

The Board monitors customer engagement by receiving a customer and conduct report at each of its scheduled meetings. We put our customers at the heart of everything that we do. The Board believes that the Company's long-term sustainability is driven by understanding customers' needs and acting in their best interests.

For more on key decisions and considerations relating to stakeholders, see pages 86 to 87, and for more information on our key stakeholders, please refer to the sustainability pillars on pages 44 to 67.

Employee engagement

The Board encourages a culture that celebrates difference and seeks to empower people so that they can thrive. The Board values the involvement and engagement of its employees and continues to listen to employees' views and opinions.

The whole Board prides itself on its engagement with the workforce with frequent and consistent engagement by Executive Directors, which has only increased during Covid-19. The Board responded immediately to the Covid-19 crisis by calling additional Board meetings, including to discuss and consider the best way to protect its wider workforce.

Further to Provision 5 of the Code, the Non-Executive Directors see it as their joint responsibility to engage with the workforce and have, therefore, chosen not to designate one Non-Executive Director for this role. The Non-Executive Directors rotate attendance at meetings of the Group's National Employee Representative Body, which are also attended by Executive Directors. The Board reviews the results of employee engagement surveys, and metrics relating to employee engagement remain an important element of the targets for the AIP for Executive Directors and other senior managers.

Having all Non-Executive Directors engaged with the workforce allows for greater accessibility for the workforce and a shared sense of responsibility. In December 2020 our Chair, Danuta Gray, attended the virtually hosted Employee Representative Body conference, at which she introduced herself to the members who were given the opportunity to ask her questions.

The Board uses various technological methods of communication, including Chief Executive Officer and Chief Financial Officer all-employee phone conferences, emails and intranet messages, acknowledging that circumstances in 2020 created challenges for interaction.

For more on key decisions and considerations relating to stakeholders see pages 86 to 87 and for more information on Board-sponsored initiatives to support the workforce, including in connection with the Covid-19 crisis, the Agile transformation programme, diversity and inclusion and on culture see the Sustainability Pillars – People on page 50, the Sustainability Committee Report on pages 109 to 110 and for wider workforce engagement and pay considerations in 2020 see the Directors' Remuneration Report on pages 113 to 139.

Employees with disabilities

The Group is committed to promoting diversity and inclusion across every area of the business through initiatives such as the Diversity Network Alliance (“DNA”). At recruitment, we adjust and enhance our application and selection process, and guide and provide additional training for interviewers, where necessary.

Our DNA focuses on a number of strands including employees with disabilities. It identifies areas where we can improve and help people to continue working for us. We reasonably adjust employees’ working environments and equipment, and roles and role requirements. We also seek to ensure that everyone can access the same opportunities. You can find more information regarding employee involvement in the Strategic report on pages 1 to 75.

Going concern

The Directors believe that the Group has sufficient financial resources to meet its financial needs, including managing a mature portfolio of insurance risk. The Directors further believe the Group is well positioned to manage its business risks successfully in the current economic climate. The Finance review on pages 20 to 35 describes the Group’s capital management strategy, including the capital actions taken in the year to ensure the continued strength of the balance sheet. The Group’s financial position is also covered in that section, including a commentary on cash and investment levels, reserves, currency management, insurance liability management, liquidity and borrowings. Additionally note 3 to the consolidated financial statements describes capital management needs and policies. The note also covers insurance, market, liquidity and credit risks which may affect the Group’s financial position.

The Directors have assessed the principal risks of the Group over the duration of the planning cycle. These included the implementation of the FCA’s Pricing Practices Review, possible adverse implications of Brexit, change risk and possible challenging market conditions due to the impact of Covid-19 on the economy and customer behaviour. The 2020 Plan modelled a number of different scenarios which were directly and indirectly influenced by the Covid-19 pandemic. These included delay to improvements in technological capability, the impact of Covid-19 on claims frequency levels and the impact of Brexit on the investment return. The key judgements applied were in relation to the likely time period of Covid-19 related restrictions, and the subsequent impact on customer behaviour and the economic recovery.

In addition, the Group’s Risk function has carried out an assessment of the risks to the Plan and the dependencies for the success of the Strategic Plan. This included running stress tests on the Plan to consider the 1 in 8 years and 1 in 25 years loss simulations based on the internal economic capital model.

A reverse stress test was also performed to identify the most probable combination of stresses that would result in capital loss and thus threaten the viability of the Group, i.e. a reduction of own funds to below the solvency capital requirement.

In all scenarios, it was concluded that the Group’s solvency capital requirement would not be breached following the implementation of management actions.

Therefore, having made due enquiries, the Directors reasonably expect that the Group has adequate resources to continue in operational existence for at least 12 months from 5 March 2021 (the date of approval of the financial statements). Accordingly, the Directors have adopted the going concern basis in preparing the financial statements.

Disclosing information to the Auditor

Each Director at the date of approving these Annual Report & Accounts confirms that: as far as they are aware, there is no relevant audit information of which Deloitte, the Company’s External Auditor, is unaware; and they have taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information, and to establish that Deloitte is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Auditor

Deloitte has expressed its willingness to continue in office as the External Auditor. A resolution to reappoint Deloitte will be proposed at the forthcoming AGM. You can find an assessment of the effectiveness of and a recommendation for reappointing Deloitte in the Audit Committee report on page 101.

Directors’ responsibility statement

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

Company law requires the Directors to prepare such financial statements for each financial year in accordance with UK-adopted international accounting standards.

The Directors have elected to prepare the Parent Company financial statements in accordance with FRS 101 “Reduced Disclosure Framework”. Under company law, the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the Company’s state of affairs and profit or loss for that period.

In preparing these financial statements, IAS 1 requires that Directors: properly select and apply accounting policies; present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance; and assess the Company’s ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that: are sufficient to show and explain the Company’s transactions and disclose, with reasonable accuracy, the Company’s financial position at any time; and enable them to ensure the financial statements comply with the Companies Act 2006. Additionally, the Directors are responsible for safeguarding the Company’s assets and, hence, taking reasonable steps to prevent and detect fraud and other irregularities. The Directors are responsible for maintaining and ensuring the integrity of the corporate and financial information included on the Company’s website at www.directlinegroup.co.uk.


Legislation in the UK governing preparing and disseminating financial statements may differ from legislation in other jurisdictions.

Directors' report *continued*

Each of the Directors, whose names and functions are listed on pages 78 to 80, confirms that, to the best of their knowledge:

- the financial statements, prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position, and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the Strategic report (on pages 1 to 75) and Directors' report (on pages 140 to 144) include a fair review of:
 - (i) the business's development and performance; and
 - (ii) the position of the Group and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face; and
- the Annual Report and the financial statements, taken as a whole, are fair, balanced and understandable, and provide the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

This report was approved by the Board on 5 March 2021 and signed on its behalf by:



Roger C. Clifton
Company Secretary

Registered address: Churchill Court, Westmoreland Road,
Bromley, BR1 1DP

Registered number: 02280426

Contents

Financial Statements			
Independent Auditor's Report	146		
Consolidated Financial Statements			
Consolidated Income Statement	157		
Consolidated Statement of Comprehensive Income	158		
Consolidated Balance Sheet	159		
Consolidated Statement of Changes in Equity	160		
Consolidated Cash Flow Statement	161		
Notes to the Consolidated Financial Statements			
1. Accounting policies	162	31. Other reserves	203
2. Critical accounting judgements and key sources of estimation uncertainty	170	32. Tier 1 notes	203
3. Risk management	172	33. Subordinated liabilities	204
4. Segmental analysis	185	34. Insurance liabilities	205
5. Net earned premium	188	35. Unearned premium reserve	208
6. Investment return	188	36. Share-based payments	208
7. Other operating income	189	37. Provisions	210
8. Net insurance claims	189	38. Trade and other payables, including insurance payables	210
9. Commission expenses	189	39. Notes to the consolidated cash flow statement	211
10. Operating expenses	189	40. Commitments and contingent liabilities	212
11. Finance costs	190	41. Leases	212
12. Tax charge	191	42. Fair value	213
13. Current and deferred tax	191	43. Related parties	214
14. Dividends and appropriations	192	44. Post balance sheet event	214
15. Earnings per share	193	Parent Company Financial Statements	
16. Net asset value per share and return on equity	193	Parent Company Balance Sheet	215
17. Goodwill and other intangible assets	194	Parent Company Statement of Comprehensive Income	216
18. Property, plant and equipment	195	Parent Company Statement of Changes in Equity	216
19. Right-of-use assets	196	Notes to the Parent Company Financial Statements	
20. Investment property	196	1. Accounting policies	217
21. Subsidiaries	196	2. Investment in subsidiary undertakings	218
22. Reinsurance assets	197	3. Other receivables	219
23. Deferred acquisition costs	197	4. Current and deferred tax	219
24. Insurance and other receivables	197	5. Derivative financial instruments	219
25. Prepayments, accrued income and other assets	197	6. Financial investments	219
26. Derivative financial instruments	198	7. Cash and cash equivalents	220
27. Retirement benefit obligations	198	8. Share capital, capital reserves and distributable reserves	220
28. Financial investments	202	9. Tier 1 notes	220
29. Cash and cash equivalents and borrowings	202	10. Subordinated liabilities	220
30. Share capital	202	11. Borrowings	220
		12. Trade and other payables	221
		13. Dividends	221
		14. Share-based payments	221
		15. Contingent liabilities	221
		16. Risk management	221
		17. Directors and key management remuneration	221

Independent Auditor's Report to the shareholders of Direct Line Insurance Group plc

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of Direct Line Insurance Group plc (the **"Parent Company"**) and its subsidiaries (together the **"Group"**) give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2020 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006, International Financial Reporting Standards (**"IFRSs"**) as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board (**"IASB"**);
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 101 'Reduced Disclosure Framework'; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the Consolidated Income Statement;
- the Consolidated and Parent Company Statements of Comprehensive Income;
- the Consolidated and Parent Company Balance Sheets;
- the Consolidated and Parent Company Statements of Changes in Equity;
- the Consolidated Cash Flow Statement; and
- the related notes 1 to 44 on the Consolidated financial statements and related notes 1 to 17 on the Parent Company financial statements, excluding the capital adequacy disclosures in note 3 calculated in accordance with the Solvency II regime which are marked as unaudited.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law, international accounting standards in conformity with the requirements of the Companies Act 2006 and IFRSs as adopted by the European Union and as issued by the IASB. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 'Reduced Disclosure Framework' (United Kingdom Generally Accepted Accounting Practice).

2. Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (**"ISAs (UK)"**) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (**"FRC"**) Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that no non-audit services prohibited by the FRC's Ethical Standard were provided to the Group or the Parent Company.

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

3. Summary of our audit approach

Key audit matters	<p>The key audit matters that we identified in 2020 were:</p> <ul style="list-style-type: none"> - valuation of insurance liabilities: <ol style="list-style-type: none"> 1) The frequency and severity assumptions for large bodily injury claims; 2) The inflation and discount rate assumptions for valuing periodic payment orders ("PPOs"); and 3) The judgement applied in setting the margin above the actuarial best estimate. - valuation of illiquid investments: <ol style="list-style-type: none"> 1) Commercial real estate loans, infrastructure debt and private placement bonds; 2) Investment property; - general ledger migration. <p>Within this report, key audit matters are identified as follows:</p> <ul style="list-style-type: none"> ⚠ Newly identified; ⬆ Increased level of risk; ◊ Similar level of risk; and ⬇ Decreased level of risk.
Materiality	<p>The materiality that we used for the Group financial statements was £28 million, which approximates to 5.6% (2019: 5.3%) of the three year average profit before tax, excluding the impact of the Ogden discount rate change to 0% in the 2018 results and minus 0.25% in the 2019 results which we elected to exclude due to the non-recurring nature of these events.</p>
Scoping	<p>Our Group audit scoping included two entities being subject to a full scope audit and a further two entities being subject to an audit of specified account balances. These four entities represent the principal business units and account for 99% of the Group's net assets, 100% of the Group's gross earned premium and 95% of the Group's profit before tax. We performed analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to a full scope audit or an audit of specified balances.</p>
Significant changes in our approach	<p>During the year we have identified one new key audit matter relating to the migration of the general ledger, given the potential wide-reaching impact this one-off event has on the financial statements.</p> <p>We have also extended two existing key audit matters in relation to:</p> <ol style="list-style-type: none"> a. the valuation of insurance liabilities, which now includes the judgement applied in setting the margin above the actuarial best estimate; and b. the valuation of illiquid investments, which now includes investment property. <p>Lastly, we have no longer identified the valuation of intangible assets as a key audit matter due to the progress made in 2020 towards rolling out the new motor trading platform.</p>

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the Directors' assessment of the Group's and Parent Company's ability to continue to adopt the going concern basis of accounting included:

- assessing the Group's process around the going concern assessment performed by management;
- evaluating the historical accuracy of forecasts prepared by management;
- challenging the reasonableness of the profit forecasts used by management; and
- evaluating the Group's current-year performance and year end liquidity and solvency capital position.

We considered as part of our risk assessment the nature of the Group, its business model and related risks including where relevant the impact of climate change, Brexit and Covid-19, the requirements of the applicable financial reporting framework and the system of internal control.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group and Parent Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In relation to the reporting on how the Group has applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the Directors' statement in the financial statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

5.1 Valuation of insurance liabilities

Refer to page 99 (Audit Committee Report), page 163 (Accounting policies) and page 205 (Financial statements).

The Group's insurance liabilities total £3.6 billion (2019: £3.8 billion) and represent the single largest liability on the balance sheet. Valuation of these liabilities requires management to select methods and assumptions that are subject to high levels of estimation uncertainty. Consequently, small changes in these methods or assumptions can materially impact the valuation of these liabilities. We have identified the following three key areas of focus for our audit given their significance to the Group's result and the high level of estimation uncertainty. We have also identified these as potential fraud risk areas.

5.1.1 The frequency and severity assumptions for bodily injury claims

Key audit matter description

The frequency and severity of bodily injury claims have a significant impact on the valuation of the insurance liabilities and the setting of these assumptions is driven by a variety of factors. These factors include the completeness and accuracy of source data, the transparency of any changes in the reporting of bodily injury claims, and actuarial assumptions being consistent with emerging data, market factors and the Group's reserving policy. As a result of these factors, there is a significant level of estimation uncertainty in the valuation of these claims, which increases the susceptibility of the balance to material misstatement due to error and fraud.

In addition, the impact of the UK government's various lockdown measures introduced first in March 2020, in response to Covid-19, has resulted in significantly reduced mobility and traffic volumes in March and April 2020 and reduced volumes for the rest of the year after further lockdown measures were introduced. The Group and the wider market have experienced reduced motor vehicle accident frequencies as a result. This further adds to the inherent uncertainty underlying the estimation of the ultimate number of bodily injury claims for the 2020 accident year.

How the scope of our audit responded to the key audit matter

We have gained a detailed understanding of the end-to-end claims and reserving process and obtained an understanding of relevant controls.

In order to gain assurance over the completeness and accuracy of source data used in the Group's actuarial calculations and by our in-house actuarial specialists in performing our work, we have tested the data reconciliation controls and performed reconciliations on the actuarial data back to the financial ledger.

Having done this, we worked with our actuarial specialists to:

- inspect and challenge the reserving process in relation to bodily injury claims undertaken by assessing relevant documentation and meeting with the Actuarial Director and his team; and
- inspect and challenge the Group's documented methodology and key assumptions in respect of the prior years as well as the current year, with particular reference to Covid-19 impacts. This included:
 - using our in-house reserving software to help us challenge the Group's response to emerging claims trends;
 - inspecting the Group's models and conducting sensitivity testing on model methodology and assumptions including prior-year changes to assumptions;
 - comparing the Group's burning cost and frequency diagnostics to market benchmarks and independent reserve review results; and
 - analysing the consistency in reserving strength and reserve releases in comparison with prior years.

Key observations

In the prior financial year we considered the frequency and severity assumptions for large bodily injury claims to be reasonable and prudent however less prudent than previous financial periods given that the Group's actuaries had given credit for favourable experience noted that year. In the current financial year we have concluded that the assumptions continue to be reasonable, albeit we have seen a continuation in the trend of reduced prudence compared to previous periods.

5.1.2 The inflation and discount rate assumptions for PPOs

Key audit matter description

The Group is required to settle a proportion of large bodily injury claims as PPOs rather than lump sum payments. The valuation of PPOs has a material impact on the financial statements, with liabilities totalling £814.8 million (2019: £800.1 million) on a discounted gross basis as detailed in note 34.

Given the ongoing uncertainty in the UK's inflation environment and investment markets, the selection of the inflation and discount rate assumptions is highly judgemental and has a material impact on the financial statements. The PPOs are sensitive to economic assumptions selected and as at 31 December 2020, the Group valued PPOs using an inflation rate of 3.5% (2019: 4%) and a discount rate of 3.5% (2019: 4%). These assumptions represent a key source of estimation uncertainty for the Group which increases the susceptibility of the balance to material misstatement due to error and fraud.

How the scope of our audit responded to the key audit matter

We have gained a detailed understanding over management's process for setting these assumptions and obtained an understanding of the relevant controls surrounding the setting of the PPO inflation rate and discount rate, which is the challenge and approval of these assumptions by the Loss Ratio Committee and Audit Committee. In addition, we tested the relevant direct and precise business control, performed weekly, over the completeness of the PPO listing. This is a key data input which has a material impact on the PPO assumptions and hence the valuation.

We have worked with our actuarial specialists to challenge:

- The PPO inflation assumption through inquiries with the Actuarial Director, reviewing relevant supporting documentation and benchmarking against market economic data with particular reference to Covid-19 uncertainty, and other market participants;
- The Group's sensitivity testing on the PPO inflation assumption;
- The selected discount rate with reference to current and future performance of the assets backing the PPO liabilities; and
- The methodology and rationale for deriving the discount rate.

Key observations

We have determined that the inflation and discount rate assumptions used in the calculation of the PPO claims reserve are in the middle of a reasonable range.

5.1.3 Judgement applied in setting the margin above the actuarial best estimate

Key audit matter description

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 reserved for. Consequently, management adds a margin to the actuarial best estimate to arrive at the booked insurance liabilities. This margin is determined by considering a range of adverse economic and non-economic scenarios and reflects the inherent uncertainty in estimating the ultimate losses on claims, over and above that which can be projected actuarially as a best estimate based on underlying claims development data.

The appropriate margin to recognise is an area of significant management judgement based on the perceived uncertainty and potential for volatility in the underlying claims. In light of the heightened uncertainties created by the Covid-19 pandemic, we have identified the margin as an area of key audit focus given its susceptibility to management bias.

How the scope of our audit responded to the key audit matter

We worked with our in-house actuarial specialists to challenge the appropriateness of the recommended margin to be applied to the actuarial best estimate. In doing so we performed the following procedures:

- Inspected and challenged the approach to, and analysis performed in, setting the margin by reviewing relevant documentation and meeting with the Chief Financial Officer and Actuarial Director;
- Leveraged third party economic studies to challenge the appropriateness of management's adverse scenarios, with a specific focus on care worker wage inflation given the sensitivity of the Group's bodily injury claims to this assumption, whilst looking back to outcomes from previous economic downturns; and
- Performed a 'stand back' test to challenge the level of prudence in the overall insurance liabilities between periods in light of the level of uncertainties that exist at each respective reporting date.

Key observations

We have determined that the margin remains appropriate and is on balance slightly more prudent than in previous periods. In combination with the conclusion drawn in relation to large bodily injury claims above, we have concluded in overall terms the total insurance liabilities show a consistent level of prudence with previous years.

5.2 Valuation of illiquid investments

Refer to page 99 (Audit Committee Report), pages 166 and 167 (Accounting policies) and pages 196 and 202 (Financial statements).

In the current year, we continue to identify the valuation of illiquid investments, specifically the commercial real estate, infrastructure and private placements investments as a key audit matter as described below. Additionally, we have identified the valuation of investment property as a key audit matter due to the greater level of estimation uncertainty in determining a fair value as a result of Covid-19.

5.2.1 Commercial real estate loans, infrastructure debt and private placement bonds

Key audit matter description

We have identified a key audit matter in relation to these credit portfolios totalling £575.1 million (2019: £587.8 million).

Given the Group continues to recognise and measure financial instruments under IAS 39, these instruments are measured at amortised cost and require the recognition of an impairment when an incurred loss event arises. Significant management judgement is required in determining if an incurred loss event has occurred and, in the instance an event has occurred, there is significant estimation uncertainty in determining the impairment charge.

We deem there to be an increasing risk of default or delinquency on these less liquid assets owing to high and sustained levels of uncertainty in the UK economy from Covid-19 restrictions coupled with the ongoing impact of the UK's exit from the European Union.

5.2.1 Commercial real estate loans, infrastructure debt and private placement bonds *continued*

How the scope of our audit responded to the key audit matter

We have obtained an understanding and tested the relevant controls that mitigate the risk over the valuation of illiquid investments. Our work included attendance at the year-end impairment review meeting in order to observe the operation of a key management review control.

In addition, we performed the following procedures:

- Tested a sample of interest payments to bank during the year to test for default or delinquency in interest payments;
- Utilised market indices to identify commercial real estate loans at risk and inspected the tenancy breakdowns for potential risks of store closure given the current economic issues facing the UK high street;
- Challenged management on loans of interest where indicators could point to issuer financial difficulty and obtained evidence to help assess whether the conclusion reached by management is reasonable; and
- Engaged our complex pricing specialists to determine an independent fair value of these assets to identify any significant decreases in value below book cost.

Key observations

We considered the accounting treatment applied to be reasonable. In performing our procedures, we did not note any indicators of material impairment.

5.2.2 Investment property

Key audit matter description

The investment properties held by the Group comprise retail, supermarkets and food stores, office, industrial and alternative properties. As noted in disclosure note 20, the total value as at 31 December 2020 is £292.1 million (2019: £291.7 million). Given the impact of Covid-19 and its potential to accelerate long-term trends in the use of various types of property, we have identified the methodology and assumptions used for valuing certain parts of the investment property portfolio as a key audit matter in the current year. The investment properties we have identified relate to the retail, office and alternative sector properties held, where tenants possessed an increased exposure to Government imposed Covid-19 lockdown restrictions which may accelerate the long-term downwards trend of property valuation in these sectors. These properties total £142.0 million (2019: £150.0 million).

We considered the valuation of the investment properties to be a key audit matter as the determination of fair value involves significant judgement by the external valuation experts in light of Covid-19 and long-term trends in the use of various types of property. Valuation methodology for investment properties is subjective in nature and involves various key assumptions. The use of different valuation methodology and assumptions could produce significantly different estimates of fair value. With the outbreak of Covid-19, the property valuers can attach less weight to previous market evidence in determining a fair value. This leads to greater levels of estimation uncertainty in determining the valuation.

How the scope of our audit responded to the key audit matter

We have obtained an understanding and tested the relevant control related to the annual meeting with management's external valuation expert where a review and challenge of the assumptions and methodologies used in determining the fair value is performed. This relevant control mitigates the risk over the valuation of investment properties.

In addition, we performed the following procedures:

- We have worked with our real estate specialists who challenged the estimated rental value, yield and capitalisation rate assumptions and methodologies used in the valuation of the properties;
- We have tested the completeness and accuracy of the data inputs used in the valuation process performed by management and their external valuer; and
- We tested the data inputs used in the valuation model for investment properties, by agreeing occupation rates, unit sizes, and contracted rent to the underlying signed agreements and property reports. We then re-performed the calculation of the yields applied using this data.

Key observations

We considered the accounting treatment applied to be reasonable. In performing our procedures, we did not note any indicators of material impairment.

5.3 General ledger migration 

Refer to page 99 (Audit Committee Report).

Key audit matter description

During May 2020 as part of the Group's ongoing Finance Transformation programme, the Group migrated their general ledger system. We have focused on this migration due to the inherent risk of error and the impact such an error may have on the control environment of the Group. The incomplete and inaccurate transfer of data to the new general ledger system could result in the incorrect presentation of balances in the Group's consolidated accounts and would affect the quality of management information that supports the decision-making for those charged with governance.

Given the increased data integrity risks inherent to the migration of financial information and the importance of maintaining complete and accurate accounting records throughout the reporting period, we consider the general ledger migration to be a key audit matter.

How the scope of our audit responded to the key audit matter

We have performed the following procedures in order to respond to this risk:

- Obtained an understanding of and tested the relevant controls in the data migration;
- Re-performed key reconciliations to verify the completeness and accuracy of the data transfer and substantively test material differences; and
- Worked with IT specialists to test the design and implementation of general IT controls around the governance of the data migration and system controls post-implementation.

Key observations

Based on the work performed, we did not identify any significant issues from our testing of the general ledger migration.

6. Our application of materiality

6.1 Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent Company financial statements
Materiality	£28.0 million (2019: £28.0 million)	£25.2 million (2019: £25.2 million)
Basis for determining materiality	The materiality approximates to 5.6% (2019: 5.3%) of the three year average profit before tax, excluding the impact of the Ogden discount rate change to 0% in the 2018 results and minus 0.25% in the 2019 results which we elected to exclude due to the non-recurring nature of these events.	Materiality equates to less than 1% of (2019: 1%) of shareholders' equity and is capped at 90% (2019: 90%) of Group materiality.
Rationale for the benchmark applied	<p>We determined that the critical benchmark for the Group was average profit before tax. This measure uses a three-year average of profit before tax, which we deemed appropriate due to the inherent volatility of profits in the insurance industry. We also elected to exclude the impact of the Ogden discount rate change to 0% in the 2018 results and minus 0.25% in the 2019 results due to the non-recurring nature of these events.</p> <p>We also considered this measure to be suitable having compared to other benchmarks: our materiality equates to 6.2% (2019: 5.5%) of statutory profit before tax, 0.9% (2019: 0.9%) of gross earned premium and 0.9% (2019: 0.9%) of total equity.</p>	<p>We determined that the critical benchmark for the Parent Company was shareholder's equity. This is because the Parent Company is not a trading entity but rather received dividend income from its subsidiaries.</p> <p>When determining materiality for the Parent Company, we also considered the appropriateness of this materiality for the consolidation of this set of financial statements to the Group's results.</p>

Group materiality is used for setting audit scope and the assessment of uncorrected misstatements. Materiality is set for each significant component in line with the component's proportion of the chosen benchmark. This is capped at the lower of 90% of Group materiality and the component materiality determined for a standalone audit. The main UK insurance trading entity, U K Insurance Limited, which makes up 100% of Group gross earned premium and 86% of Group statutory profit before tax, is scoped to a component materiality of £25.2 million (2019: £25.2 million). Component materialities for other entities within the scope of our Group audit ranged from £0.8 million to £8.8 million (2019: £0.8 million to £9.0 million).

Average PBT Group materiality

6. Our application of materiality continued

6.2 Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

	Group financial statements	Parent Company financial statements
Performance materiality	67.5% (2019: 70%) of Group materiality	67.5% (2019: 70%) of Parent Company materiality
Basis and rationale for determining performance materiality	<p>In determining performance materiality, we considered the following factors:</p> <ul style="list-style-type: none"> - We have audited the Group for a number of years and so have knowledge of both the Group and the environment it operates in; - Our ability to rely on controls over a number of significant business processes; - Our past experience of the audit, which has indicated a low number of corrected and uncorrected misstatements identified in prior periods; - Misstatements noted in prior periods have not been indicative of deficiencies in internal control and so there is a low likelihood they will occur in the current period; and - The potential impact of Covid-19. 	For consistency within the Group, the same percentage of 67.5% of materiality has been applied to the Parent Company.

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £1.4 million (2019: £1.4 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. An overview of the scope of our audit

7.1 Identification and scoping of components

The scope of our Group audit was determined by obtaining an understanding of the Group and its environment, including group wide controls and assessing the risks of material misstatement at Group level.

Consistent with the prior period, this resulted in two entities being subject to a full scope audit and a further two were subject to an audit of specified account balances where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group's operations. All entities within scope of the Group audit are based in the UK.

These four entities represent the principal trading and service operations of the Group and account for 99% (2019: 99%) of the Group's net assets, 100% (2019: 100%) of the Group's gross earned premium and 95% (2019: 98%) of the Group's profit before tax. They were also selected to provide an appropriate basis for undertaking audit work to address the risks of material misstatement identified above.

Gross Earned Premium

Net Assets

Profit before tax

Full audit scope

Full audit scope
Specified audit procedures
Review at group level

Full audit scope
Specified audit procedures
Review at group level

At the Group level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

The Group audit team directly performed the audit work for all of the entities listed above, including the Parent Company.

7.2 Our consideration of the control environment

IT Controls

In planning our 2020 audit we identified 13 systems that were material to the Group's financial reporting processes. These systems handled data relating to premiums, claims, expenses and payroll and we intended to rely on the IT and business controls associated with these systems. Having worked with our in-house IT specialists to assess the operating effectiveness of the IT controls associated with these systems, as well as the wider general IT control environment across the Group, we were able to rely upon the IT controls associated with all 13 systems identified.

Business process and financial reporting controls

In planning our 2020 audit, we identified 20 business cycles that were material to the Group's financial reporting processes. These cycles spanned the Group's material transactions and account balances including the premiums, claims, reinsurance, expenses, payroll, investments and intangibles cycles and part of the reserving cycle relating to reconciliation of data, and we intended to rely on the business controls associated with all of these cycles. Having completed our testing over the operating effectiveness of business controls associated with these cycles, through a combination of current period testing and reliance on prior period testing, we concluded that we were able to rely upon the business controls associated with all 20 cycles.

8. Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information contained within the annual report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

9. Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

10. Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Independent Auditor's Report to the shareholders of Direct Line Insurance Group plc *continued*

11. Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

11.1 Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the Group's remuneration policies, key drivers for Directors' remuneration, bonus levels and performance targets;
- the Group's own assessment of the risks that irregularities may occur either as a result of fraud or error that was approved by the Board Risk Committee on 11 February 2021;
- results of our enquiries of management, internal audit, and the Audit Committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the Group's documentation of their policies and procedures relating to:
 - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
 - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
 - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations; and
 - the matters discussed among the audit engagement team and involving relevant internal specialists, including tax, valuations, pensions, IT and industry specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas: the valuation of the insurance liabilities. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory framework that the Group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules and tax legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the Group's ability to operate or to avoid a material penalty. These included the Group's operating licence, regulatory solvency requirements such as those under the relevant Solvency II requirements and those required by the PRA and FCA and environmental regulations.

11.2 Audit response to risks identified

As a result of performing the above, we identified valuation of insurance liabilities and valuation of intangible assets as key audit matters related to the potential risk of fraud or non-compliance with laws and regulations. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the Audit Committee and in-house legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with HMRC, PRA and FCA; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments, assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and remained alert to any indicators of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

12. Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and the Parent Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic report or the Directors' report.

13. Corporate governance statement

The Listing Rules require us to review the Directors' statement in relation to going concern, longer-term viability and that part of the Corporate Governance Statement relating to the Group's compliance with the provisions of the UK Corporate Governance Code specified for our review.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- the Directors' statement with regards to the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on page 143;
- the Directors' explanation as to its assessment of the Group's prospects, the period this assessment covers and why the period is appropriate set out on page 75;
- the Directors' statement on fair, balanced and understandable set out on page 95;
- the Board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 95;
- the section of the Annual Report and Accounts that describes the review of effectiveness of risk management and internal control systems set out on page 172; and
- the section describing the work of the Audit Committee set out on page 97.

14. Matters on which we are required to report by exception

14.1 Adequacy of explanations received and accounting records

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

14.2 Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' remuneration report to be audited is not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

15. Other matters which we are required to address

15.1 Auditor tenure

Following the recommendation of the Audit Committee of Royal Bank of Scotland Group plc. ("RBSG"), which at the time owned Direct Line, we were appointed by the Board of Directors of RBSG on 21 March 2000 to audit the financial statements for the year ending 31 December 2000 and subsequent financial periods. When the Group became independent of RBSG the Group's Board reappointed us to audit the newly demerged Group. Taking into account our service to predecessor organisations, the period of total uninterrupted engagement including previous renewals and reappointments of the firm is 21 years, covering the years ending 31 December 2000 to 31 December 2020. Under the Companies Act 2006, the last financial year of our maximum engagement period is the year ending 31 December 2023.

15.2 Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

Independent Auditor's Report to the shareholders of Direct Line Insurance Group plc *continued*

16. Use of our report

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

Colin Rawlings

COLIN RAWLINGS FCA (SENIOR STATUTORY AUDITOR)

FOR AND ON BEHALF OF DELOITTE LLP

SENIOR STATUTORY AUDITOR

LONDON, UNITED KINGDOM

5 MARCH 2021

Consolidated Income Statement

For the year ended 31 December 2020

	Notes	2020 £m	2019 £m
Gross earned premium		3,189.3	3,202.6
Reinsurance premium		(228.8)	(217.7)
Net earned premium	5	2,960.5	2,984.9
Investment return	6	95.1	134.6
Instalment income		109.3	114.0
Other operating income	7	49.9	66.2
Total income		3,214.8	3,299.7
Insurance claims		(1,730.4)	(1,917.3)
Insurance claims recoverable from reinsurers		16.8	69.7
Net insurance claims	8	(1,713.6)	(1,847.6)
Commission expenses	9	(254.7)	(211.5)
Operating expenses (including restructuring and one-off costs)	10	(763.8)	(704.9)
Total expenses		(1,018.5)	(916.4)
Finance costs	11	(31.3)	(26.0)
Profit before tax		451.4	509.7
Tax charge	12	(84.2)	(89.8)
Profit for the year attributable to the owners of the Company		367.2	419.9
Earnings per share:			
Basic (pence)	15	25.8	29.5
Diluted (pence)	15	25.5	29.2

The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2020

	Notes	2020 £m	2019 £m
Profit for the year attributable to the owners of the Company		367.2	419.9
Other comprehensive income			
Items that will not be reclassified subsequently to the income statement:			
Actuarial loss on defined benefit pension scheme	27	(0.4)	(7.3)
Tax relating to items that will not be reclassified	13	0.3	1.3
		(0.1)	(6.0)
Items that may be reclassified subsequently to the income statement:			
Cash flow hedges		(0.1)	(0.7)
Fair value gain on AFS investments	31	47.4	118.1
Less: net gains on AFS investments transferred to income statement on disposals	31	(1.1)	(16.5)
Tax relating to items that may be reclassified	31	(9.9)	(17.3)
		36.3	83.6
Other comprehensive income for the year net of tax		36.2	77.6
Total comprehensive income for the year attributable to the owners of the Company		403.4	497.5

The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

Consolidated Balance Sheet
As at 31 December 2020

DIRECT LINE INSURANCE GROUP PLC
Company number **02280426**

	Notes	2020 £m	2019 £m
Assets			
Goodwill and other intangible assets	17	786.8	702.5
Property, plant and equipment	18	146.1	143.4
Right-of-use assets	19	137.8	149.2
Investment property	20	292.1	291.7
Reinsurance assets	22	1,129.2	1,251.3
Deferred acquisition costs	23	172.2	176.2
Insurance and other receivables	24	848.2	846.5
Prepayments, accrued income and other assets	25	126.0	120.2
Derivative financial instruments	26	73.4	121.5
Retirement benefit asset	27	9.0	9.7
Financial investments	28	4,681.4	4,673.4
Cash and cash equivalents	29	1,220.1	948.6
Total assets		9,622.3	9,434.2
Equity			
Shareholders' equity		2,699.7	2,643.6
Tier 1 notes	32	346.5	346.5
Total equity		3,046.2	2,990.1
Liabilities			
Subordinated liabilities	33	516.6	259.0
Insurance liabilities	34	3,617.0	3,819.6
Unearned premium reserve	35	1,497.1	1,506.0
Borrowings	29	51.9	52.3
Derivative financial instruments	26	57.2	30.5
Provisions	37	114.8	74.3
Trade and other payables, including insurance payables	38	549.9	478.1
Lease liabilities		152.4	164.4
Deferred tax liabilities	13	8.7	9.6
Current tax liabilities	13	10.5	50.3
Total liabilities		6,576.1	6,444.1
Total equity and liabilities		9,622.3	9,434.2

The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 5 March 2021. They were signed on its behalf by:



PENNY JAMES
CHIEF EXECUTIVE OFFICER

Consolidated Statement of Changes in Equity

For the year ended 31 December 2020

	Share capital (note 30) £m	Employee trust shares £m	Capital reserves (note 31) £m	AFS revaluation reserve (note 31) £m	Foreign exchange translation reserve £m	Retained earnings £m	Shareholders' equity £m	Tier 1 notes (note 32) £m	Total equity £m
Balance at 1 January 2019	150.0	(35.2)	1,450.0	(36.8)	0.8	1,029.4	2,558.2	346.5	2,904.7
Profit for the year	–	–	–	–	–	419.9	419.9	–	419.9
Other comprehensive income	–	–	–	84.3	(0.7)	(6.0)	77.6	–	77.6
Dividends and appropriations paid (note 14)	–	–	–	–	–	(420.7)	(420.7)	–	(420.7)
Shares acquired by employee trusts	–	(10.4)	–	–	–	–	(10.4)	–	(10.4)
Credit to equity for equity-settled share-based payments (note 36)	–	–	–	–	–	18.4	18.4	–	18.4
Shares distributed by employee trusts	–	15.4	–	–	–	(15.4)	–	–	–
Tax on share-based payments	–	–	–	–	–	0.6	0.6	–	0.6
Balance at 31 December 2019	150.0	(30.2)	1,450.0	47.5	0.1	1,026.2	2,643.6	346.5	2,990.1
Profit for the year	–	–	–	–	–	367.2	367.2	–	367.2
Other comprehensive income	–	–	–	36.4	(0.1)	(0.1)	36.2	–	36.2
Dividends and appropriations paid (note 14)	–	–	–	–	–	(312.5)	(312.5)	–	(312.5)
Shares acquired by employee trusts	–	(23.8)	–	–	–	–	(23.8)	–	(23.8)
Shares cancelled following buyback (note 30)	(1.1)	–	1.1	–	–	(30.0)	(30.0)	–	(30.0)
Credit to equity for equity-settled share-based payments (note 36)	–	–	–	–	–	18.5	18.5	–	18.5
Shares distributed by employee trusts	–	13.7	–	–	–	(13.7)	–	–	–
Tax on share-based payments	–	–	–	–	–	0.5	0.5	–	0.5
Balance at 31 December 2020	148.9	(40.3)	1,451.1	83.9	–	1,056.1	2,699.7	346.5	3,046.2

The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December 2020

	Notes	2020 £m	2019 £m
Net cash generated from operating activities before investment of insurance assets	39	268.8	88.2
Cash generated from investment of insurance assets	39	315.9	373.9
Net cash generated from operating activities		584.7	462.1
Cash flows used in investing activities			
Purchases of goodwill and other intangible assets	17	(140.7)	(175.7)
Purchases of property, plant and equipment	18	(20.1)	(11.9)
Net cash flows from acquisition of subsidiaries		(0.2)	–
Net cash used in investing activities		(161.0)	(187.6)
Cash flows used in financing activities			
Dividends and appropriations paid	14	(312.5)	(420.7)
Finance costs (including lease interest)		(30.2)	(26.4)
Principal element of lease payments	39	(12.5)	(13.1)
Purchase of employee trust shares		(23.8)	(10.4)
Proceeds on issue of subordinated Tier 2 notes	39	257.2	–
Shares purchased in buyback	30	(30.0)	–
Net cash used in financing activities		(151.8)	(470.6)
Net increase / (decrease) in cash and cash equivalents		271.9	(196.1)
Cash and cash equivalents at the beginning of the year	29	896.3	1,092.4
Cash and cash equivalents at the end of the year	29	1,168.2	896.3

The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

Corporate information

Direct Line Insurance Group plc is a public limited company registered in England and Wales (company number 02280426). The address of the registered office is Churchill Court, Westmoreland Road, Bromley, BR1 1DP, England.

1. Accounting policies

Basis of preparation

As required by the Companies Act 2006 and Article 4 of the EU IAS Regulation, the Group's consolidated financial statements are prepared in accordance with IFRSs issued by the IASB as adopted by the EU on 31 December 2020 and by the UK's Department of Business, Energy & Industrial Strategy ("BEIS") in 2021. The BEIS has been given the power of endorsing and adopting international accounting standards while the UK Endorsement Board ("UKEB") is still being established. The Group has elected to prepare its parent entity financial statements in accordance with FRS 101 'Reduced Disclosure Framework'.

The consolidated financial statements are prepared on the historical cost basis except for available-for-sale ("AFS") financial assets, investment property and derivative financial instruments, which are measured at fair value (fair value is defined in note 42).

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 the years ended 31 December 2020 and 31 December 2019 to items considered material to the consolidated financial statements.

The Company's financial statements and the Group's consolidated financial statements are presented in sterling, which is the functional currency of the Company and the Group.

Going concern

The Directors believe that the Group has sufficient financial resources to meet its financial needs, including managing a mature portfolio of insurance risk. The Directors believe the Group is well positioned to manage its business risks successfully in the current economic climate. The Finance review on pages 20 to 35 describes the Group's capital management strategy, including the capital actions taken in the year to ensure the continued strength of the balance sheet. The Group's financial position is also covered in that section, including a commentary on cash and investment levels, reserves, currency management, insurance liability management, liquidity and borrowings. Additionally, note 3 to the consolidated financial statements describes capital management needs and policies. The note also covers insurance, market, liquidity and credit risks which may affect the Group's financial position.

The Directors have assessed the principal risks faced by the Group over the duration of the planning cycle. These included the implementation of the FCA's Pricing Practices Review, possible adverse implications of Brexit, change risk and possible challenging market conditions due to the impact of Covid-19 on the economy and customer behaviour. The 2020 Plan modelled a number of different scenarios which were directly and indirectly influenced by the Covid-19 pandemic and Brexit. These included delay to improvements in technological capability, the impact of Covid-19 on claims frequency levels and the impact of Brexit on the investment return. The key judgements applied were in relation to the likely time period of Covid-19-related restrictions, and the subsequent impact on customer behaviour and the economic recovery.

In addition, the Group's Risk Function has carried out an assessment of the risks to the Plan and the dependencies for the success of the Strategic Plan. This included running stress tests on the Plan to consider the 1 in 8 years and 1 in 25 years loss simulations based on the internal economic capital model.

A reverse stress test was also performed to identify the most probable combination of stresses that would result in capital loss and thus threaten the viability of the Group, i.e. a reduction of own funds to below the solvency capital requirement.

In all scenarios, it was concluded that the Group's solvency capital requirement would not be breached following the implementation of management actions.

Therefore, having made due enquiries, the Directors reasonably expect that the Group has adequate resources to continue in operational existence for at least 12 months from 5 March 2021 (the date of approval of the financial statements). Accordingly, the Directors have adopted the going concern basis in preparing the financial statements.

Adoption of new and revised standards

The Group has adopted the following new amendments to IFRSs and International Accounting Standards ("IASs") that became mandatorily effective for the Group for the first time during 2020.

None of these amendments require changes to existing accounting policies.

Amendment to IFRS 16 'Leases Covid-19-related Rent Concessions' permits lessees, as a practical expedient, not to assess whether particular rent concessions occurring as a direct consequence of the Covid-19 pandemic are lease modifications and instead to account for those rent concessions as if they are not lease modifications.

'Amendments to References to the Conceptual Framework in IFRS Standards' amends some references to previous versions of the Conceptual Framework in IFRS Standards and their accompanying documents and IFRS Practice Statements.

Amendments to IFRS 3 'Business Combinations', narrow and clarify the definition of a business. They also permit a simplified assessment of whether an acquired set of activities and assets is a group of assets rather than a business.

Amendments to IAS 1 and IAS 8: 'Definition of Material', clarify and align the definition of "material" and provide guidance to help improve consistency in the application of that concept whenever it is used in IFRS Standards.

1.1 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and the entities that are controlled by the Group at 31 December 2020 and 31 December 2019. Control exists when the Group is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In assessing whether the Group controls another entity, the existence and effect of the potential voting rights that are currently exercisable or convertible are considered.

A subsidiary acquired is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated financial statements at fair value.

All intercompany transactions, balances, income and expenses between Group entities are eliminated on consolidation.

1.2 Foreign currencies

The Group's consolidated financial statements are presented in sterling, which is the presentational currency of the Group.

Group entities record transactions in the currency of the primary economic environment in which they operate (their functional currency), translated 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.

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 the income statement except for differences arising on AFS non-monetary financial assets, 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 consolidated statement of comprehensive income. The amount accumulated in equity is reclassified from equity to the consolidated 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 policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

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.

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 reserve, which represents the proportion of the premiums incepted in the year or prior periods that relate to periods of insurance cover 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.

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.

Cash back payments to policyholders under motor telematics policies represent a reduction in earned premiums.

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.

Rental income from investment property is recognised in the income statement on a straight-line basis over the period of the contract.

Dividend income is recognised when the right to receive payment is established.

Instalment income

Instalment income comprises the interest income earned on policyholder receivables, 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

Vehicle replacement referral income

Vehicle replacement referral income comprises fees recognised at a point in time in respect of referral income received when a customer or a non-fault policyholder (claimant) of another insurer has been provided with a hire vehicle from a preferred supplier.

Income is recognised when the customer or claimant has been provided with a vehicle by the supplier.

Revenue from vehicle recovery and repair services

Fees in respect of services for vehicle recovery are recognised at a point in time on satisfaction of performance obligations. The cost of providing the service is incurred as the service is rendered.

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 repair obligations. The price is determined using market rates for the services and materials used after discounts have been deducted where applicable.

Legal services income

Legal services income represents the amount charged to clients for professional services provided during the year including recovery of expenses but excluding value added tax. Income relating to variable legal services fees is recognised on a best estimate basis.

Other income

Commission fee income in respect of services is recognised at a point in time on satisfaction of related performance obligations. Where variable consideration is identified in a contract, this revenue is estimated and constrained to the extent that it is highly improbable that revenue recognised will be reversed. 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.

1.5 Insurance claims continued

A 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 note 2.4. 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.

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 provisions are increasingly driven by methods based on actual claims 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 provisions at a margin above the actuarial best estimate. This amount is recorded within claims provisions.

A liability adequacy provision is made for unexpired risks arising where the expected value of 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 deferred and other prepaid amounts. 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 product line. 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 and this is taken as an indication of a reinsurer's difficulty in meeting its obligations under the reinsurance contracts. This also includes an assessment in respect of the ceded part of claims provisions to reflect the counterparty default risk exposure to long-term reinsurance assets particularly in relation to PPOs. Increases in this provision affect the Group by reducing the carrying value of the asset 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 is 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, directly attributable administration costs, 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, associates 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 operating expenses. The estimated useful economic lives for software development costs is up to 10 years.

Expenditure on internally generated goodwill and indirect advertising costs is written off as incurred. Direct costs relating to the development of internal-use computer software and associated business processes 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 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 are expensed as incurred, as are all training costs and general overheads.

1.9 Property, plant and equipment

Items of property, plant and equipment (except investment property – see note 1.12) 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. The estimated useful lives are as follows:

Freehold and leasehold buildings	50 years or the period of the lease if shorter
Vehicles	3 years
Computer equipment	Up to 5 years
Other equipment, including property adaptation costs	2 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 of those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit ("CGU") 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 CGU, discounted at a rate that reflects market interest rates, adjusted for risks specific to the asset or CGU 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 Right-of-use assets and lease liabilities

Where the Group is a lessee

At inception, the Group assesses whether a contract contains a lease arrangement, which involves assessing whether it obtains substantially all the economic benefits from the use of a specific asset, and it has the right to direct the use of that asset. The Group recognises a right-of-use asset and a lease liability at the commencement of the lease (when the underlying asset is available for use), except for short-term leases of 12 months or less and low value leases which are expensed on a straight-line basis in the income statement. The right-of-use asset is initially

measured based on the present value of the lease payments, plus initial direct costs less any incentives received. Lease payments include fixed payments and variable payments. Variable payments relate to contractual rent increases linked to inflation indices. The right-of-use asset is depreciated over the lease term and is subject to impairment testing if there is an indicator of impairment. When leases contain an extension or purchase option which is reasonably expected to be exercised this is included in the measurement of the lease.

In calculating the present value of lease payments, the Group uses the incremental borrowing rate at the lease commencement date unless the interest rate implicit in the lease is readily determinable. The incremental borrowing rate is determined based on available risk-free market yield-to-maturity pricing linked to the lease amount and term, and includes a credit spread. The lease liability is subsequently measured at amortised cost using the effective interest rate method and remeasured, with a corresponding adjustment to the right-of-use asset, when there is a change in future lease payments, terms or reassessment of options.

The Group's leasehold property mainly relates to office space and vehicle repair centres. Leases in respect of motor vehicles relate to recovery and replacement vehicles, and management cars. The Group also leases certain IT equipment which is not a significant portion of the total leased asset portfolio.

Where the Group is a lessor

Leases where a significant proportion of the risks and rewards of ownership is retained by the lessor are classified as operating leases. Lease income from operating leases is recognised in the income statement on a straight-line basis over the lease term.

Where assets are subject to finance leases, the present value of the lease payments, together with any unguaranteed residual value, is recognised as a receivable.

1.12 Investment property

Investment property comprises freehold and 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 adjusted for the specific characteristics of each property. Any gain or loss arising from a change in fair value is recognised in the income statement.

Investment property is derecognised when it has been either disposed of or permanently withdrawn from use and no future economic benefit is expected from disposal. Any gains or losses on the retirement or disposal of investment property are recognised in the income statement in the year of retirement or disposal.

1.13 Financial assets

Financial assets are classified as available-for-sale, held-to-maturity, designated at fair value through profit or loss, or loans and receivables.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place are recognised on the date that the Group commits to purchase or sell the asset.

1.13 Financial assets continued

Available-for-sale ("AFS")

Financial assets can be designated as AFS on initial recognition. AFS 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 translating the amortised cost of foreign currency monetary AFS financial assets, are recognised in the income statement, together with interest calculated using the effective interest rate method. Other changes in the fair value of AFS 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.

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 (for example, 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 the fair value by using a valuation technique. Valuation techniques include using recent arm's-length market transactions between knowledgeable and 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.

AFS financial assets include equity investments.

Held-to-maturity ("HTM")

Non-derivative financial assets not designated as AFS, or loans and receivables with fixed or determinable payments and fixed maturity, where the intention and ability to hold them to maturity exists, are classified as HTM.

Subsequent to initial recognition, HTM financial assets are measured at amortised cost using the effective interest rate method less any impairment losses.

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 AFS or HTM. 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.

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 AFS, HTM 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.

AFS

When a decline in the fair value of a financial asset classified as AFS 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 AFS equity instruments are not reversed through profit or loss, but those on AFS debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

HTM or loans and receivables

If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as HTM or 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.

Insurance receivables

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.

Receivables also include amounts due in respect of the provision of legal services.

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 charged to the income statement and the bad debt provision is released 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.

Gains and losses arising from changes in the 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 enters into fair value hedge relationships and a small amount of cash flow hedges.

Hedge relationships are formally documented at inception. The documentation identifies the hedged item and 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 a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income. 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.

Derecognition of financial assets

A financial asset is derecognised when the rights to receive the cash flows from that asset have expired or when the Group has transferred its rights to receive cash flows from the asset and has transferred substantially all the risk and rewards of ownership of the asset.

1.14 Cash and cash equivalents and borrowings

Cash and cash equivalents comprise cash in 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, are measured at amortised cost using the effective interest rate method and are part of the Group's cash management approach and are repayable on demand.

1.15 Financial liabilities

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 rate method.

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

1.16 Subordinated liabilities

Subordinated liabilities comprise subordinated guaranteed dated 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.

1.17 Provisions

The Group recognises a provision for a present legal or constructive obligation from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount can be reliably estimated.

The Group makes provision for all insurance industry levies, such as the Financial Services Compensation Scheme and Motor Insurance Bureau.

When the Group has an onerous contract, it recognises the present obligation under the contract as a provision. A contract is onerous when the unavoidable costs of meeting the contractual obligations exceed the expected future economic benefit.

Restructuring provisions are made, including redundancy costs, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan and has communicated the plan to those affected.

1.18 Pensions and other post-retirement benefits

The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

Contributions to the Group's defined contribution pension scheme are recognised in the income statement when payable.

The Group's defined benefit pension scheme, as described in note 27, 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 net interest on the net pension liability or asset, is charged or credited 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 under "Items that will not be reclassified subsequently to the income statement".

1.19 Taxation

The tax charge or credit represents the proportion of the tax payable and receivable arising in the current year only.

The current tax charge is based on the taxable profits for the year as determined in accordance with the relevant tax legislation, after any adjustments in respect of prior years. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Provision for taxation is calculated using tax rates that have been enacted, or substantively enacted, by the balance sheet date and is allocated over profits before taxation or amounts charged or credited to components of other comprehensive income and equity, as appropriate.

Deferred taxation is accounted for in full using the balance sheet liability method on all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes.

Deferred tax liabilities are generally recognised for all taxable temporary timing differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is probable that they will not be recovered.

1.19 Taxation *continued*

Deferred tax assets and liabilities are calculated at the tax rates expected to apply when the assets are realised or liabilities are settled based on laws and rates that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited to other comprehensive income or equity, in which case the deferred tax is also dealt with in other comprehensive income or directly in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current assets and liabilities on a net basis.

1.20 Share-based payment

The Group operates a number of share-based compensation plans under which it awards Ordinary Shares and share options to its employees. Such awards are generally subject to vesting conditions that can alter the amount of cash or shares to which an employee is entitled.

Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the Group to meet specified performance targets).

The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility.

The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of the Company's Ordinary Shares).

The cost is expensed on a straight-line basis over the vesting period (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest.

The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

1.21 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.

The Tier 1 notes are classified as equity as they have a perpetual maturity and the Group has full discretion over interest payments, including ability to defer or cancel interest payments indefinitely.

The consideration for any Ordinary Share of the Company purchased by the Group for the benefit of the employee trusts is deducted from equity.

1.22 Dividends

Interim dividends on Ordinary Shares are recognised in equity in the period in which they are paid. Final dividends on Ordinary Shares are recognised when they have been approved at the AGM.

1.23 Accounting developments

New IFRS standards and amendments that are issued, but not yet effective for the 31 December 2020 reporting period and have not been early adopted by the Group, are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective, except for amendments to IFRS 9 'Financial Instruments', as explained below.

In July 2014, the IASB issued the final version of IFRS 9 'Financial Instruments' which replaces IAS 39 'Financial Instruments: Recognition and Measurement' and all previous versions of IFRS 9; it was endorsed by the EU in 2016. IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets. It was effective for annual periods beginning on or after 1 January 2018, however adoption by the Group has been deferred as described below.

In September 2016, the IASB issued Amendments to IFRS 4: 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' to address issues arising from the different effective dates of IFRS 9 and IFRS 17 'Insurance Contracts'. These amendments to IFRS 4 were endorsed by the EU in November 2017.

These amendments permitted insurers who satisfied certain criteria to defer the effective date of IFRS 9, to coincide with the expected effective date of IFRS 17. The Group conducted a high-level assessment of the three aspects of IFRS 9 and based on current information, the impact of applying the expected loss model for the first time is currently immaterial. The Group does not expect any other significant impact on its financial statements.

The amendments required insurance entities to evaluate whether their activities were predominantly connected to insurance as at their annual reporting date immediately preceding 1 April 2016, providing an option to defer adoption of IFRS 9 if liabilities connected to insurance comprised a predominant proportion of their total liabilities as at that date. The Group concluded that it satisfied the criteria and there have been no significant changes in the Group's activities since this assessment to require a reassessment of the criteria.

As a result, the Group has decided to defer the application of IFRS 9 and continues to do so. The amendments to IFRS 4 also require certain interim disclosures in relation to the fair value movements of financial assets as outlined below.

The fair value at the end of the reporting period for financial assets with contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount are disclosed in note 42. The amount of change in the fair value during the period for these financial assets was:

- AFS debt securities £96.7 million increase (2019: £118.6 million increase);
- HTM debt securities £0.2 million decrease (2019: £3.8 million increase);
- infrastructure debt £1.1 million increase (2019: £10.6 million increase); and
- commercial real estate loans £3.8 million decrease (2019: £2.5 million decrease).

Derivative assets do not have contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. The fair value of these financial assets is disclosed in note 42 and the amount of change in the fair value during the period was an increase of £64.5 million (2019: £111.8 million increase).

In note 3.3.3 the Group has disclosed the carrying amount of financial assets at the end of the reporting period by credit risk rating grade, as defined in IFRS 7 'Financial Instruments: Disclosures'. The fair value and the carrying amount of financial assets that meet the 'solely payments of principal and interest' criteria, and at the end of the reporting period do not have a low credit risk, was £377.2 million (2019: £390.8 million).

IFRS 9 information that relates to entities within the Group that is not provided in the Group's consolidated financial statements can be obtained from their individual financial statements, which are filed at Companies House.

As the effective date of IFRS 17 has since been delayed to 1 January 2023, 'Amendments to IFRS 4 – Deferral of IFRS 9' was issued in June 2020 which delays the effective date of IFRS 9 so as to remain in line with IFRS 17. The amendments were endorsed by the UK's Department of Business, Energy & Industrial Strategy ("BEIS") in January 2021.

'Amendments to IFRS 9: Prepayment Features with Negative Compensation' was issued in October 2017 and is endorsed by the EU to allow instruments with symmetric prepayment options to qualify for amortised cost or fair value through other comprehensive income measurement because they would otherwise fail the 'solely payments of principal and interest' test on the principal amount condition. The amendments are effective from the same period as IFRS 9.

IFRS 17 was issued by the IASB in May 2017 to replace IFRS 4 'Insurance Contracts' and is effective for reporting periods beginning on or after 1 January 2023, with comparative figures required. IFRS 17 is a comprehensive new accounting standard for all insurance contracts covering recognition and measurement, presentation and disclosure. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers and to replace the requirements of IFRS 4 that allowed insurers to apply grandfathering of previous local accounting policies.

The core of IFRS 17 is the general model, supplemented by an optional simplified premium allocation approach which is permitted for the liability for the remaining coverage for short-duration contracts. The general model measures insurance contracts using the building blocks of: discounted probability-weighted cash flows; an explicit risk adjustment; and a contractual service margin representing the unearned profit of the contract which is recognised as revenue over the coverage period.

An initial assessment of the impact of IFRS 17 on the Group's financial statements has been completed and work has now started on the design and build of the systems that will provide the foundation for reporting under IFRS 17 from 1 January 2023. The Group expects to be able to apply the simplified premium allocation approach to all material insurance and reinsurance contract groups. As the standard was not endorsed by the EU before 31 December 2020, it will instead require endorsement by the UKEB.

In September 2019, the IASB issued 'Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39 and IFRS 7' which the Group adopted in 2019. These Phase 1 amendments modify some specific hedge accounting requirements to provide relief from the potential effects of the uncertainty caused by the IBOR reform. In addition, it requires companies to disclose additional information about their hedging relationships which are directly affected by these uncertainties. The amendments allow the Group to continue applying hedge accounting to some of its benchmark interest rate exposure, as the amendments permit the continuation of hedge accounting where in future the hedged benchmark interest rate may no longer be separately available. The amendments do not alter the requirement for the designated interest rate risk component to be measurable. If the risk component is no longer reliably measurable, the hedging relationship is discontinued. The relief provided by the amendments ceases to apply prospectively when the uncertainties arising from the interest rate benchmark reform are no longer present.

The Group holds investments in US dollar and Euro fixed rate debt securities which it includes in a macro fair value hedge of the USD LIBOR and EURIBOR risk component of these investments respectively.

The Group will not discontinue hedge accounting should the retrospective assessment of hedge effectiveness fall outside the 80-125% range where the hedging relationship is subject to interest rate benchmark reforms. However, for those hedging relationships that are not subject to the interest rate benchmark reforms the entity continues to cease hedge accounting if retrospective effectiveness is outside the 80-125% range.

In August 2020, the IASB issued 'Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 'Interest Rate Benchmark Reform – Phase 2'.

The Phase 2 amendments provide additional temporary reliefs from applying specific IFRS 9 and IAS 39 hedge accounting requirements to hedging relationships directly affected by IBOR reform. They also require disclosure of: (i) how the entity is managing the transition to alternative benchmark rates, its progress and the risks arising from the transition; (ii) quantitative information about derivatives and non-derivatives that have yet to transition, disaggregated by significant interest rate benchmark; and (iii) a description of any changes to the risk management strategy as a result of IBOR reform.

The Phase 2 amendments are effective for annual periods starting on or after 1 January 2021 and were endorsed by the BEIS in January 2021.

In January 2020 the IASB issued 'Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)' which clarifies the requirements for classifying liabilities as current or non-current. More specifically:

- The amendments specify that the conditions which exist at the end of the reporting period are those which will be used to determine whether a right to defer settlement of a liability exists.
- Management expectations about events after the balance sheet date, for example on whether a covenant will be breached, or whether early settlement will take place, are not relevant.
- The amendments clarify the situations that are considered to determine settlement of a liability.

In July 2020 a further amendment was made: 'Classification of Liabilities as Current or Non-Current – Deferral of Effective Date (Amendment to IAS 1)' to defer the effective date of the January 2020 'Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)' to annual reporting periods beginning on or after 1 January 2023.

1.23 Accounting developments continued

The new guidance is effective for annual periods starting on or after 1 January 2023 and will require endorsement by the UKEB.

In May 2020 the IASB issued narrow-scope amendments to three Standards:

- Amendments to IFRS 3 'Business Combinations' update a reference in IFRS 3 to the Conceptual Framework for Financial Reporting without changing the accounting requirements for business combinations.
- Amendments to IAS 16 'Property, Plant and Equipment' prohibit a company from deducting from the cost of property, plant and equipment amounts received from selling items produced while the company is preparing the asset for its intended use. Instead, a company will recognise such sales proceeds and related cost in profit or loss.
- Amendments to IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' specify which costs a company includes when assessing whether a contract will be loss-making.

These three amendments have an IASB effective date of 1 January 2022 and will require endorsement by the UKEB.

Also, in May 2020 the IASB issued 'Annual Improvements to IFRS Standards 2018-2020' which makes minor amendments to:

- IFRS 1 'First-time Adoption of International Financial Reporting Standards' which simplifies the application of IFRS 1 for a subsidiary that becomes a first-time adopter of IFRS Standards later than its parent;
- IFRS 9 'Financial Instruments' - this amendment clarifies that - for the purpose of performing the '10 per cent test' for derecognition of financial liabilities - in determining those fees paid net of fees received, a borrower includes only fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf; and
- IFRS 16 'Leases' which removes the illustration of payments from the lessor relating to leasehold improvements.

All amendments are effective 1 January 2022 and will require endorsement by the UKEB.

2. Critical accounting judgements and key sources of estimation uncertainty

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 162 to 170. Company law and IFRSs 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.

In the absence of an applicable standard or interpretation, IAS 8 'Accounting policies, Changes in Accounting Estimates and Errors' 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.

2.1 Impairment provisions - financial assets

Accounting judgement

The Group makes a judgement that financial assets are impaired when there is objective evidence that an event or events have occurred since initial recognition that have adversely affected the amount or timing of future cash flows from the asset. The determination of which events could have adversely affected the amount or timing of future cash flows from the asset requires judgement. In making this judgement, the Group evaluates, among other factors: the normal price volatility of the financial asset; the financial health of the investee; industry and sector performance; changes in technology or operational and financing cash flow; and whether there has been a significant or prolonged decline in the fair value of the asset below its cost. Impairment may be appropriate when there is evidence of deterioration in these factors. There was a small impairment of £2.7 million within the loans and receivables portfolio in the year ended 31 December 2020 (2019: £nil). On a quarterly basis, the Group reviews whether there is any objective evidence that a financial asset is impaired based on the following criteria:

- actual, or imminent, default on coupon interest or nominal;
- adverse movements in the credit rating for the investee/borrower;
- price performance of a particular AFS debt security, or group of AFS debt securities, demonstrating an adverse trend compared to the market as a whole; and
- whether an event has occurred that could be reliably estimated and which had an impact on the financial asset or its future cash flows.

Had all the declines in AFS asset values met the criteria above at 31 December 2020, the Group would have suffered a loss of £3.0 million (2019: £4.0 million), being the transfer of the total AFS reserve for unrealised losses to the income statement. However, these movements represent mark-to-market movements and, as there was no objective evidence of any loss events that could affect future cash flows, no impairments have been recorded.

2.2 Fair value of investment properties

Sources of estimation uncertainty

The Group holds a portfolio of investment properties, with a value at 31 December 2020 of £292.1 million (2019: £291.7 million). Where quoted market prices are not available, valuation techniques are used to value these properties. The fair value was determined using a methodology based on recent market transactions for similar properties, which have been adjusted for the specific characteristics of each property within the portfolio. The valuation in the financial statements is based on valuations by independent registered valuers and the techniques used include some unobservable inputs. The valuations used for investment properties are classified in the level 3 category of the fair value hierarchy (see note 42).

2.3 Impairment provisions - intangible assets

Accounting judgement

Judgement is applied to determine whether there is indication of impairment to intangible assets. In making this judgement, the Group considers: the projection of the economic benefits associated with each asset; subsequent re-measurement of these benefits through the development cycle and into use; the projected ultimate cost of each asset at each point through the development cycle due to specification changes; and the likelihood of obsolescence of any component parts.

Sources of estimation uncertainty

Sources of estimation uncertainty can arise where there are indicators of impairment of an intangible asset and an impairment provision is deemed appropriate. Factors, such as whether the carrying amount of the asset is expected to be greater than the recoverable amount are assessed, and in 2020 the Group recognised an impairment provision of £6.6 million (2019: £1.3 million) in relation to ongoing IT projects primarily relating to the development of new systems.

The sensitivities to the assumptions made by the Group in respect of the testing for impairment of goodwill and other intangible assets are shown in note 17.

2.4 General insurance: outstanding claims provisions and related reinsurance recoveries

Accounting judgement

Reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal actuarial best estimate. This margin is set by reference to various actuarial scenario assessments and reserve distribution percentiles. It also considers other long and short-term risks not reflected in the actuarial inputs, as well as management's view of the uncertainties in relation to the actuarial best estimate.

Source of estimation uncertainty

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 associated claims handling costs. Outstanding claims provisions net of related reinsurance recoveries at 31 December 2020 amounted to £2,591.7 million (2019: £2,670.0 million).

Claims reserves are assessed separately for large and attritional claims, typically using standard actuarial methods of projection. Key sources of estimation uncertainty include those arising from the selection of specific methods as well as assumptions for claims frequency and severity through the review of historical claims and emerging trends. The Group seeks to adopt a conservative approach to assessing claims liabilities, as evidenced by the favourable development of historical claims reserves.

The corresponding reinsurance recoveries are calculated on an equivalent basis, with similar estimation uncertainty, as discussed in note 1.6. The reinsurance bad debt provision is mainly held against expected recoveries on future PPO payments.

The most common method of settling bodily injury claims is by a lump sum. When this includes an element of indemnity for recurring costs, such as loss of earnings or ongoing medical care, the settlement calculations apply the statutory discount rate (known as the Ogden discount rate) to reflect the fact that payment is made on a one-off basis rather than periodically over time. The current Ogden discount rate is minus 0.25% for England and Wales, minus 0.75% in Scotland, and 2.5% in Northern Ireland.

The Group reserves its large bodily injury claims at the relevant discount rate for each jurisdiction, with the overwhelming majority now reserved at minus 0.25% as most will be settled under the law in England and Wales. The Ogden discount rate will be reviewed again at the latest in 2024 but, following the most recent change in 2019, only small movements are expected in future. These will have a low impact on the Group's reserves. This is also a function of the ongoing reduction in large bodily injury exposures as a result of continued positive prior-year development of claims reserves, and a higher proportion of reserves being covered by reinsurance as a result of the decision to opt for a lower reinsurance attachment point from 2014 onwards.

The Group settles some large bodily injury claims as PPOs rather than lump sum payments. The Group has estimated the likelihood of large bodily injury claims settling as PPOs. Anticipated PPOs consist of both existing large loss case reserves including allowances for development and claims yet to be reported to the Group. Reinsurance is applied at claim level and the net cash flows are discounted for the time value of money. The discount rate is consistent with the long duration and the assumed future indexation of the claims payments.

The Covid-19 pandemic has led to the largest shock to the UK economy on record and the outlook remains unusually uncertain at year end 2020. Much depends on the evolution of the pandemic and measures taken to protect public health, as well as the transition to the new trading arrangements between the EU and the UK. In addition to concerns about general indicators of economic health, such as falls in gross domestic product ("GDP"), rising unemployment and rising public sector debt ratios, the Group's reserves are exposed to the risk of changes in claims development patterns and claims inflation resulting from the pandemic. Changes in claims frequency present greater uncertainty for the unearned part of the business, whereas uncertainty over the level of claims severity has a greater impact on the earned claims reserves. Claims severity risk is particularly acute with respect to care costs for large bodily injury claims and car repair costs due to potential supply chain interruptions. The Group has therefore developed additional claims inflation scenarios, which look at 100 basis point changes in the claims inflation assumed in the actuarial best estimate over the next two years.

The table in note 34 to the financial statements provides an analysis of outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2020 and 31 December 2019 and further details on sources of estimation uncertainty. Details of sensitivity analysis to the discount rate applied to PPO claims and the impact of changes in claims inflation are shown in note 3.3.1.

3. Risk management

3.1 Enterprise Risk Management Strategy and Framework

The Enterprise Risk Management Strategy and Framework sets out, at a high level, the Group's approach and processes for managing risks. Further information can be found in the Risk management section of the Strategic report on page 69.

3.2 Risk and capital management modelling

The Board has ultimate responsibility for ensuring that the Group has sufficient funds to meet its liabilities as they fall due. The Group carries out detailed modelling of its assets, liabilities and the key risks to which these are exposed. This modelling includes the Group's own assessment of its SCR, using its partial internal model approved by the PRA in 2016. The SCR quantifies the insurance, market, credit, operational and liquidity risks that the regulated entities are undertaking.

The Board is closely involved in the SCR process and reviews, challenges and approves its assumptions and results.

3.3 Principal risks from insurance activities and use of financial instruments

The Risk management section of the Strategic report also sets out all the risks assessed by the Group as principal risks. Detailed below is the Group's risk exposure arising from its insurance activities and use of financial instruments specifically in respect of insurance risk, market risk, credit risk, operational risk and liquidity risk.

Following the end of the transition period on 31 December 2020 and the trade and co-operation agreement between the UK and the EU, there still remains considerable uncertainty as to the effect of Brexit on the Group. The Group has proactively considered a variety of possible implications of a disruptive end to existing trading and other arrangements between the UK and the EU, including of a financial and operational nature. Additionally, the risk of a UK-wide recession and global financial instability as a result of the Covid-19 pandemic remains high and the Group continues to monitor the worst-case impact. The implications of both these risks are referred to in the Risk management section of the Strategic report.

3.3.1 Insurance risk

The Group is exposed to insurance risk as a primary consequence of its business. Key insurance risks focus on the risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting.

The Group is mainly exposed to the following insurance risks:

Reserve risk

Reserve risk relates to both premium and claims. This is the risk of understatement or overstatement of reserves arising from:

- the uncertain nature of claims;
- data issues and changes to the claims reporting process;
- operational failures;
- failure to recognise claims trends in the market; and
- changes in underwriting and business written so that past trends are not necessarily a predictor of the future.

Understatement of reserves may result in not being able to pay claims when they fall due. Alternatively, overstatement of reserves can lead to a surplus of funds being retained resulting in opportunity cost; for example, lost investment return or insufficient resource to pursue strategic projects and develop the business.

Reserve risk is controlled through a range of processes:

- regular reviews of the claims and premiums, along with an assessment of the requirement for a liability adequacy provision for the main classes of business by the internal actuarial team;
- the use of external actuaries to review periodically the actuarial best estimate reserves produced internally, either through peer review or through provision of independent reserve estimates;
- 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
- regular assessment of the uncertainty in the reserves to help the Board set management best estimate reserves.

The Group's reserves are subject to the risk of retrospective changes in judicial conditions such as the recent changes in the Ogden discount rate. Detailed information on the Ogden discount rate is provided in note 2.4.

Uncertainty in claims reserves estimation is larger for claims such as PPOs for which annually indexed payments are made, typically over the lifetime of the injured party. Claims reserves for PPOs are held on a discounted basis and are sensitive to a change in the discount rate.

The table below provides a sensitivity analysis of the potential net impact of a change in a single factor (the internal discount rate used for PPOs, Ogden discount rate or claims inflation) with all other assumptions left unchanged. Other potential risks beyond the ones described could have additional financial impacts on the Group.

	Increase / (decrease) in profit before tax ^{1,2}	
	2020	2019
	£m	£m
At 31 December		
PPOs³		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	45.9	48.5
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(62.7)	(66.5)
Ogden discount rate⁴		
Impact of the Group reserving at a discount rate of 0.75% compared to minus 0.25% (2019: 0.75% compared to minus 0.25%)	43.7	53.3
Impact of the Group reserving at a discount rate of minus 1.25% compared to minus 0.25% (2019: minus 1.25% compared to minus 0.25%)	(61.1)	(75.0)
Claims inflation		
Impact of a decrease in claims inflation by 100 basis points for two consecutive years (new scenario in 2020)	32.4	—
Impact of an increase in claims inflation by 100 basis points for two consecutive years (new scenario in 2020)	(32.2)	—

Notes:

1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at 31 December and should not be interpreted as predictions.
3. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0% for reserving. The PPO sensitivity has been calculated on the direct impact of the change in the real internal discount rate with all other factors remaining unchanged.
4. Ogden discount rate sensitivity has been calculated on the direct impact of a permanent change in the discount rate in England and Wales with all other factors remaining unchanged. The Group will consider the statutory discount rate when setting its reserves but not necessarily provide on this basis. This is intended to ensure that reserves are appropriate for current and potential future developments.

The PPO sensitivity above is calculated on the basis of a change in the internal discount rate used for the actuarial best estimate reserves as at 31 December 2020. It does not take into account any second order impacts such as changes in PPO propensity or reinsurance bad debt assumptions.

There is the risk that claims are reserved or paid inappropriately, including the timing of such activity. However, there are claims management controls in place to mitigate this risk, as outlined below:

- 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 their authority, 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;
- 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;
- specialist bodily injury claims teams are responsible for handling these types of losses, with the nature of handling dependent on the level and type of claim. Claims exceeding a certain threshold are referred to the technical and large loss teams who also deal with all other claim types above defined limits or within specific criteria; and
- a process is in place to deal with major weather and other catastrophic events, known as the 'Surge Demand Plan'. A surge is the collective name given to an incident which significantly increases the volume of claims reported to the Group's claims function. The plan covers surge demand triggers, stages of incident, operational impact, communication and management information monitoring of the plan.

Underwriting risk

This is the risk that future claims experience on business written is materially different from the results expected, resulting in current-year losses. The Group predominantly underwrites personal lines insurance including motor, residential property, roadside assistance, creditor, travel and pet business. The Group also underwrites commercial risks primarily for low-to-medium risk trades within the small and medium-sized enterprises 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 revise renewal terms by amending the premium or other policy terms and conditions such as the excess as appropriate.

Underwriting risk includes catastrophe risk and the risk of loss, or of adverse change in the value of the insurance liabilities resulting from significant uncertainty of pricing, underwriting and provisioning assumptions related to extreme or exceptional circumstances.

3. Risk management continued

3.3.1 Insurance risk continued

The key risks relating to climate change today are UK floods and major UK windstorms.

The Group recognises that climate change may impact its business over the longer term. In particular, there is a risk that climate change affects the frequency and severity of extreme weather events (physical risk), which will change the Group's view of underwriting risk, reinsurance and pricing. The Group will be developing its risk management systems and monitoring tools over 2021 for physical risk alongside participating in the Climate Biennial Exploratory Scenario ("CBES"). Low-frequency, high-severity weather losses are mitigated to a significant degree by the catastrophe reinsurance programme, the ceding of home high flood risks to Flood Re, and the commercial underwriting strategy which reduces high flood risk exposure. Furthermore, there is a risk that the Group's insurance products will not meet its customers' needs as a result of changes in market dynamics and customer behaviour in relation to climate change, for example a rapid shift towards electric vehicle usage. The Group expects these specific risks to materialise in the medium to longer-term (see page 63 for definition) and anticipates that its continued strategic and operational response to the transition to a lower-carbon economy will support mitigation of these risks and the associated impacts in the long term.

When underwriting policies, the Group is subject to concentration risk in a variety of forms, including:

- geographic concentration risk - the Group purchases a catastrophe reinsurance programme to protect against a modelled 1-in-200 year catastrophe loss. The programme renews annually on 1 July and has a retention of £130 million and an upper limit of £1,125 million;
- 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; and
- sector concentration risk - the concentration of the Group to any given industry sector is monitored and analysed in respect of commercial customers.

It is important to note that none of these risk categories is independent of the others and that giving due consideration to the relationship between these risks is an important aspect of the effective management of insurance risk.

Distribution risk

The risk of a material reduction in profit compared to plan due to the Group not writing its planned policy volumes in each segment.

Pricing risk

The risk of economic loss arising from business being incorrectly priced or underwritten.

Reinsurance risk

This is the risk of inappropriate selection and/or placement of reinsurance arrangements, with either individual or multiple reinsurers, which renders the transfer of insurance risk to the reinsurer(s) inappropriate and/or ineffective.

Other risks include:

- reinsurance concentration risk - the concentration of credit exposure to any given counterparty;
- reinsurance capacity being reduced and/or withdrawn;
- underwriting risk appetite and reinsurance contract terms not being aligned;
- reinsurance contract terms being inappropriate or ineffective resulting in classes or types of business not being appropriately reinsured;
- non-adherence to the reinsurance policy terms and conditions, in terms of both policy management and claims not being handled within the reinsurance contract terms and conditions, or paid on an *ex-gratia* basis, resulting in reinsurance recoveries not being made in full;
- inappropriate or inaccurate management information and/or modelling being used to determine the value for money and purchasing of reinsurance (including aggregate modelling); and
- changes in the external legal, regulatory, social or economic environment (including changes resulting from climate change) altering the definition and application of reinsurance policy wordings or the effectiveness or value for money of reinsurance.

The Group uses reinsurance to:

- protect the underwriting result against low-frequency, high-severity losses through the transfer of catastrophe claims volatility to reinsurers;
- protect the underwriting result against unforeseen volumes of, or adverse trends in, large individual claims in order to reduce volatility and to improve stability of earnings;
- reduce the Group's capital requirements; and/or
- transfer risk that is not within the Group's current risk appetite.

3.3.2 Market risk

Market risk is the risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.

The Group is mainly exposed to the following market risk factors:

- spread risk;
- interest rate risk;
- property risk; and
- currency risk.

The Group has policies and limits approved by the Investment Committee for managing the market risk exposure. These set out the principles that the business should adhere to for managing market risk and establishing the maximum limits the Group is willing to accept having considered strategy, risk appetite and capital resources.

The Group monitors its market risk exposure on a daily basis and, in addition, has established an aggregate exposure limit consistent with its risk objective to maintain capital adequacy. Interdependencies across risk types have also been considered within the aggregate exposure limit. The allocation of the Group's investments across asset classes has been approved by the Investment Committee. The strategic asset allocation within the investment portfolio is reviewed by the Investment Committee, which makes recommendations to the Board for its investment strategy approval. The Investment Committee determines policy and controls, covering such areas as risk, liquidity and performance. The Investment Committee meets at least three times a year 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 the first and second lines of defence.

The investment management objectives are to:

- maintain the safety of the portfolio's principal both in economic terms and from a capital, accounting and reporting perspective;
- maintain sufficient liquidity to provide cash requirements for operations, including in the event of a catastrophe; and
- maximise the portfolio's total return within the constraints of the other objectives and the limits defined by the investment guidelines and capital allocation.

During the year, the Investment Committee agreed long-term targets for the investment portfolio in relation to supporting the Group's objectives on climate change. These are: ensuring the Group's entire investment portfolio is net carbon neutral by 2050 in line with the aims of the Paris Agreement; and an interim target of a 50% reduction in weighted average greenhouse gas emissions intensity by 2030 within the Group's corporate bonds portfolio, the largest part of its investment portfolio.

The Group has a property portfolio and an infrastructure debt portfolio to generate a real return which, from an asset and liability matching perspective, is used to offset the liability arising from longer duration PPOs.

When setting the strategic asset allocation, the Group is subject to concentration risk in a variety of forms including:

- large exposures to individual assets (either bond issuers or deposit-taking institutions); and
- large exposures to different assets where movements in values and ratings are closely correlated.

Concentration risk on investments 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 having 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. Risk management continued

3.3.2 Market risk continued

The table below analyses the distribution of debt securities by geographical area (commercial real estate loans and infrastructure debt are all within the UK).

At 31 December 2020	Corporate £m	Local government £m	Sovereign £m	Supranational £m	Debt securities total £m
Australia	205.7	—	—	—	205.7
Austria	17.1	—	—	—	17.1
Belgium	38.0	—	—	—	38.0
Canada	127.6	—	—	—	127.6
Cayman Islands	1.8	—	—	—	1.8
Czech Republic	1.1	—	—	—	1.1
Denmark	11.9	—	—	—	11.9
Finland	27.7	12.3	—	—	40.0
France	311.0	13.1	—	—	324.1
Germany	199.6	—	1.3	—	200.9
Ireland	7.1	—	—	—	7.1
Italy	27.1	—	—	—	27.1
Japan	48.2	—	—	—	48.2
Luxembourg	4.4	—	—	—	4.4
Mexico	14.0	—	—	—	14.0
Netherlands	155.3	—	—	—	155.3
New Zealand	8.1	—	—	—	8.1
Norway	15.0	10.2	—	—	25.2
Peru	1.9	—	—	—	1.9
South Africa	10.0	—	—	—	10.0
South Korea	3.1	—	—	—	3.1
Spain	75.8	—	—	—	75.8
Sweden	61.4	—	—	—	61.4
Switzerland	33.1	—	—	—	33.1
UAE	3.6	—	—	—	3.6
UK	1,201.1	—	15.1	—	1,216.2
USA	1,514.2	—	8.8	—	1,523.0
Supranational	—	—	—	21.3	21.3
Total	4,124.9	35.6	25.2	21.3	4,207.0

The table below analyses the distribution of debt securities by geographical area (commercial real estate loans and infrastructure debt are all within the UK).

	Corporate £m	Local government £m	Sovereign £m	Supranational £m	Debt securities total £m
At 31 December 2019					
Australia	198.1	—	—	—	198.1
Austria	17.8	—	—	—	17.8
Belgium	35.6	—	—	—	35.6
Canada	89.7	—	—	—	89.7
Cayman Islands	14.1	—	—	—	14.1
Denmark	7.6	—	—	—	7.6
Finland	19.9	12.1	—	—	32.0
France	293.8	7.0	0.7	—	301.5
Germany	176.4	—	1.3	—	177.7
Ireland	12.9	—	—	—	12.9
Italy	30.2	—	—	—	30.2
Japan	33.6	—	—	—	33.6
Luxembourg	8.0	—	—	—	8.0
Mexico	17.2	—	—	—	17.2
Netherlands	133.4	—	0.3	—	133.7
New Zealand	34.7	—	—	—	34.7
Norway	23.2	10.1	—	—	33.3
South Africa	2.4	—	—	—	2.4
South Korea	3.0	—	—	—	3.0
Spain	67.1	—	—	—	67.1
Sweden	77.4	—	—	—	77.4
Switzerland	86.5	—	—	—	86.5
UK	1,105.5	—	91.8	—	1,197.3
USA	1,540.4	—	5.4	—	1,545.8
Zambia	1.1	—	—	—	1.1
Supranational	—	—	—	31.3	31.3
Total	4,029.6	29.2	99.5	31.3	4,189.6

3. Risk management continued

3.3.2 Market risk continued

The table below analyses the distribution of debt securities by industry sector classifications.

At 31 December	2020		2019	
	£m	%	£m	%
Basic materials	104.5	3%	121.0	3%
Communications	212.2	5%	262.2	6%
Consumer, cyclical	358.0	9%	305.1	7%
Consumer, non-cyclical	426.7	10%	405.5	10%
Diversified	20.8	0%	6.4	0%
Energy	184.2	4%	181.7	4%
Financial	1,897.0	45%	1,861.7	44%
Industrial	280.3	7%	293.5	7%
Sovereign, supranational and local government	82.1	2%	160.1	4%
Technology	103.9	3%	145.3	4%
Transport	13.4	0%	13.4	0%
Utilities	523.9	12%	433.7	11%
Total	4,207.0	100%	4,189.6	100%

The table below analyses the distribution of infrastructure debt by industry sector classifications.

At 31 December	2020		2019	
	£m	%	£m	%
Social, of which:				
Education	115.7	44%	121.1	44%
Healthcare	70.3	26%	73.2	26%
Other	50.7	19%	53.5	19%
Transport	27.8	11%	30.3	11%
Total	264.5	100%	278.1	100%

The Group uses its internal economic capital model to determine its capital requirements and market risk limits and monitors its market risk exposure based on a 99.5% value-at-risk measure. The Group also applies market risk stress and scenario testing for the economic impact of specific severe market conditions. The results of this analysis are used to enhance the understanding of market risk. The market risk minimum standard explicitly prohibits the use of derivatives for speculative or gearing purposes. However, the Group is able to and does use derivatives for hedging its currency risk and interest rate risk exposures.

Spread risk

This is the risk of loss from the sensitivity of the value of assets and investments to changes in the level or in the volatility of credit spreads over the risk-free interest rate term structure. The level of spread is the difference between the risk-free rate and actual rate paid on the asset, with larger spreads being associated with higher risk assets. The Group is exposed to spread risk through its asset portfolio, most notably through its investment in corporate bonds.

Net interest rate risk

This is the risk of loss from changes in the term structure of interest rates or interest rate volatility which impact assets and liabilities. The Group's interest rate risk arises mainly from its debt, floating interest rate investments and assets and liabilities exposed to fixed interest rates.

The Group has subordinated guaranteed dated Tier 2 notes with fixed coupon rates which were issued on 27 April 2012 at a fixed rate of 9.25% and have a redemption date of 27 April 2042; at the time of issue, the Group entered into a 10-year interest rate swap, to exchange the fixed rate of interest on these notes to a floating rate, to hedge exposure to interest rates. This was treated as a designated hedging instrument.

Of the £500 million notes issued, the Group has bought back a total nominal value of £250 million.

The hedging relationship between the subordinated debt and the interest rate swap was redesignated to reflect this transaction and ensure continuing hedge effectiveness. However, on 31 July 2020 the Group identified that the hedge no longer met the criteria of hedge effectiveness under IAS 39 'Financial Instruments: Recognition and Measurement' and, under the rules of the standard, the accumulated hedging adjustment is being amortised to the income statement from the date of the last successful hedge effectiveness test over the remaining life of the subordinated debt using an effective interest rate calculation.

The Group also has subordinated Tier 2 notes with fixed coupon rates with a nominal value of £260 million that were issued on 5 June 2020 and perpetual Tier 1 notes with fixed coupon rates with a nominal value of £350 million that were issued on 7 December 2017.

The Group also invests in floating rate debt securities, whose investment income is influenced by the movement of the short-term interest rate. A movement of the short-term interest rate will affect the expected return on these investments.

The market value of the Group's financial investments with fixed coupons is affected by the movement of interest rates. For the majority of investments in US dollar and Euro corporate bonds, the Group hedges its exposure to US dollar and Euro interest rate risk using swaps, excluding £361.8 million of US dollar short duration high yield bonds (2019: £398.9 million), £99.9 million of US dollar subordinated financial debt and £71.4 million of Euro subordinated financial debt (2019: £111.4 million US dollar and £64.7 million Euro) and £58.7 million short duration Euro credit (2019: £194.3 million).

The Group is exposed to the following interest rate benchmarks within its hedging relationships: GBP LIBOR, USD LIBOR and EURIBOR. The first two are subject to interest rate benchmark reform. The hedged items include issued sterling fixed rate subordinated debt (which is no longer treated as designated under IAS 39) and holdings of US dollar and Euro denominated fixed rate debt securities.

The Group has in place an IBOR transition plan which is updated regularly. The most recent version of the plan was reviewed by the Investment Committee in November 2020. The plan identifies where the Group has IBOR exposures and the departments responsible for ensuring a suitable plan is in place to enable a smooth transition to alternative benchmark rates. Delivering the plan is under the governance of the Chief Financial Officer. The Group has also provided the plan and data in response to data submission requests from the PRA in 2020.

In the course of 2020 and early 2021 the following steps were undertaken as part of the transition process:

- amendments were made to the intra-company loan agreements to ensure that they contain LIBOR fall-back language;
- U K Insurance Limited adhered to the International Swaps and Derivative Association fall-back protocol which covers the interest rate swap held to hedge issued subordinated debt which references GBP LIBOR; the external asset managers too have to adhere to the protocol, thus covering the interest rate swaps in the managed portfolios;
- the Loan Market Association published the exposure drafts of facility agreements which in the first half of 2021 will be used to add LIBOR fall-back clauses to the existing loan agreements in the infrastructure debt and commercial real estate loan portfolios; and
- these fall-back clauses will be added to any new agreements.

The designated hedging instruments and hedged items in scope of the IFRS 9/IAS 39 amendments due to benchmark interest rate reform are set out in the table below by hedge type.

Hedge type	Instrument type	Maturing in	Nominal	Hedged item
Fair value hedges	Pay USD fixed, receive 3-month USD LIBOR interest rate swaps	2023 - 2051	US\$131 million	Portfolio fair value hedge of the 3-month USD LIBOR component of US dollar denominated fixed rate debt securities
	Pay USD fixed, receive 1-month USD LIBOR interest rate swaps	2021 - 2031	US\$1,016 million	Portfolio fair value hedge of the 1-month USD LIBOR component of US dollar denominated fixed rate debt securities
	Pay Euro fixed, receive 6-month EURIBOR interest rate swaps	2023 - 2041	€107 million	Portfolio fair value hedge of the 6-month EURIBOR component of Euro denominated fixed rate debt securities

The Group will continue to apply the amendments to IFRS 9/IAS 39 until the uncertainty arising from the interest rate benchmark reforms with respect to the timing and the amount of the underlying cash flows to which the Group is exposed ends. The Group has assumed that this uncertainty will not end until the Group's contracts that reference IBORs are amended to specify the date the interest rate benchmark will be replaced, the cash flows of the alternative benchmark rate and any resulting spread adjustments. This will, in part, be dependent on the introduction of fall-back clauses which have yet to be added to some of the Group's contracts and the negotiation with borrowers.

Property risk

This is the risk of loss arising from sensitivity of assets and financial investments to the level or volatility of market prices, rental yields, or occupancy rates of properties. At 31 December 2020, the value of these property investments was £292.1 million (2019: £291.7 million). The property investments are located in the UK.

Currency risk

This is the risk of loss from changes in the level or volatility of currency exchange rates.

Exposure to currency risk is generated by the Group's investments in US dollar and Euro denominated debt bonds.

The Group maintains exposure to US dollar securities through £1,331.9 million (2019: £1,366.1 million) of investments in US dollar bonds and Euro securities through £231.1 million (2019: £359.1 million) of Euro bonds. The foreign currency exposure of these investments is hedged by foreign currency forward contracts, maintaining a minimal unhedged currency exposure on these portfolios, as well as a low basis risk on the hedging contracts.

A limited exposure to currency risk also arises through the Group's insurance and other contractual liabilities.

Currency risk is not material at Group level.

3. Risk management continued

3.3.2 Market risk continued

Use of derivatives

The Group uses derivatives to hedge against interest rate and currency risk.

The tables below analyse the maturity of the Group's derivative assets and liabilities.

	Notional amounts	Maturity and fair value			Total
	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	
At 31 December 2020					
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	2,182.8	63.5	–	–	63.5
Interest rate swaps ¹	250.0	1.0	7.2	–	8.2
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	4.1	0.1	–	–	0.1
Interest rate swaps	150.3	–	–	1.6	1.6
Total	2,587.2	64.6	7.2	1.6	73.4

	Notional amounts	Maturity and fair value			Total
	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	
At 31 December 2020					
Derivative liabilities					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	696.4	12.3	–	–	12.3
Designated as hedging instruments:					
Interest rate swaps	785.1	2.4	17.7	24.8	44.9
Total	1,481.5	14.7	17.7	24.8	57.2

1. The 2012 interest rate swap which was entered into at the same time as the issue of the 9.25% subordinated Tier 2 notes due 2042 was treated as a designated hedging instrument in 2019 and as fair value through the income statement in 2020.

	Notional amounts	Maturity and fair value			Total
	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	
At 31 December 2019					
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	2,310.3	112.1	–	–	112.1
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	7.8	0.4	–	–	0.4
Interest rate swaps	277.7	0.7	8.3	–	9.0
Total	2,595.8	113.2	8.3	–	121.5

	Notional amounts	Maturity and fair value			Total
	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	
At 31 December 2019					
Derivative liabilities					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	652.6	10.1	–	–	10.1
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	10.4	0.2	–	–	0.2
Interest rate swaps	853.2	2.6	2.8	14.8	20.2
Total	1,516.2	12.9	2.8	14.8	30.5

Sensitivity analysis

The table below provides a sensitivity analysis of the potential impact on financial investments and derivatives of a change in a single factor with all other assumptions left unchanged. Other potential risks beyond the ones described in the table could have an additional financial impact on the Group.

	Increase / (decrease) in profit before tax ¹		Decrease in total equity ¹ at 31 December	
	2020 £m	2019 £m	2020 £m	2019 £m
Spread				
Impact of a 100 basis points increase in spreads on financial investments ^{2,3}	–	–	(151.2)	(146.4)
Interest rate				
Impact of a 100 basis points increase in interest rates on financial investments and derivatives ^{2,3,4}	12.5	12.0	(114.1)	(103.7)
Investment property				
Impact of a 15% decrease in property markets	(43.8)	(43.8)	(43.8)	(43.8)

Notes:

- These sensitivities exclude the impact of taxation and have not considered the impact of the general market changes on the value of the Group's insurance liabilities or retirement benefit obligations. They reflect one-off impacts at 31 December and should not be interpreted as predictions.
- The income statement impact on financial investments is limited to floating rate instruments and interest rate derivatives used to hedge a portion of the portfolio. The income statement is not impacted in relation to fixed rate instruments, in particular AFS debt securities, where the coupon return is not impacted by a change in prevailing market rates, as the accounting treatment for AFS debt securities means that only the coupon received is processed through the income statement, with fair value movements being recognised through total equity.
- The increase or decrease in total equity does not reflect any fair value movement in infrastructure debt, HTM debt securities and commercial real estate loans that would not be recorded in the financial statements under IFRSs as they are classified as loans and receivables and HTM respectively, which are carried at amortised cost. It is estimated that a fair value reduction in these asset categories resulting from a 100 basis points increase in spreads would have been £15.1 million (2019: £16.7 million) and a 100 basis points increase in interest rates would have been £4.4 million (2019: £4.9 million).
- The sensitivities set out above reflect one-off impacts at 31 December, with the exception of the income statement interest rate sensitivity on financial investments and derivatives, which projects a movement in a full year's interest charge as a result of the increase in the interest rate applied to these assets or liabilities on those positions held at 31 December.

The Group has a number of open interest rate and foreign exchange derivative positions. Collateral management arrangements are in place for significant counterparty exposures. At 31 December 2020, the Group has pledged £65.8 million in cash (2019: £37.8 million) to cover initial margins and out-of-the-money derivative positions. At 31 December 2020, counterparties have pledged £12.0 million in cash and £8.1 million in UK Gilts (2019: £0.3 million in cash and £9.2 million in UK Gilts) to the Group to cover in-the-money derivative positions.

The terms and conditions of collateral pledged for both assets and liabilities are market standard. When securities are pledged they are required to be readily convertible to cash, and as such no policy has been established for the disposal of assets not readily convertible into cash.

3.3.3 Credit risk

This is the risk of loss resulting from defaults in obligations due and/or changes in credit standing of either issuers of securities, counterparties or any debtors to which the Group is exposed. The Group is mainly exposed to counterparty default risk.

Counterparty default risk

This is the risk of loss from unexpected default or deterioration in the credit standing of the counterparties and debtors of Group undertakings. This risk is monitored by three forums: the Investment Risk Forum monitors credit spreads as indicators of potential losses on investments incurred but not yet realised; the Credit Risk Forum monitors reinsurance and corporate insurance counterparty default risk; and the NIG Credit Committee is responsible for monitoring broker credit risk. The main responsibility of these forums is to ensure that all material aspects of counterparty default risk within the Group are identified, monitored and measured.

The main sources of counterparty default risk for the Group are:

- investments – this arises from the investment of funds in a range of investment vehicles permitted by the investment policy;
- reinsurance recoveries – this arises in respect of reinsurance claims against which a reinsurance bad debt provision is assessed. PPOs have the potential to increase the ultimate value of a claim and, by their very nature, to increase significantly the length of time to reach final payment. This can increase reinsurance counterparty default risk in terms of both amount and longevity;
- commercial credit – this arises as brokers collect premiums on behalf of the Group; and
- consumer credit – exposure from offering monthly instalments on annual insurance contracts.

3. Risk management continued

3.3.3 Credit risk continued

The Group cedes insurance risk to reinsurers but, in return, assumes counterparty default risk against which a reinsurance bad debt provision is assessed. The financial security of the Group's panel of reinsurers is therefore important and both the quality and amount of the assumed counterparty default risk are subject to an approval process whereby reinsurance is only purchased from reinsurers that hold a credit rating of at least A- at the time cover is purchased. The Group's leading counterparty exposures are reviewed on a quarterly basis by the Head of Reinsurance and Corporate Insurance. The Group aims to deal with a diverse range of reinsurers on its contracts to mitigate the credit and/or non-payment risks associated with its reinsurance exposures.

Certain reinsurance contracts have long durations as a result of bodily injury and PPO claims, and insurance reserves therefore include provisions beyond the levels created for shorter-term reinsurance bad debt. For these contracts, reinsurance is only purchased from reinsurers that hold a credit rating of at least A+ at the time cover is purchased.

The following tables analyse the carrying value of financial and insurance assets that bear counterparty default risk between those assets that have not been impaired by age in relation to due date, and those that have been impaired.

	Neither past due nor impaired	Past due 1 - 90 days	Past due more than 90 days	Carrying value in the balance sheet
	£m	£m	£m	£m
At 31 December 2020				
Reinsurance assets	1,129.1	—	0.1	1,129.2
Insurance and other receivables	802.6	45.0	0.6	848.2
Derivative assets	73.4	—	—	73.4
Debt securities	4,207.0	—	—	4,207.0
Infrastructure debt	264.5	—	—	264.5
Commercial real estate loans	206.7	—	—	206.7
Cash and cash equivalents ¹	1,220.1	—	—	1,220.1
Total	7,903.4	45.0	0.7	7,949.1

	Neither past due nor impaired	Past due 1 - 90 days	Past due more than 90 days	Carrying value in the balance sheet
	£m	£m	£m	£m
At 31 December 2019				
Reinsurance assets	1,251.2	—	0.1	1,251.3
Insurance and other receivables	805.9	40.5	0.1	846.5
Derivative assets	121.5	—	—	121.5
Debt securities	4,189.6	—	—	4,189.6
Infrastructure debt	278.1	—	—	278.1
Commercial real estate loans	205.7	—	—	205.7
Cash and cash equivalents ¹	948.6	—	—	948.6
Total	7,800.6	40.5	0.2	7,841.3

Note:

1. This represents money market funds with no notice period for withdrawal and cash at bank and in hand.

Within the analysis of debt securities above are bank debt securities at 31 December 2020 of £1,282.8 million (2019: £1,292.2 million) that can be further analysed as: secured £16.2 million (2019: £20.9 million); unsecured £1,125.2 million (2019: £1,105.5 million); and subordinated £141.4 million (2019: £165.8 million).

The tables below analyse the credit quality of debt securities that are neither past due nor impaired.

	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and below	Total
	£m	£m	£m	£m	£m	£m
At 31 December 2020						
Corporate	68.1	400.9	1,842.3	1,447.1	366.5	4,124.9
Supranational	21.3	—	—	—	—	21.3
Local government	10.2	25.4	—	—	—	35.6
Sovereign	10.1	15.1	—	—	—	25.2
Total	109.7	441.4	1,842.3	1,447.1	366.5	4,207.0

	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ and below £m	Total £m
At 31 December 2019						
Corporate	70.9	498.8	1,809.2	1,259.9	390.8	4,029.6
Supranational	31.3	—	—	—	—	31.3
Local government	10.1	19.1	—	—	—	29.2
Sovereign	6.7	92.8	—	—	—	99.5
Total	119.0	610.7	1,809.2	1,259.9	390.8	4,189.6

The tables below analyse the credit quality of financial and insurance assets that are neither past due nor impaired (excluding debt securities analysed above). The tables include reinsurance exposure, after provision. The Group's approach to reinsurance counterparty default risk is detailed on page 181.

	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ and below £m	Not rated £m	Total £m
At 31 December 2020							
Reinsurance assets	—	766.9	359.7	1.9	—	0.6	1,129.1
Insurance and other receivables ¹	—	17.3	40.2	16.4	—	728.7	802.6
Derivative assets	—	8.5	64.9	—	—	—	73.4
Infrastructure debt	—	—	71.7	192.8	—	—	264.5
Commercial real estate loans	1.2	44.7	117.8	32.3	10.7	—	206.7
Cash and cash equivalents ²	995.2	55.7	169.2	—	—	—	1,220.1
Total	996.4	893.1	823.5	243.4	10.7	729.3	3,696.4

	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ and below £m	Not rated £m	Total £m
At 31 December 2019							
Reinsurance assets	—	842.0	406.3	2.3	—	0.6	1,251.2
Insurance and other receivables ¹	—	2.8	30.3	11.3	—	761.5	805.9
Derivative assets	—	111.5	10.0	—	—	—	121.5
Infrastructure debt	—	—	75.8	202.3	—	—	278.1
Commercial real estate loans	—	46.6	118.9	26.7	13.5	—	205.7
Cash and cash equivalents ²	725.5	123.7	98.8	0.6	—	—	948.6
Total	725.5	1,126.6	740.1	243.2	13.5	762.1	3,611.0

Notes:

1. Includes receivables due from policyholders, agents, brokers and intermediaries which generally do not have a credit rating.
2. This represents money market funds with no notice period for withdrawal and cash at bank and in hand.

3.3.4 Operational risk

This is the risk of loss due to inadequate or failed internal processes, people, systems, or from external events. Material sources of operational risk for the Group include:

Change risk

This is the risk of failing to manage the Group's change portfolio resulting in conflicting priorities and failure to deliver strategic outcomes to time, cost or quality.

Technology and infrastructure risk

This is the risk that information or services are unavailable because of compromised, unstable or inadequately performing systems, all of which impact customers.

Outsourcing risk

This is the risk of failing to implement a robust framework for the sourcing, appointment and ongoing contract management of third-party suppliers, outsourced service providers and intra-group relationships. This includes both domestic and offshore outsourcing activities.

Information security risk

This is the risk of loss or corruption to Group or customer data, intellectual property or failure of business-critical systems resulting in reputational damage, regulatory censure, supervision, fines and/or loss of competitive advantage.

Partnership contractual obligations

This is the risk of contractual obligations not being delivered for business partners resulting in damaged reputation, the loss of contract at renewal, significant liability payments and/or the early termination of a partnership scheme.

The Group has in place agreed policies and standards to establish and monitor key controls relating to operational risk.

3. Risk management continued

3.3.5 Liquidity risk

This is the risk of being unable to access cash from the sale of investments or other assets in order to settle financial obligations as they fall due.

The measurement and management of the Group's liquidity risk is undertaken within the limits and other policy parameters of the Group's liquidity risk appetite and is detailed in the liquidity risk minimum standard. As part of this process the Investment and Treasury team are required to put in place a liquidity plan which must consider expected and stressed scenarios for cash inflows and outflows that is reviewed at least annually by the Investment Committee. Compliance is monitored in respect of both the minimum standard and the regulatory requirements of the PRA.

The following table analyses the carrying value of financial investments and cash and cash equivalents, by contractual maturity, which can fund the repayment of liabilities as they crystallise.

	Within 1 year	1 - 3 years	3 - 5 years	5 - 10 years	Over 10 years	Total
	£m	£m	£m	£m	£m	£m
At 31 December 2020						
Debt securities	407.7	1,053.8	1,133.6	1,492.8	119.1	4,207.0
Infrastructure debt	14.0	31.4	34.9	98.1	86.1	264.5
Commercial real estate loans	35.0	106.3	65.4	—	—	206.7
Cash and cash equivalents ¹	1,220.1	—	—	—	—	1,220.1
Total	1,676.8	1,191.5	1,233.9	1,590.9	205.2	5,898.3

	Within 1 year	1 - 3 years	3 - 5 years	5 - 10 years	Over 10 years	Total
	£m	£m	£m	£m	£m	£m
At 31 December 2019						
Debt securities	506.1	1,054.8	1,089.7	1,391.3	147.7	4,189.6
Infrastructure debt	13.8	29.2	34.2	95.1	105.8	278.1
Commercial real estate loans	45.8	122.9	37.0	—	—	205.7
Cash and cash equivalents ¹	948.6	—	—	—	—	948.6
Total	1,514.3	1,206.9	1,160.9	1,486.4	253.5	5,622.0

Note:

1. This represents money market funds with no notice period for withdrawal and cash at bank and in hand.

The following table analyses the undiscounted cash flows of insurance and financial liabilities by contractual repricing or maturity dates, whichever is earlier.

	Within 1 year	1 - 3 years	3 - 5 years	5 - 10 years	Over 10 years	Total	Carrying value
	£m	£m	£m	£m	£m	£m	£m
At 31 December 2020							
Subordinated liabilities	33.5	282.4	20.8	52.0	280.8	669.5	516.6
Insurance liabilities ¹	1,053.5	953.8	456.8	371.6	1,817.6	4,653.3	3,617.0
Borrowings	51.9	—	—	—	—	51.9	51.9
Lease liabilities	17.6	29.6	25.9	57.1	75.4	205.6	152.4
Provisions	108.2	6.5	0.1	—	—	114.8	114.8
Trade and other payables, including insurance payables	543.6	6.1	0.2	—	—	549.9	549.9
Total	1,808.3	1,278.4	503.8	480.7	2,173.8	6,245.0	5,002.6

	Within 1 year	1 - 3 years	3 - 5 years	5 - 10 years	Over 10 years	Total	Carrying value
	£m	£m	£m	£m	£m	£m	£m
At 31 December 2019							
Subordinated liabilities	23.1	284.7	—	—	—	307.8	259.0
Insurance liabilities ¹	1,120.0	1,000.1	514.9	428.0	2,096.7	5,159.7	3,819.6
Borrowings	52.3	—	—	—	—	52.3	52.3
Lease liabilities	18.3	32.8	29.1	48.8	95.7	224.7	164.4
Provisions	74.3	—	—	—	—	74.3	74.3
Trade and other payables, including insurance payables	473.7	4.2	0.2	—	—	478.1	478.1
Total	1,761.7	1,321.8	544.2	476.8	2,192.4	6,296.9	4,847.7

Note:

1. Insurance liabilities exclude unearned premium reserves as there are no liquidity risks inherent in them.

The following table analyses the undiscounted cash flows of derivative financial instruments, by contractual maturity.

	Within 1 year £m	1 - 3 years £m	3 - 5 years £m	5 - 10 years £m	Over 10 years £m	Total £m	Carrying value £m
At 31 December 2020							
Derivatives assets	69.2	2.3	0.1	1.9	—	73.5	73.4
Derivatives liabilities	(24.6)	(18.2)	(10.8)	(3.6)	(0.1)	(57.3)	(57.2)
Total	44.6	(15.9)	(10.7)	(1.7)	(0.1)	16.2	16.2
At 31 December 2019							
Derivatives assets	116.1	5.5	—	—	—	121.6	121.5
Derivatives liabilities	(15.4)	(6.8)	(5.3)	(3.7)	—	(31.2)	(30.5)
Total	100.7	(1.3)	(5.3)	(3.7)	—	90.4	91.0

3.4 Capital management

At 31 December 2020, the Group's capital position was comprised of shareholders' equity of £2,699.7 million (31 December 2019: £2,643.6 million) and Tier 1 notes of £346.5 million (31 December 2019: £346.5 million). In addition, the Group's balance sheet also included £516.6 million of subordinated loan capital (31 December 2019: £259.0 million) which is classified as Tier 2 for Solvency II purposes.

The Group manages capital in accordance with the Group's capital management minimum standard, the aims of which are to manage capital efficiently and generate long-term sustainable value for shareholders, while balancing operational, regulatory, credit rating agency and policyholder requirements. The Group seeks to hold capital resources such that, in normal circumstances, the solvency capital ratio is around the middle of the target range of 140% to 180%.

The Group's regulatory capital position is assessed against the Solvency II framework. From 1 July 2016, the Group gained approval to assess its SCR using a partial internal model, including a full internal economic capital model for the U K Insurance Limited underwriting entity. The model is calibrated to a 99.5% confidence interval and considers business written to date and one year of future written business over a one-year time horizon, in line with Solvency II requirements.

3.5 Capital adequacy (unaudited)

Using the Group's partial internal model, there is a capital surplus of approximately £1.22 billion above an estimated SCR of £1.34 billion as at 31 December 2020 (31 December 2019: £0.85 billion and £1.32 billion respectively). The Group's capital requirements and solvency position are produced and presented to the Board on a regular basis.

4. Segmental analysis

The Directors manage the Group primarily by product type and present the segmental analysis on that basis. The segments, which are all UK based, reflect the management structure whereby a member of the Executive Committee is accountable to the Chief Executive Officer for each of the operating segments:

Motor

This segment consists of personal motor insurance together with the associated legal protection cover. The Group sells motor insurance direct to customers through its own brands Direct Line, Churchill, Privilege and Darwin, and through partnership brands such as vehicle manufacturers and through price comparison websites ("PCWs").

Home

This segment consists of home insurance together with associated legal protection cover. The Group sells home insurance products through its brands Direct Line, Churchill and Privilege, and its partnership brands (Royal Bank of Scotland and NatWest), as well as through PCWs.

Rescue and other personal lines

This segment consists of rescue products which are sold direct through the Group's own brand, Green Flag, and other personal lines insurance, including travel, pet and creditor sold through its own brands Direct Line, Churchill and Privilege, and through partnership brands and through PCWs.

Commercial

This segment consists of commercial insurance for small and medium-sized enterprises sold through the Group's brands NIG, Direct Line for Business and Churchill. NIG sells its products exclusively through brokers operating across the UK. Direct Line for Business sells its products directly to customers, and Churchill sells its products directly to customers and through PCWs.

Restructuring and one-off costs

Restructuring costs are costs incurred in respect of those business activities which have a material effect on the nature and focus of the Group's operations. One-off costs are costs that are non-recurring in nature.

No inter-segment transactions occurred in the year ended 31 December 2020 (2019: £nil). If any transaction were to occur, transfer prices between operating segments would be 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.

4. Segmental analysis continued

For each operating segment, there is no individual policyholder or customer that represents 10% or more of the Group's total revenue.

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2020.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
Gross written premium	1,616.9	577.9	417.8	567.8	3,180.4
Gross earned premium	1,635.3	581.9	425.6	546.5	3,189.3
Reinsurance premium	(150.5)	(26.1)	(2.7)	(49.5)	(228.8)
Net earned premium	1,484.8	555.8	422.9	497.0	2,960.5
Investment return	62.8	10.3	3.4	18.6	95.1
Instalment income	80.1	19.2	3.0	7.0	109.3
Other operating income	38.4	0.2	8.9	2.4	49.9
Total income	1,666.1	585.5	438.2	525.0	3,214.8
Insurance claims	(889.2)	(316.5)	(279.1)	(245.6)	(1,730.4)
Insurance claims recoverable from / (payable to) reinsurers	1.1	7.4	18.0	(9.7)	16.8
Net insurance claims	(888.1)	(309.1)	(261.1)	(255.3)	(1,713.6)
Commission expenses	(47.4)	(45.0)	(69.4)	(92.9)	(254.7)
Operating expenses before restructuring and one-off costs	(367.1)	(130.0)	(100.9)	(126.4)	(724.4)
Total expenses	(414.5)	(175.0)	(170.3)	(219.3)	(979.1)
Operating profit	363.5	101.4	6.8	50.4	522.1
Restructuring and one-off costs					(39.4)
Finance costs					(31.3)
Profit before tax					451.4
Underwriting profit / (loss)	182.2	71.7	(8.5)	22.4	267.8
Loss ratio	59.8%	55.6%	61.7%	51.4%	57.9%
Commission ratio	3.2%	8.1%	16.4%	18.7%	8.6%
Expense ratio	24.7%	23.4%	23.9%	25.4%	24.5%
Combined operating ratio	87.7%	87.1%	102.0%	95.5%	91.0%

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2020.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total £m
Goodwill	129.6	45.8	28.7	10.1	214.2
Other segment assets	6,874.0	765.5	304.2	1,464.4	9,408.1
Segment liabilities	(4,771.6)	(558.7)	(196.2)	(1,049.6)	(6,576.1)
Segment net assets	2,232.0	252.6	136.7	424.9	3,046.2

The segmental analysis of assets and liabilities is prepared using a combination of asset and liability balances directly attributable to each operating segment and an apportionment of assets and liabilities managed at a Group-wide level. This does not represent the Group's view of the capital requirements for its operating segments.

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2019.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
Gross written premium	1,651.6	586.6	436.0	528.9	3,203.1
Gross earned premium	1,653.2	598.8	427.4	523.2	3,202.6
Reinsurance premium	(145.5)	(25.2)	(2.2)	(44.8)	(217.7)
Net earned premium	1,507.7	573.6	425.2	478.4	2,984.9
Investment return	88.6	16.7	5.6	23.7	134.6
Instalment income	83.8	20.5	2.8	6.9	114.0
Other operating income	51.3	0.6	11.1	3.2	66.2
Total income	1,731.4	611.4	444.7	512.2	3,299.7
Insurance claims	(1,086.8)	(276.2)	(285.2)	(269.1)	(1,917.3)
Insurance claims recoverable from reinsurers	43.5	7.8	0.8	17.6	69.7
Net insurance claims	(1,043.3)	(268.4)	(284.4)	(251.5)	(1,847.6)
Commission expenses	(39.9)	(55.7)	(27.2)	(88.7)	(211.5)
Operating expenses before restructuring and one-off costs	(345.6)	(136.7)	(94.0)	(117.4)	(693.7)
Total expenses	(385.5)	(192.4)	(121.2)	(206.1)	(905.2)
Operating profit	302.6	150.6	39.1	54.6	546.9
Restructuring and one-off costs					(11.2)
Finance costs					(26.0)
Profit before tax					509.7
Underwriting profit	78.9	112.8	19.6	20.8	232.1
Loss ratio	69.3%	46.8%	66.9%	52.7%	61.9%
Commission ratio	2.6%	9.7%	6.4%	18.5%	7.1%
Expense ratio	22.9%	23.8%	22.1%	24.5%	23.2%
Combined operating ratio	94.8%	80.3%	95.4%	95.7%	92.2%

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2019.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total £m
Goodwill	129.6	45.8	28.7	10.1	214.2
Other segment assets	6,839.9	682.6	230.3	1,467.2	9,220.0
Segment liabilities	(4,770.4)	(489.1)	(154.6)	(1,030.0)	(6,444.1)
Segment net assets	2,199.1	239.3	104.4	447.3	2,990.1

The segmental analysis of assets and liabilities is prepared using a combination of asset and liability balances directly attributable to each operating segment and an apportionment of assets and liabilities managed at a Group-wide level. This does not represent the Group's view of the capital requirements for its operating segments.

5. Net earned premium

	2020	2019
	£m	£m
Gross earned premium:		
Gross written premium	3,180.4	3,203.1
Movement in unearned premium reserve	8.9	(0.5)
	3,189.3	3,202.6
Reinsurance premium paid and payable:		
Premium payable	(231.0)	(215.9)
Movement in reinsurance unearned premium reserve	2.2	(1.8)
	(228.8)	(217.7)
Total	2,960.5	2,984.9

6. Investment return

	2020	2019
	£m	£m
Investment income:		
Interest income from debt securities	98.6	108.4
Interest income from cash and cash equivalents	2.5	7.9
Interest income from infrastructure debt	5.8	7.0
Interest income from commercial real estate loans	6.5	6.9
Interest income	113.4	130.2
Rental income from investment property	13.7	16.2
	127.1	146.4
Net realised gains / (losses):		
AFS debt securities	1.1	16.5
Derivatives	69.9	(9.5)
Investment property (note 20)	–	(0.7)
	71.0	6.3
Net unrealised losses:		
Impairment of loans and receivables	(2.7)	–
Derivatives	(90.2)	(12.6)
Investment property (note 20)	(10.1)	(5.5)
	(103.0)	(18.1)
Total	95.1	134.6

The table below analyses the realised and unrealised gains and losses on derivative instruments included in investment return.

	Realised	Unrealised	Realised	Unrealised
	2020	2020	2019	2019
	£m	£m	£m	£m
Derivative gains / (losses):				
Foreign exchange forward contracts ¹	57.4	(50.8)	(56.8)	103.4
Associated foreign exchange risk	28.1	(45.7)	53.4	(123.8)
Net gains / (losses) on foreign exchange forward contracts	85.5	(96.5)	(3.4)	(20.4)
Interest rate swaps ¹	(26.2)	(23.0)	(16.8)	(33.6)
Associated interest rate risk on hedged items	10.6	29.3	10.7	41.4
Net (losses) / gains on interest rate derivatives	(15.6)	6.3	(6.1)	7.8
Total	69.9	(90.2)	(9.5)	(12.6)

Note:

- All foreign exchange forward contracts and certain interest rate swaps are measured at fair value through profit and loss. There are also interest rate swaps designated as hedging instruments.

7. Other operating income

	2020	2019
	£m	£m
Revenue from vehicle recovery and repair services	24.0	28.3
Vehicle replacement referral income	12.2	19.1
Legal services income	8.8	11.3
Other income ¹	4.9	7.5
Total	49.9	66.2

Note:

1. Other income mainly includes fee income from insurance intermediary services.

8. Net insurance claims

	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	2020	2020	2020	2019	2019	2019
	£m	£m	£m	£m	£m	£m
Current accident year claims paid	1,056.4	(18.1)	1,038.3	1,232.9	(0.2)	1,232.7
Prior accident year claims paid	876.6	(123.0)	753.6	870.7	(25.1)	845.6
Decrease in insurance liabilities	(202.6)	124.3	(78.3)	(186.3)	(44.4)	(230.7)
Total	1,730.4	(16.8)	1,713.6	1,917.3	(69.7)	1,847.6

Claims handling expenses¹ for the year ended 31 December 2020 of £208.2 million (2019: £202.9 million) have been included in the claims figures above.

Note:

1. Includes costs in respect of low value leases of £0.8 million (2019: £0.3 million).

9. Commission expenses

	2020	2019
	£m	£m
Commission expenses	180.9	171.2
Expenses incurred under profit participations	73.8	40.3
Total	254.7	211.5

10. Operating expenses

	2020	2019
	£m	£m
Staff costs ^{1,2}	270.3	267.3
IT and other operating expenses ^{1,2,3}	220.2	163.4
Marketing	106.6	113.9
Insurance levies	80.4	81.5
Depreciation and amortisation ^{1,4,5}	86.3	78.8
Total operating expenses (including restructuring and one-off costs)	763.8	704.9
Of which restructuring and one-off costs	39.4	11.2
Total excluding restructuring and one-off costs	724.4	693.7

Notes:

1. Restructuring and one-off costs of £39.4 million (2019: £11.2 million) are included as follows: staff costs of £14.7 million (2019: £5.8 million), other operating expenses of £24.2 million (2019: £5.4 million) and depreciation of £0.5 million (2019: £nil).
2. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
3. IT and other operating expenses include professional fees and property costs.
4. For year ended 31 December 2020, depreciation and amortisation include a £6.6 million impairment charge (2019: £1.3 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.
5. Includes depreciation on right-of-use assets of £14.8 million (2019: £14.2 million).

The table below analyses the number of people employed by the Group's operations.

	At 31 December		Average for the year	
	2020	2019	2020	2019
Insurance operations	8,022	7,963	8,010	8,388
Repair centre operations	1,441	1,444	1,454	1,384
Support	1,344	1,355	1,388	1,350
Total	10,807	10,762	10,852	11,122

10. Operating expenses continued

The aggregate remuneration of those employed by the Group's operations comprised:

	2020	2019
	£m	£m
Wages and salaries	393.5	387.2
Social security costs	43.6	41.9
Pension costs	26.2	25.5
Share-based payments	18.5	18.4
Total	481.8	473.0

The table below analyses Auditor's remuneration in respect of the Group's operations.

	2020	2019
	£m	£m
Fees payable for the audit of:		
The Company's annual accounts	0.2	0.2
The Company's subsidiaries	1.9	1.8
Total audit fees	2.1	2.0
Audit-related assurance services	0.2	0.2
Non-audit services	0.6	0.1
Total	2.9	2.3

Aggregate Directors' emoluments

The table below analyses the total amount of Directors' remuneration in accordance with Schedule 5 to the Accounting Regulations.

	2020	2019
	£m	£m
Salaries, fees, bonuses and benefits in kind	3.8	4.4
Gains on exercise of share options	–	5.3
Total	3.8	9.7

Further information about the remuneration of individual Directors is provided in the Directors' Remuneration Report.

At 31 December 2020, no Directors (2019: one Director) had retirement benefits accruing under the defined contribution pension scheme in respect of qualifying service. During the year ended 31 December 2020, one Director exercised share options (2019: three Directors).

11. Finance costs

	2020	2019
	£m	£m
Interest expense on subordinated liabilities ¹	29.1	23.1
Net interest received on interest rate swap ²	(4.1)	(3.4)
Unrealised losses on interest rate swap ²	1.9	–
Unrealised (gain) / loss on designated hedging instrument ²	(1.2)	0.1
Unrealised loss / (gains) on associated interest rate risk on hedged item ²	0.9	(0.8)
Amortisation of arrangement costs, discount on issue and fair value hedging adjustment of subordinated liabilities	(1.3)	0.3
Interest expense on lease liabilities	6.0	6.7
Total	31.3	26.0

Notes:

- On 5 June 2020, the Group issued subordinated Tier 2 notes at a fixed rate of 4.0%. See note 33.
- As described in note 33, on 27 April 2012 the Group issued subordinated guaranteed dated Tier 2 notes with a nominal value of £500 million at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year interest rate swap to exchange the fixed rate of interest on the notes for a floating rate. This was treated as a hedging instrument. On 8 December 2017, the Group redeemed £250 million nominal value of the notes and the hedging agreement was redesignated accordingly. On 31 July 2020, the Group identified that the hedge no longer met the criteria of hedge effectiveness under IAS 39 and, under the rules of the standard, the accumulated hedging adjustment has begun to be amortised to the income statement from the date of the last successful hedge effectiveness test over the remaining life of the subordinated debt using an effective interest rate calculation.

12. Tax charge

	2020	2019
	£m	£m
Current taxation:		
Charge for the year	95.2	101.9
Over provision in respect of prior year	(0.5)	(1.1)
	94.7	100.8
Deferred taxation (note 13):		
Credit for the year	(11.1)	(5.4)
Under / (over) provision in respect of prior year	0.6	(5.6)
	(10.5)	(11.0)
Current taxation	94.7	100.8
Deferred taxation (note 13)	(10.5)	(11.0)
Tax charge for the year	84.2	89.8

The following table analyses the difference between the actual income tax charge and the expected income tax charge computed by applying the standard rate of corporation tax of 19.0%¹ (2019: 19.0%).

	2020	2019
	£m	£m
Profit before tax	451.4	509.7
Expected tax charge	85.8	96.8
Effects of:		
Disallowable expenses	1.3	2.9
Effect of change in corporation taxation rate ¹	0.1	–
Under / (over) provision in respect of prior year	0.1	(6.7)
Revaluation of property	0.1	–
Deductible Tier 1 notes coupon payment in equity	(3.2)	(3.2)
Tax charge for the year	84.2	89.8
Effective income tax rate	18.7%	17.6%

Note:

- In the Finance Act 2020 the UK Government cancelled the previously enacted reduction in the UK corporation tax rate from 19% to 17% which had been due to take effect from 1 April 2020. The impact of this change on the tax charge for the year is set out in the table above.

13. Current and deferred tax

	2020	2019
	£m	£m
Per balance sheet:		
Current tax liabilities	10.5	50.3
Deferred tax liabilities	8.7	9.6

13. Current and deferred tax continued

The table below analyses the major deferred tax assets and liabilities recognised by the Group and movements thereon.

	Provisions and other temporary differences	Retirement benefit obligations	Depreciation in excess of capital allowances	Non-distributable reserve ¹	Share-based payments	AFS revaluation reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 January 2019	5.4	(3.0)	(3.4)	(13.7)	2.2	8.0	(4.5)
(Charge) / credit to the income statement	(1.1)	(0.1)	7.4	4.9	(0.1)	—	11.0
Credit / (charge) to other comprehensive income	—	1.3	—	—	—	(17.4)	(16.1)
At 31 December 2019	4.3	(1.8)	4.0	(8.8)	2.1	(9.4)	(9.6)
Credit / (charge) to the income statement	5.9	(0.3)	0.2	3.9	0.8	—	10.5
Credit / (charge) to other comprehensive income	—	0.3	—	—	—	(10.1)	(9.8)
Credit direct to equity	—	—	—	—	0.2	—	0.2
At 31 December 2020	10.2	(1.8)	4.2	(4.9)	3.1	(19.5)	(8.7)

Note:

- The non-distributable reserve was a statutory claims equalisation reserve calculated in accordance with the rules of the PRA. With the introduction of Solvency II on 1 January 2016, the requirement to maintain the claims equalisation reserve ceased and the balance at 31 December 2015 was released to retained earnings. The taxation of this release is spread over six years from the change in regulation. It is provided for in deferred tax above as it represents the future unwind of previously claimed tax deductions for transfers into the reserve.

In addition, the Group has an unrecognised deferred tax asset at 31 December 2020 of £5.0 million (2019: £4.5 million) in relation to capital losses of which £5.0 million (2019: £4.5 million) relates to realised losses and £nil (2019: £nil) relates to unrealised losses.

On 3 March 2021, the Chancellor of the Exchequer announced that the rate of UK corporation tax will increase to 25% from 1 April 2023. This is not reflected in the figures above as it was not substantively enacted at the balance sheet date, however the effect is not expected to be material.

14. Dividends and appropriations

	2020	2019
	£m	£m
Amounts recognised as distributions to equity holders in the period:		
2020 interim dividend of 7.4 pence per share paid on 4 September 2020	100.4	—
2020 special interim dividend of 14.4 pence per share paid on 4 September 2020	195.5	—
2019 first interim dividend of 7.2 pence per share paid on 6 September 2019	—	98.6
2018 final dividend of 14.0 pence per share paid on 16 May 2019	—	191.8
2018 special dividend of 8.3 pence per share paid on 16 May 2019	—	113.7
	295.9	404.1
Coupon payments in respect of Tier 1 notes ¹	16.6	16.6
	312.5	420.7
Proposed dividends:		
2020 final dividend of 14.7 pence per share	199.3	—
2019 final dividend of 14.4 pence per share	—	198.0

Note:

- Coupon payments on the Tier 1 notes issued in December 2017 are treated as an appropriation of retained profits and, accordingly, are accounted for when paid.

The proposed final dividends for 2020 have not been included as a liability in these financial statements.

The Board has also approved a share buyback of up to £100 million, with an initial tranche of up to £50 million expected to be completed by the time of the half-year results.

On 3 March 2020, the Group announced that the Board had approved a share buyback of up to £150 million. On 19 March 2020, the Board cancelled that share buyback programme given the uncertainty in the capital markets at the time, driven by the rapidly emerging Covid-19 pandemic.

Following the cancellation of the dividend as announced on 8 April 2020, the final dividend for 2019 was not paid. A special interim dividend of 14.4 pence per share reflecting a full catch-up of the cancelled 2019 final dividend was paid on 4 September 2020.

The trustees of the employee share trusts waived their entitlement to dividends on shares held to meet obligations arising on the Long-Term Incentive Plan, Deferred Annual Incentive Plan and Restricted Share Plan awards, which reduced the total dividends paid for the year ended 31 December 2020 by £1.6 million (2019: £1.5 million).

15. Earnings per share

Earnings per share is calculated by dividing earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the year.

Basic

Basic earnings per share is calculated by dividing the earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the period, excluding Ordinary Shares held as employee trust shares.

	2020 £m	2019 £m
Earnings attributable to owners of the Company	367.2	419.9
Coupon payments in respect of Tier 1 notes	(16.6)	(16.6)
Profit for the calculation of earnings per share	350.6	403.3
Weighted average number of Ordinary Shares (millions)	1,356.5	1,367.2
Basic earnings per share (pence)	25.8	29.5

As noted in note 30, the Group cancelled the share buyback programme on 19 March 2020. At the time of cancellation, the Group had repurchased 10.4 million Ordinary Shares.

Diluted

Diluted earnings per share is calculated by dividing the earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the period, excluding Ordinary Shares held as employee trust shares, adjusted for the dilutive potential Ordinary Shares. The Company has share options and contingently issuable shares as categories of dilutive potential Ordinary Shares.

	2020 £m	2019 £m
Earnings attributable to owners of the Company	367.2	419.9
Coupon payments in respect of Tier 1 notes	(16.6)	(16.6)
Profit for the calculation of earnings per share	350.6	403.3
Weighted average number of Ordinary Shares (millions)	1,356.5	1,367.2
Effect of dilutive potential of share options and contingently issuable shares (millions)	18.6	15.3
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	1,375.1	1,382.5
Diluted earnings per share (pence)	25.5	29.2

16. Net asset value per share and return on equity

Net asset value per share is calculated as total shareholders' equity (which excludes Tier 1 notes) divided by the number of Ordinary Shares at the end of the period excluding shares held by employee share trusts.

Tangible net asset value per share is calculated as total shareholders' equity less goodwill and other intangible assets divided by the number of Ordinary Shares at the end of the period, excluding shares held by employee share trusts.

The table below analyses net asset and tangible net asset value per share.

	2020 £m	2019 £m
At 31 December		
Net assets	2,699.7	2,643.6
Goodwill and other intangible assets ¹	(786.8)	(702.5)
Tangible net assets	1,912.9	1,941.1
Number of Ordinary Shares (millions)	1,364.6	1,375.0
Shares held by employee share trusts (millions)	(12.8)	(8.4)
Closing number of Ordinary Shares (millions)	1,351.8	1,366.6
Net asset value per share (pence)	199.7	193.4
Tangible net asset value per share (pence)	141.5	142.0

Note:

1. Goodwill has arisen on acquisition by the Group of subsidiary companies and on acquisition of new accident repair centres. Intangible assets primarily comprise software development costs.

16. Net asset value per share and return on equity continued

Return on equity

The table below details the calculation of return on equity.

	2020 £m	2019 £m
Earnings attributable to owners of the Company	367.2	419.9
Coupon payments in respect of Tier 1 notes	(16.6)	(16.6)
Profit for the calculation of return on equity	350.6	403.3
Opening shareholders' equity	2,643.6	2,558.2
Closing shareholders' equity	2,699.7	2,643.6
Average shareholders' equity	2,671.7	2,600.9
Return on equity	13.1%	15.5%

17. Goodwill and other intangible assets

	Goodwill £m	Other intangible assets £m	Total £m
Cost			
At 1 January 2019	212.7	779.4	992.1
Acquisitions and additions	1.5	174.2	175.7
Disposals and write-off ¹	–	(8.8)	(8.8)
At 31 December 2019	214.2	944.8	1,159.0
Acquisitions and additions	–	140.7	140.7
At 31 December 2020	214.2	1,085.5	1,299.7
Accumulated amortisation and impairment			
At 1 January 2019	–	425.3	425.3
Charge for the year	–	38.7	38.7
Disposals and write-off ¹	–	(8.8)	(8.8)
Impairment losses ²	–	1.3	1.3
At 31 December 2019	–	456.5	456.5
Charge for the year	–	49.8	49.8
Impairment losses ²	–	6.6	6.6
At 31 December 2020	–	512.9	512.9
Carrying amount			
At 31 December 2020	214.2	572.6	786.8
At 31 December 2019	214.2	488.3	702.5

Notes:

- Disposals and write-off include fully amortised intangible assets no longer utilised by the Group in its operating activities.
- Impairment losses relate to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.

Included within other intangible assets are assets still in development of £370.7 million (2019: £343.5 million). These assets are tested for impairment during the Group's annual impairment review at each reporting date.

Goodwill arose on the acquisition of U K Insurance Limited (£141.0 million), Churchill Insurance Company Limited (£70.0 million) and accident repair networks (£3.2 million) and is allocated to reportable segments.

The Group's testing for impairment of goodwill and intangible assets includes the comparison of the recoverable amount of each CGU to which goodwill and other intangible assets have been allocated with its carrying value and is updated at each reporting date and whenever there are indications of impairment.

The table below analyses the carrying amount of goodwill allocated to each CGU.

	2020 £m	2019 £m
Motor	129.6	129.6
Home	45.8	45.8
Rescue and other personal lines	28.7	28.7
Commercial	10.1	10.1
Total	214.2	214.2

There is no goodwill impairment for the year ended 31 December 2020 (2019: Enil).

The recoverable amount is the higher of the CGU 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 estimated amount that could be obtained from the sale of the CGU in an arm's-length transaction between knowledgeable and willing parties.

The recoverable amounts of all CGUs were based on the value-in-use test, using the Group's strategic plan. The long-term growth rates have been based on gross domestic product rates adjusted for inflation. The risk discount rates incorporate observable market long-term government bond yields and average industry betas adjusted for an appropriate risk premium based on independent analysis.

The table below details the recoverable amounts in excess of carrying value for the CGUs where goodwill and other intangible assets are held. Sensitivity information is included to enhance user understanding of the influence of key assumptions. Following the annual impairment review, no reasonable possible change in these key assumptions would have resulted in an impairment of goodwill and other intangible assets.

CGU	Assumptions		Sensitivity: impact on recoverable amount of a:			
	Terminal growth rate	Pre-tax discount rate	Recoverable amount in excess of carrying value	1% decrease in terminal growth rate	1% increase in pre-tax discount rate	1% decrease in forecast pre-tax profit ¹
	%	%	£m	£m	£m	£m
Motor	1.5	10.7	759.2	(211.7)	(298.1)	(293.6)
Home	1.5	10.7	540.9	(59.0)	(83.0)	(83.1)
Rescue and other personal lines	1.5	10.7	640.1	(56.9)	(79.1)	(74.2)
Commercial	1.5	10.7	323.4	(57.2)	(79.6)	(73.9)

Note:

1. Reflects a 1% decrease in the profit for each year of the strategic plan, which is five years.

18. Property, plant and equipment

	Land and buildings	Other equipment	Total
	£m	£m	£m
Cost			
At 1 January 2019	79.8	185.0	264.8
Additions	—	11.9	11.9
Disposals	—	(7.7)	(7.7)
At 31 December 2019	79.8	189.2	269.0
Additions	—	20.1	20.1
Disposals	—	(13.4)	(13.4)
At 31 December 2020	79.8	195.9	275.7
Accumulated depreciation and impairment			
At 1 January 2019	5.3	103.3	108.6
Depreciation charge for the year	1.1	23.5	24.6
Disposals	—	(7.6)	(7.6)
At 31 December 2019	6.4	119.2	125.6
Depreciation charge for the year	1.1	14.0	15.1
Disposals	—	(11.1)	(11.1)
At 31 December 2020	7.5	122.1	129.6
Carrying amount			
At 31 December 2020	72.3	73.8	146.1
At 31 December 2019	73.4	70.0	143.4

The Group is satisfied that the aggregate fair value of property, plant and equipment is not less than its carrying value.

19. Right-of-use assets

	Property £m	Motor vehicles £m	IT equipment £m	Total £m
Cost				
At 1 January 2019	204.0	14.0	1.2	219.2
Additions	5.9	4.3	–	10.2
Disposals	–	(4.3)	–	(4.3)
At 31 December 2019	209.9	14.0	1.2	225.1
Additions	4.2	1.8	–	6.0
Disposals	(18.7)	(3.2)	–	(21.9)
At 31 December 2020	195.4	12.6	1.2	209.2
Accumulated depreciation and impairment				
At 1 January 2019	58.5	7.0	0.3	65.8
Depreciation charge for the year	10.2	3.8	0.2	14.2
Disposals	–	(4.1)	–	(4.1)
At 31 December 2019	68.7	6.7	0.5	75.9
Depreciation charge for the year	11.0	3.6	0.2	14.8
Disposals	(16.1)	(3.2)	–	(19.3)
At 31 December 2020	63.6	7.1	0.7	71.4
Carrying amount				
At 31 December 2020	131.8	5.5	0.5	137.8
At 31 December 2019	141.2	7.3	0.7	149.2

20. Investment property

	2020 £m	2019 £m
At 1 January	291.7	322.1
Additions at cost	10.5	–
Decrease in fair value during the year	(10.1)	(6.2)
Disposals	–	(24.2)
At 31 December¹	292.1	291.7

Note:

1. The cost included in the carrying value at 31 December 2020 is £233.4 million (2019: £222.9 million).

The investment properties are measured at fair value derived from valuation work carried out at the balance sheet date by independent property valuers.

The valuation conforms to international valuation standards. The fair value was determined using a methodology based on recent market transactions for similar properties, which have been adjusted for the specific characteristics of each property within the portfolio. This approach to valuation is consistent with the methodology used in the year ended 31 December 2019.

Lease agreements with tenants are drawn up in line with local practice and the Group has no exposure to leases that include contingent rents.

21. Subsidiaries

The principal subsidiary undertakings of the Group, over which it exercises 100% voting power, are shown below. Their capital consists of Ordinary Shares which are unlisted. All subsidiaries (a full list of which is included in note 2 of the Parent Company's financial statements) are included in the Group's consolidated financial statements.

Name of subsidiary	Company registration number	Place of incorporation and operation	Principal activity
DL Insurance Services Limited	03001989	United Kingdom	Management services
U K Insurance Limited	01179980	United Kingdom	General insurance

On 15 September 2020, the Group acquired 100% of the issued share capital of Brolly UK Technology Limited. The Group did not dispose of any subsidiaries in the year ended 31 December 2020 (31 December 2019: no acquisitions or disposals).

For the period ended 31 December 2020, it is expected that Brolly UK Technology Limited will be exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of section 479 A.

22. Reinsurance assets

	Notes	2020 £m	2019 £m
Reinsurers' share of general insurance liabilities		1,071.6	1,190.1
Impairment provision ¹		(46.3)	(40.5)
Total excluding reinsurers' unearned premium reserves	34	1,025.3	1,149.6
Reinsurers' unearned premium reserve	35	103.9	101.7
Total		1,129.2	1,251.3

Note:

1. Impairment provision relates to reinsurance debtors, allowing for the risk that reinsurance assets may not be collected, or where the reinsurer's credit rating has been significantly downgraded and it may have difficulty in meeting its obligations.

Movements in reinsurance asset impairment provision

	2020 £m	2019 £m
At 1 January	(40.5)	(54.7)
Additional provision	(13.7)	(4.2)
Release to income statement	7.9	18.4
At 31 December	(46.3)	(40.5)

23. Deferred acquisition costs

	2020 £m	2019 £m
At 1 January	176.2	170.4
Additions	361.6	366.8
Recognised in the income statement	(365.6)	(361.0)
At 31 December	172.2	176.2

24. Insurance and other receivables

	2020 £m	2019 £m
Receivables arising from insurance contracts:		
Due from policyholders	614.6	684.8
Impairment provision of policyholder receivables	(2.2)	(1.0)
Due from agents, brokers and intermediaries	136.0	111.5
Impairment provision of agent, broker and intermediary receivables	(0.3)	(0.2)
Amounts due from reinsurers	51.8	10.1
Other debtors	48.3	41.3
Total	848.2	846.5

Movement in impairment provisions during the year

	Policyholders £m	Agents, brokers and intermediaries £m	Total £m
At 1 January 2020	1.0	0.2	1.2
Additional provision	25.2	0.3	25.5
Released to income statement	(24.0)	(0.2)	(24.2)
At 31 December 2020	2.2	0.3	2.5

25. Prepayments, accrued income and other assets

	2020 £m	2019 £m
Prepayments	95.1	99.2
Accrued income and other assets	30.9	21.0
Total	126.0	120.2

26. Derivative financial instruments

	2020	2019
	£m	£m
Derivative assets		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	63.5	112.1
Interest rate swaps ¹	8.2	–
Designated as hedging instruments:		
Foreign exchange contracts (forwards) ²	0.1	0.4
Interest rate swaps ¹	1.6	9.0
Total	73.4	121.5
Derivative liabilities		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	12.3	10.1
Designated as hedging instruments:		
Foreign exchange contracts (forwards) ²	–	0.2
Interest rate swaps	44.9	20.2
Total	57.2	30.5

Notes:

- As described in note 33, the 2012 interest rate swap, which was entered into at the same time as the issue of the 9.25% subordinated Tier 2 notes due 2042, was treated as a designated hedging instrument in 2019 and as fair value through the income statement in 2020.
- Foreign exchange contracts (forwards) are designated as cash flow hedges in relation to supplier payments.

27. Retirement benefit obligations

Defined contribution scheme

The pension charge in respect of the defined contribution scheme for the year ended 31 December 2020 was £26.2 million (2019: £25.5 million).

Defined benefit scheme

The Group's defined benefit pension scheme was closed in 2003, although the Group remains the sponsoring employer for obligations to current and deferred pensioners based on qualifying years' service and final salaries. The defined benefit scheme is legally separated from the Group with trustees who are required by law to act in the interests of the scheme and of all the relevant stakeholders. The trustees of the pension scheme are responsible for the investment policy with regard to the assets of the scheme.

The trustee invests the scheme's assets in an appropriate mix of return-seeking assets and liability matching assets to better match the assets to future pension obligations. The main risks impacting funding levels are interest rates, changes in inflation expectations and the performance of the dynamic bond fund. The split of scheme assets is shown below. The matching assets are invested in liability-driven investment strategies, primarily UK gilts and index-linked gilt funds, but also including some leveraged gilt funds and interest rate and inflation swap funds. These are used to reduce the scheme's inflation and duration risks against its liabilities.

The weighted average duration of the defined benefit obligations at 31 December 2020 is 20 years (2019: 20 years) using accounting assumptions.

The table below sets out the principal assumptions used in determining the defined benefit scheme obligations.

	2020	2019
	%	%
Rate of increase in pension payment	2.2	2.1
Rate of increase of deferred pensions	2.2	2.1
Discount rate	1.4	2.0
Inflation rate	2.9	3.0

No assumption has been made for salary growth as there are no obligations in the scheme that are linked to future increases in salaries.

Post-retirement mortality assumptions

	2020	2019
Life expectancy at age 60 now:		
Males	87.5	87.1
Females	89.3	88.8
Life expectancy at age 60 in 20 years' time:		
Males	89.3	88.9
Females	91.1	90.7

The table below analyses the fair value of the scheme assets by type of asset.

	2020	2019
	£m	£m
Index-linked bonds	30.0	28.1
Government bonds	33.6	29.1
Liquidity fund ¹	1.5	2.5
Absolute return bond fund ²	–	40.2
Dynamic bond fund ³	42.3	–
Other	0.3	0.1
Total	107.7	100.0

Notes:

1. The liquidity fund is an investment in an open-ended fund incorporated in the Republic of Ireland which targets capital stability and income in the UK. It is invested in short-term fixed income and variable rate securities (such as treasury bills) listed or traded on one or more recognised exchanges.
2. The absolute return bond fund is an investment in an open-ended fund incorporated in Luxembourg which targets positive returns in all market conditions. It is invested in short-term fixed income asset classes and seeks additional returns via a range of additional investments including certificates of deposit, rates and global currencies.
3. In the third quarter of 2020, the scheme transferred the absolute return bond mandate to a new dynamic bond fund which targets positive returns over a three-year rolling basis. It is invested to maximise the total return from a globally diversified portfolio, predominantly comprising high-yield corporate and government bonds.

All UK debt instruments have quoted prices in active markets. The dynamic bond fund holds bonds that, rather than being traded on an exchange, are traded through agents, brokers or investment banks matching buyers and sellers.

27. Retirement benefit obligations continued

Movement in net pension surplus

	Fair value of defined benefit scheme assets	Present value of defined benefit scheme obligations	Net pension surplus
	£m	£m	£m
At 1 January 2019	95.6	(78.6)	17.0
Income statement:			
Net interest income / (cost) ¹	2.7	(2.2)	0.5
Administration costs	(0.5)	–	(0.5)
Statement of comprehensive income:			
Remeasurement losses			
Return on plan assets excluding amounts included in the net interest on the defined benefit asset	4.4	–	4.4
Actuarial gains of defined benefit scheme			
Experience gains	–	0.4	0.4
Gains from change in demographic assumptions	–	0.8	0.8
Loss from change in financial assumptions	–	(12.9)	(12.9)
Benefits paid	(2.2)	2.2	–
At 31 December 2019	100.0	(90.3)	9.7
Income statement:			
Net interest income / (cost) ¹	1.9	(1.8)	0.1
Administration costs	(0.4)	–	(0.4)
Statement of comprehensive income:			
Remeasurement losses			
Return on plan assets excluding amounts included in the net interest on the defined benefit asset	9.0	–	9.0
Actuarial gains of defined benefit scheme			
Experience gains	–	2.4	2.4
Loss from change in demographic assumptions	–	(1.7)	(1.7)
Loss from change in financial assumptions	–	(10.1)	(10.1)
Benefits paid	(2.8)	2.8	–
At 31 December 2020	107.7	(98.7)	9.0

Note:

1. The net interest income / (cost) in the income statement has been included under other operating expenses.

The table below details the history of the scheme for the current and prior years.

	2020	2019	2018	2017	2016
	£m	£m	£m	£m	£m
Present value of defined benefit scheme obligations	(98.7)	(90.3)	(78.6)	(87.3)	(90.5)
Fair value of defined benefit scheme assets	107.7	100.0	95.6	101.7	102.5
Net surplus	9.0	9.7	17.0	14.4	12.0
Experience gains on scheme liabilities	2.4	0.4	—	1.5	1.2
Return on plan assets excluding amounts included in the net interest on the defined benefit asset	9.0	4.4	(3.5)	1.0	13.7

Sensitivity analysis

The sensitivity analysis has been calculated by valuing the pension scheme liabilities using the amended assumptions shown in the table below and keeping the remaining assumptions the same as disclosed in the table above, except in the case of the inflation sensitivity where other assumptions that depend on assumed inflation have also been amended correspondingly. The pension cost has been determined allowing for the estimated impact on the scheme's assets. The sensitivity to discount rates is based on movements in credit spreads, rather than gilt yields, which are hedged in the scheme's assets. The selection of these movements to illustrate the sensitivity of the defined benefit obligation to key assumptions should be viewed as illustrative, rather than providing a view on the likely size of any change.

	Impact on pension cost		Impact on present value of defined benefit scheme obligations	
	2020	2019	2020	2019
	£m	£m	£m	£m
Discount rate				
0.25% increase in discount rate	(0.1)	(0.1)	(4.9)	(4.5)
0.25% decrease in discount rate	0.1	0.1	4.9	4.5
Inflation rate				
0.25% increase in inflation rate	—	—	2.5	2.3
0.25% decrease in inflation rate	—	—	(2.5)	(2.3)
Life expectancy				
1-year increase in life expectancy	0.1	0.1	3.6	3.2
1-year decrease in life expectancy	(0.1)	(0.1)	(3.6)	(3.2)

The most recent funding valuation of the Group's defined benefit scheme was carried out as at 1 October 2017. This showed an excess of assets over liabilities. The Group agreed with the trustees to make contributions of up to £1.5 million per annum in 2019, 2020 and 2021, in the event that a deficit subsequently emerges, on the anniversary of the funding valuation date.

At the date of signing these financial statements, no contributions are expected to be payable in 2021 (2020: £nil). The Group is currently undertaking a funding valuation of the defined benefit scheme at 1 October 2020, the results of which are due to be agreed with the trustees in 2021.

28. Financial investments

	2020	2019
	£m	£m
AFS debt securities		
Corporate	4,021.0	3,925.6
Supranational	21.3	31.3
Local government	35.6	29.2
Sovereign	25.2	99.5
Total	4,103.1	4,085.6
HTM debt securities		
Corporate	103.9	104.0
Total debt securities	4,207.0	4,189.6
Total debt securities		
Fixed interest rate ¹	4,184.5	4,166.5
Floating interest rate	22.5	23.1
Total	4,207.0	4,189.6
Loans and receivables		
Infrastructure debt	264.5	278.1
Commercial real estate loans	206.7	205.7
Total loans and receivables	471.2	483.8
Equity investments²	3.2	—
Total	4,681.4	4,673.4

Notes:

- The Group swaps a fixed interest rate for a floating rate of interest on its US dollar and Euro corporate debt securities by entering into interest rate derivatives. The hedged amount at 31 December 2020 was £971.1 million (2019: £955.8 million).
- An equity fund which is valued based on external valuation reports received from a third-party fund manager.

29. Cash and cash equivalents and borrowings

	2020	2019
	£m	£m
Cash at bank and in hand	224.9	223.1
Short-term deposits with credit institutions ¹	995.2	725.5
Cash and cash equivalents	1,220.1	948.6
Bank overdrafts ²	(51.9)	(52.3)
Cash and bank overdrafts³	1,168.2	896.3

Notes:

- This represents money market funds.
- Bank overdrafts represent short-term timing differences between transactions posted in the records of the Group and transactions flowing through the accounts at the bank.
- Cash and bank overdrafts total is included for the purposes of the consolidated cash flow statement.

The effective interest rate on short-term deposits with credit institutions for the year ended 31 December 2020 was 0.25% (2019: 0.79%) and average maturity was 10 days (2019: 10 days).

30. Share capital

Issued and fully paid: equity shares	2020			2019	
	Number of shares	Share capital	Transfer to capital redemption reserve	Number of shares	Share capital
	millions	£m	£m	millions	£m
Ordinary Shares of 10 10/11 pence each ¹					
At 1 January	1,375.0	150.0	—	1,375.0	150.0
Shares cancelled following share buyback ²	(10.4)	(1.1)	1.1	—	—
At 31 December	1,364.6	148.9	1.1	1,375.0	150.0

Notes:

- The shares have full voting dividend and capital distribution rights (including wind-up) attached to them; these do not confer any rights of redemption.
- On 3 March 2020, the Group announced a share buyback of Ordinary Shares for an aggregate purchase price of £150 million. On 19 March 2020 the buyback programme was cancelled, given the uncertainty in the capital markets at the time driven by the rapidly emerging Covid-19 pandemic. At the time of cancellation, the Group had repurchased 10,448,395 Ordinary Shares for an aggregate consideration of £30,014,567 as reflected in retained earnings. The shares were subsequently cancelled giving rise to a capital redemption reserve of an equivalent amount as required by the Companies Act 2006.

Employee trust shares

The Group satisfies share-based payments under the Group's share plans primarily through shares purchased in the market and held by employee share trusts.

At 31 December 2020, 12,753,755 Ordinary Shares (2019: 8,445,670 Ordinary Shares) were owned by the employee share trusts at a cost of £40.3 million (2019: £30.2 million). These Ordinary Shares are carried at cost and at 31 December 2020 had a market value of £40.7 million (2019: £26.4 million).

31. Other reserves

Movements in the AFS investments revaluation reserve

	2020	2019
	£m	£m
At 1 January	47.5	(36.8)
Revaluation during the year - gross	47.4	118.1
Revaluation during the year - tax	(10.1)	(20.1)
Net gains transferred to income statement on disposals - gross	(1.1)	(16.5)
Net gains transferred to income statement on disposals - tax	0.2	2.8
At 31 December	83.9	47.5

Capital reserves

	2020	2019
	£m	£m
Capital contribution reserve ¹	100.0	100.0
Capital redemption reserve ²	1,351.1	1,350.0
Total	1,451.1	1,450.0

Notes:

1. Arose on the cancellation of a debt payable to a shareholder.
2. Arose on the reduction of nominal value of each share in issue with a corresponding transfer to capital redemption reserve. An additional £1.1 million arose in 2020 when shares repurchased through buyback were cancelled.

32. Tier 1 notes

	2020	2019
	£m	£m
Tier 1 notes	346.5	346.5

On 7 December 2017, the Group issued £350 million of fixed rate perpetual Tier 1 notes with a coupon rate of 4.75% per annum.

The Group has an optional redemption date of 7 December 2027. If the notes are not repaid on that date, a fixed rate of interest per annum will be reset. The notes are direct, unsecured and subordinated obligations of the issuer ranking pari passu and without any preference amongst themselves.

The Tier 1 notes are treated as a separate category within equity and the coupon payments are recognised outside of the profit after tax result and directly in shareholders' equity.

The Group has the option to cancel the coupon payment. Cancellation becomes mandatory if: the Solvency condition¹ is not met at the time of, or following, coupon payment; there is non-compliance with the SCR or the minimum capital requirement; the Group has insufficient distributable reserves; or the relevant regulator requires the coupon payment to be cancelled.

Note:

1. All payments shall be conditional upon the Group being solvent at the time of payment and immediately after payment. The Issuer will be solvent if (i) it is able to pay its debts owed to senior creditors as they fall due and (ii) its assets exceed its liabilities.

33. Subordinated liabilities

	2020	2019
	£m	£m
Subordinated Tier 2 notes	516.6	259.0

£250 million 9.25% subordinated Tier 2 notes due 2042

Subordinated guaranteed dated notes with a nominal value of £500 million were issued on 27 April 2012 at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year interest rate swap to exchange the fixed rate of interest for a floating rate of 3-month LIBOR plus a spread of 706 basis points which was credit value adjusted to 707 basis points with effect from 29 July 2013. This was treated as a designated hedging instrument.

On 8 December 2017, the Group repurchased £250 million nominal value of the subordinated guaranteed dated notes for a purchase price of £330.1 million including accrued interest of £2.7 million and associated transaction costs of £0.6 million. The designated hedging agreement was adjusted accordingly.

The remaining notes, with a nominal value of £250 million, have a redemption date of 27 April 2042 with the option to repay the notes on 27 April 2022. If the notes are not repaid on that date, the terms of the notes provide that the rate of interest will be reset at a rate of 6-month LIBOR plus 7.91%. If LIBOR has been discontinued by this time, the terms of the notes provide for an ultimate fall back rate of interest of 9.25% for subsequent interest periods. The terms of the notes do not automatically provide for the transition of LIBOR to SONIA, which would require a separate agreement between the Group and the noteholders.

The Group has the option, in certain circumstances, to defer interest payments on the notes but to date has not exercised this right.

During 2020 the Group identified that the hedge no longer met the criteria of hedge effectiveness under IAS 39 'Financial Instruments: Recognition and Measurement' and, under the rules of the standard, the accumulated hedging adjustment has begun to be amortised to the income statement from the date of the last successful hedge effectiveness test over the remaining life of the subordinated debt using an effective interest rate calculation.

£260 million 4.0% subordinated Tier 2 notes due 2032

On 5 June 2020, the Group issued subordinated Tier 2 notes at a fixed rate of 4.0%. The notes have a redemption date of 5 June 2032 and may be redeemed at the option of the Group commencing on 5 December 2031 until the maturity date.

The Group has the option, in certain circumstances, to defer interest payments on the notes but to date has not exercised this right.

The 2032 and 2042 notes are unsecured and subordinated obligations of the Group and rank pari passu and 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 senior creditors have been met and will rank at least pari passu with the claims of holders of other Tier 2 capital.

34. Insurance liabilities

	2020		2019								
	£m		£m								
Insurance liabilities	3,617.0		3,819.6								
Gross insurance liabilities											
Accident year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Estimate of ultimate gross claims costs:											
At end of accident year	2,698.1	2,372.7	2,184.0	2,094.5	2,118.1	2,157.7	2,217.3	2,300.1	2,110.4	1,847.3	
One year later	(99.3)	(163.3)	(117.6)	20.7	(30.0)	(86.7)	(116.2)	(62.3)	(67.2)		
Two years later	(94.6)	(118.9)	(153.0)	(38.4)	(143.5)	(53.3)	(103.1)	(52.0)			
Three years later	(89.3)	(49.3)	(21.0)	(144.9)	(62.4)	(82.8)	(42.4)				
Four years later	(60.9)	(9.9)	(102.1)	(50.2)	(22.9)	(46.1)					
Five years later	(21.2)	(79.2)	(50.8)	(51.6)	(22.0)						
Six years later	(60.3)	(36.2)	(27.4)	(33.6)							
Seven years later	(25.1)	(23.8)	(14.0)								
Eight years later	(27.9)	(1.6)									
Nine years later	(11.0)										
Current estimate of cumulative claims	2,208.5	1,890.5	1,698.1	1,796.5	1,837.3	1,888.8	1,955.6	2,185.8	2,043.2	1,847.3	
Cumulative payments to date	(2,183.0)	(1,873.8)	(1,683.5)	(1,682.6)	(1,688.8)	(1,693.8)	(1,665.8)	(1,740.8)	(1,467.3)	(895.7)	
Gross liability recognised in balance sheet	25.5	16.7	14.6	113.9	148.5	195.0	289.8	445.0	575.9	951.6	2,776.5
2010 and prior											762.5
Claims handling provision											78.0
Total											3,617.0

34. Insurance liabilities continued

Net insurance liabilities

Accident year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Estimate of ultimate net claims costs:											
At end of accident year	2,644.4	2,271.8	2,093.9	1,971.0	1,926.7	1,922.2	2,016.9	2,125.9	1,941.2	1,674.5	
One year later	(131.5)	(146.7)	(123.6)	(29.7)	(67.0)	(18.9)	(79.7)	(41.4)	(34.5)		
Two years later	(82.1)	(107.8)	(134.4)	(42.0)	(77.8)	(38.2)	(65.3)	(27.1)			
Three years later	(76.5)	(35.6)	(27.8)	(100.7)	(30.4)	(43.7)	(14.0)				
Four years later	(48.7)	(11.6)	(64.3)	(41.3)	(24.1)	(16.9)					
Five years later	(37.3)	(54.2)	(38.9)	(52.5)	(20.7)						
Six years later	(37.0)	(30.4)	(17.7)	(8.3)							
Seven years later	(20.4)	(14.6)	(10.6)								
Eight years later	(23.0)	(1.2)									
Nine years later	(6.6)										
Current estimate of cumulative claims	2,181.3	1,869.7	1,676.6	1,696.5	1,706.7	1,804.5	1,857.9	2,057.4	1,906.7	1,674.5	
Cumulative payments to date	(2,159.5)	(1,856.3)	(1,664.4)	(1,653.8)	(1,638.5)	(1,678.8)	(1,637.6)	(1,731.4)	(1,459.3)	(878.0)	
Net liability recognised in balance sheet	21.8	13.4	12.2	42.7	68.2	125.7	220.3	326.0	447.4	796.5	2,074.2
2010 and prior											439.5
Claims handling provision											78.0
Total											2,591.7

Movements in gross and net insurance liabilities

	Gross £m	Reinsurance £m	Net £m
Claims reported	3,001.0	(809.8)	2,191.2
Incurred but not reported	924.9	(295.4)	629.5
Claims handling provision	80.0	–	80.0
At 1 January 2019	4,005.9	(1,105.2)	2,900.7
Cash paid for claims settled in the year	(2,103.6)	25.3	(2,078.3)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,311.3	(169.2)	2,142.1
Arising from prior-year claims	(394.0)	99.5	(294.5)
At 31 December 2019	3,819.6	(1,149.6)	2,670.0
Claims reported	2,916.0	(829.3)	2,086.7
Incurred but not reported	825.4	(320.3)	505.1
Claims handling provision	78.2	–	78.2
At 31 December 2019	3,819.6	(1,149.6)	2,670.0
Cash paid for claims settled in the year	(1,933.0)	141.1	(1,791.9)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,057.3	(169.9)	1,887.4
Arising from prior-year claims	(326.9)	153.1	(173.8)
At 31 December 2020	3,617.0	(1,025.3)	2,591.7
Claims reported	2,762.0	(842.8)	1,919.2
Incurred but not reported	777.0	(182.5)	594.5
Claims handling provision	78.0	–	78.0
At 31 December 2020	3,617.0	(1,025.3)	2,591.7

Movement in prior-year net claims liabilities by operating segment

	2020 £m	2019 £m
Motor	(100.6)	(180.5)
Home	(10.8)	(41.4)
Rescue and other personal lines	(5.6)	(7.6)
Commercial	(56.8)	(65.0)
Total	(173.8)	(294.5)

34. Insurance liabilities continued

Analysis of outstanding PPO claims provisions on a discounted and an undiscounted basis

The Group settles some large bodily injury claims as PPOs rather than lump sum payments.

The table below analyses the outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2020 and 31 December 2019. These represent the total cost of PPOs rather than any costs in excess of purely Ogden-based settlements.

	Discounted 2020 £m	Undiscounted 2020 £m	Discounted 2019 £m	Undiscounted 2019 £m
At 31 December				
Gross claims				
Approved PPO claims provisions	561.1	1,289.5	529.7	1,425.5
Anticipated PPOs	253.7	561.6	270.4	716.8
Total	814.8	1,851.1	800.1	2,142.3
Reinsurance				
Approved PPO claims provisions	(309.3)	(743.6)	(277.2)	(786.9)
Anticipated PPOs	(186.9)	(435.8)	(185.6)	(529.1)
Total	(496.2)	(1,179.4)	(462.8)	(1,316.0)
Net of reinsurance				
Approved PPO claims provisions	251.8	545.9	252.5	638.6
Anticipated PPOs	66.8	125.8	84.8	187.7
Total	318.6	671.7	337.3	826.3

The provisions for PPOs have been categorised as either claims which have already been determined by the courts as PPOs (approved PPO claims provisions) or those expected to settle as PPOs in the future (anticipated PPOs). The Group has estimated the likelihood of large bodily injury claims settling as PPOs. The anticipated PPOs in the table above are based on historically-observed propensities adjusted for the assumed Ogden discount rate.

In the majority of cases, the inflation agreed in the settlement is the Annual Survey of Hours and Earnings SOC 6115 inflation published by the Office for National Statistics, for which the long-term rate is assumed to be 3.5% (2019: 4%). The Group has estimated a rate of interest used for the calculation of present values as 3.5% (2019: 4%), which results in a real discount rate of 0% (2019: 0%). The Group will continue to review the inflation and discount rates used to calculate these insurance reserves.

35. Unearned premium reserve

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2019	1,505.5	(103.5)	1,402.0
Written in the period	3,203.1	(215.9)	2,987.2
Earned in the period	(3,202.6)	217.7	(2,984.9)
At 31 December 2019	1,506.0	(101.7)	1,404.3
Written in the period	3,180.4	(231.0)	2,949.4
Earned in the period	(3,189.3)	228.8	(2,960.5)
At 31 December 2020	1,497.1	(103.9)	1,393.2

36. Share-based payments

The Group operates equity-settled, share-based compensation plans in the form of a Long-Term Incentive Plan ("LTIP"), a Restricted Shares Plan, a Deferred Annual Incentive Plan ("DAIP") and Direct Line Group Share Incentive Plans, including both the Free Share awards and a Buy-As-You-Earn Plan, details of which are set out below. All awards are to be satisfied using market-purchased shares.

Long-Term Incentive Plan

Executive Directors and certain members of senior management are eligible to participate in the LTIP with awards granted in the form of nil-cost options. Under the plan, the shares vest at the end of a three year period dependent upon the continued employment by the Group and also the Group achieving predefined performance conditions associated with Total Shareholder Return ("TSR") and return on tangible equity ("RoTE"). For awards since August 2017, the Directors are subject to an additional two year holding period following the three year vesting period.

Awards were made in the year ended 31 December 2020 over 4.7 million Ordinary Shares with an estimated fair value of £13.2 million at the 2020 grant dates (2019: 4.5 million Ordinary Shares with an estimated fair value of £14.4 million).

The estimated fair value of the LTIP share awards with market-based performance conditions was calculated using a Monte-Carlo simulation model.

The table below details the inputs into the model.

	2020	2019
Weighted average assumptions during the year:		
Share price (pence)	290	318
Exercise price (pence)	0	0
Volatility of share price	34%	19%
Average comparator volatility	48%	29%
Expected life	3 years	3 years
Risk-free rate	0.02%	0.50%

Expected volatility was determined by considering the actual volatility of the Group's share price since its initial public offering and that of a group of listed UK insurance companies.

Plan participants are entitled to receive additional shares in respect of dividends paid to shareholders over the vesting period. Therefore, no deduction has been made from the fair value of awards in respect of dividends.

Expected life was based on the contractual life of the awards and adjusted based on management's best estimate, for the effects of exercise restrictions and behavioural considerations.

Restricted Shares Plan

The purpose of the Restricted Shares Plan is to facilitate the wider participation in Group share-based awards of eligible employees. These awards can be granted in the form of a nil-cost option at any time during the year, generally have no performance criteria, and vest over periods ranging up to seven years from the date of the grant, subject to continued employment. During the year awards were made over 1.0 million Ordinary Shares (2019: 0.2 million Ordinary Shares) with an estimated fair value of £2.9 million (2019: £0.7 million) using the market value at the date of grant.

Deferred Annual Incentive Plan

To incentivise delivery of performance over a one-year operating cycle, Executive Directors and certain members of senior management are eligible for awards under the Annual Incentive Plan ("AIP"), of which at least 40% is granted in the form of a nil-cost option under the DAIP with the remainder being settled in cash following year end. During the year awards were made over 1.8 million Ordinary Shares (2019: 1.3 million Ordinary Shares) under this plan with an estimated fair value of £4.6 million (2019: £4.5 million) using the market value at the date of grant.

The awards outstanding at 31 December 2020 have no performance criteria attached; there is a requirement that the employee remains in employment with the Group for three years from the date of grant.

Direct Line Group Share Incentive Plans: Free Share awards

In early 2020, the Group offered all eligible employees a Free Share award granting 180 Ordinary Shares free of charge as a measure of thanks to the employees for the part they played in the good results that the Group reported for 2019. These awards have no performance criteria attached and vest on the third anniversary of the award grant date, subject to completion of three years continuing employment. The Group initially granted 1.9 million Ordinary Shares with an estimated fair value of £5.4 million using the market value at the date of grant. No free shares were awarded in the year ended 31 December 2019.

Direct Line Group Share Incentive Plans: Buy-As-You-Earn Plan

The Buy-As-You-Earn Plan entitles employees to purchase shares from pre-tax pay for between £10 and £150 per month and receive one matching share for every two shares purchased.

In the year ended 31 December 2020, matching share awards were granted over 0.6 million Ordinary Shares (2019: 0.5 million Ordinary Shares) with an estimated fair value of £1.6 million (2019: £1.6 million). The fair value of each matching share award is estimated using the market value at the date of grant.

Under the plan, the shares vest at the end of a three-year period dependent upon continued employment with the Group together with continued ownership of the associated purchased shares up to the point of vesting.

36. Share-based payments continued

Movement in total share awards

	Number of share awards	
	2020	2019
	millions	millions
At 1 January	21.6	21.3
Granted during the year ¹	11.3	8.0
Forfeited during the year	(1.9)	(3.0)
Exercised during the year	(4.1)	(4.7)
At 31 December	26.9	21.6
Exercisable at 31 December	1.5	1.6

Note:

1. In accordance with the rules of the LTIP, Restricted Shares Plan and DAIP, additional awards of 1.3 million shares were granted during the year ended 31 December 2020 (2019: 1.5 million) in respect of the equivalent dividend.

In respect of the outstanding options at 31 December 2020, the weighted average remaining contractual life is 1.61 years (2019: 1.57 years). No share awards expired during the year (2019: nil).

The weighted average share price for awards exercised during the year ended 31 December 2020 was £2.86 (2019: £3.29).

The Group recognised total expenses in the year ended 31 December 2020 of £18.5 million (2019: £18.4 million) relating to equity-settled share-based compensation plans. An equivalent credit was recognised in retained earnings.

Further information on share-based payments, in respect of Executive Directors, is provided in the Directors' Remuneration Report.

37. Provisions

Movement in provisions during the year

	Regulatory levies	Restructuring	Other	Total
	£m	£m	£m	£m
At 1 January 2020	40.0	2.5	31.8	74.3
Additional provision	59.3	26.5	45.6	131.4
Utilisation of provision	(57.7)	(1.8)	(23.9)	(83.4)
Released to income statement	—	(1.3)	(6.2)	(7.5)
At 31 December 2020	41.6	25.9	47.3	114.8

Of the above, £6.0 million (2019: £nil) is due to be settled outside of 12 months.

Regulatory levies provisions include undiscounted balances held for MIB, FSCS and other insurance levies where the Group is charged in the following year.

Restructuring provisions include balances held in respect of various property dilapidations and a number of restructuring programmes within the Group, including office site closures and staff restructuring.

Other provisions primarily include balances held in respect of staff bonuses and reward.

38. Trade and other payables, including insurance payables

	2020	2019
	£m	£m
Trade creditors and accruals	293.5	224.2
Other taxes	100.4	101.3
Other creditors	89.1	95.3
Due to reinsurers	60.2	43.7
Due to agents, brokers and intermediaries	2.5	9.7
Deferred income	3.3	2.9
Due to insurance companies	0.9	1.0
Total	549.9	478.1

39. Notes to the consolidated cash flow statement

	2020	2019
	£m	£m
Profit for the year	367.2	419.9
Adjustments for:		
Investment return	(95.1)	(134.6)
Instalment income	(109.3)	(114.0)
Finance costs	31.3	26.0
Defined benefit pension scheme - net interest charge	0.7	-
Equity-settled share-based payment charge	18.5	18.4
Tax charge	84.2	89.8
Depreciation and amortisation charge	79.7	77.5
Impairment of property, plant and equipment, goodwill and intangible assets	6.6	1.3
Impairment provision movements on reinsurance contracts	5.8	(14.1)
Loss on sale of property, plant and equipment and right of use assets	4.9	0.3
Movement in prepayments	4.1	(0.2)
Operating cash flows before movements in working capital	398.6	370.3
Movements in working capital:		
Net decrease in net insurance liabilities including reinsurance assets, unearned premium reserves and deferred acquisition costs	(91.3)	(220.1)
Net (increase) / decrease in insurance and other receivables	(1.6)	29.4
Net (increase) / decrease in accrued income and other assets	(9.9)	4.5
Net increase / (decrease) in trade and other payables, including insurance payables and provisions	106.8	(1.7)
Cash generated from operations	402.6	182.4
Taxes paid	(134.0)	(95.8)
Cash flow hedges	0.2	1.6
Net cash generated from operating activities before investment of insurance assets	268.8	88.2
Interest received	260.0	280.7
Rental income received from investment property	13.7	16.2
Purchase of investment property	(10.5)	-
Proceeds on disposal of investment property	-	24.2
Proceeds on disposal / maturity of AFS debt securities	1,614.0	1,886.4
Advances made for commercial real estate loans	(46.3)	(32.3)
Repayments of infrastructure debt and commercial real estate loans	56.7	40.6
Purchase of AFS debt securities	(1,568.5)	(1,838.8)
Purchase of equity investments	(3.2)	-
Purchase of HTM debt securities	-	(3.1)
Cash generated from investment of insurance assets	315.9	373.9

39. Notes to the consolidated cash flow statement continued

The table below details changes in liabilities arising from the Group's financing activities.

	Leases		Subordinated liabilities		Interest rate swap associated with subordinated debt ¹	
	2020 £m	2019 £m	2020 £m	2019 £m	2020 £m	2019 £m
At 1 January	164.4	167.3	(259.0)	(259.5)	9.0	9.0
Proceeds on issue of subordinated liabilities ²	–	–	(257.2)	–	–	–
Interest paid on subordinated liabilities	–	–	28.3	23.1	–	–
Interest rate swap cash settlement	–	–	–	–	(4.1)	(3.4)
Lease cash flows	(18.5)	(19.8)	–	–	–	–
Interest on lease payments	6.0	6.7	–	–	–	–
Financing cash flows	(12.5)	(13.1)	(228.9)	23.1	(4.1)	(3.4)
Net lease additions	0.5	10.2	–	–	–	–
Amortisation of arrangement costs and discount on issue of subordinated liabilities	–	–	(0.5)	(0.3)	–	–
Amortisation of fair value hedging	–	–	1.8	–	–	–
Accrued interest expense on subordinated liabilities	–	–	(29.1)	(23.1)	–	–
Unrealised (loss) / gain on associated interest rate risk on hedged item	–	–	(0.9)	0.8	–	–
Net accrued interest on interest rate swap	–	–	–	–	0.3	–
Fair value movement in interest rate swap	–	–	–	–	3.0	3.4
Non-cash changes	0.5	10.2	(28.7)	(22.6)	3.3	3.4
At 31 December	152.4	164.4	(516.6)	(259.0)	8.2	9.0

Notes:

- As described in note 33, the Group entered into a 10-year interest rate swap on the same date as issuing the £250 million 9.25% subordinated Tier 2 notes due 2042.
- As described in note 33, on 5 June 2020 the Group issued £260.0 million of subordinated Tier 2 notes at a fixed rate of 4.0%. The notes have a redemption date of 5 June 2032 and may be redeemed at the option of the Group commencing on 5 December 2031 until the maturity date. Proceeds are net of issue costs of £2.8 million.

40. Commitments and contingent liabilities

The Group did not have any material commitments and contingent liabilities at 31 December 2020 (2019: none).

41. Leases

Operating lease commitments where the Group is the lessor

The following table analyses future aggregate minimum lease payments receivable under non-cancellable operating leases in respect of property leased to third-party tenants.

	2020 £m	2019 £m
Within one year	13.7	13.8
In the second to fifth years inclusive	38.6	39.2
After five years	66.5	69.1
Total¹	118.8	122.1

Note:

- At year ended 31 December 2020, £116.6 million of the total operating lease commitments where the Group is the lessor relates to the lease of investment properties detailed in note 20 (2019: £119.6 million).

Other leases disclosures

Sublease income in respect of property right-of-use assets was £0.2 million during the year (2019: £0.3 million). Expenses relating to short-term and variable lease payments were not included in the measurement of lease liabilities as they were not significant. Total cash outflow in respect of leases for the year ended 31 December 2020 was £18.7 million (2019: £20.1 million).

42. Fair value

Fair value hierarchy

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique.

For disclosure purposes, fair value measurements are classified as level 1, 2 or 3 based on the degree to which fair value is observable:

- 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.
- Level 2 financial assets and liabilities are measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. These include AFS debt security assets for which pricing is obtained via pricing services, but where prices have not been determined in an active market, or financial assets with fair values based on broker quotes or assets that are valued using the Group's own models whereby the majority of assumptions are market-observable. Derivatives are valued using broker quotes or appropriate valuation models. Model inputs include a range of factors which are deemed to be observable, including current market and contractual prices for underlying instruments, period to maturity, correlations, yield curves and volatility of underlying instruments.
- Level 3 fair value measurements used for investment properties, HTM debt securities, infrastructure debt, commercial real estate loans and equity investments are those derived from a valuation technique that includes inputs for the asset that are unobservable.

Comparison of carrying value to fair value of financial instruments and assets where fair value is disclosed

	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
At 31 December 2020					
Assets held at fair value:					
Investment property (note 20)	292.1	—	—	292.1	292.1
Derivative assets (note 26)	73.4	—	73.4	—	73.4
AFS debt securities (note 28)	4,103.1	25.2	4,077.9	—	4,103.1
Equity investments (note 28)	3.2	—	—	3.2	3.2
Other financial assets:					
HTM debt securities (note 28)	103.9	—	14.2	93.7	107.9
Infrastructure debt (note 28)	264.5	—	—	273.6	273.6
Commercial real estate loans (note 28)	206.7	—	—	202.9	202.9
Total	5,046.9	25.2	4,165.5	865.5	5,056.2
Liabilities held at fair value:					
Derivative liabilities (note 26)	57.2	—	57.2	—	57.2
Other financial liabilities:					
Subordinated liabilities (note 33)	516.6	—	589.0	—	589.0
Total	573.8	—	646.2	—	646.2

	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
At 31 December 2019					
Assets held at fair value:					
Investment property (note 20)	291.7	—	—	291.7	291.7
Derivative assets (note 26)	121.5	—	121.5	—	121.5
AFS debt securities (note 28)	4,085.6	99.5	3,986.1	—	4,085.6
Other financial assets:					
HTM debt securities (note 28)	104.0	—	14.1	94.0	108.1
Infrastructure debt (note 28)	278.1	—	—	285.6	285.6
Commercial real estate loans (note 28)	205.7	—	—	203.0	203.0
Total	5,086.6	99.5	4,121.7	874.3	5,095.5
Liabilities held at fair value:					
Derivative liabilities (note 26)	30.5	—	30.5	—	30.5
Other financial liabilities:					
Subordinated liabilities (note 33)	259.0	—	297.8	—	297.8
Total	289.5	—	328.3	—	328.3

42. Fair value continued

Differences arise between carrying value and fair value where the measurement basis of the asset or liability is not fair value (e.g. assets and liabilities carried at amortised cost). Fair values of the following assets and liabilities approximate their carrying values:

- insurance and other receivables;
- cash and cash equivalents;
- borrowings; and
- trade and other payables, including insurance payables.

The movements in assets held at fair value and classified as level 3 in the fair value hierarchy relate to investment property and equity investments. Investment property is analysed in note 20 along with further details on the Group's valuation approach. A summary of realised and unrealised gains or losses in relation to investment property at fair value are presented in note 6. Sensitivity analysis in respect of investment property has been provided in note 3. There were no changes in the categorisation of assets between levels 1, 2 and 3 for assets and liabilities held by the Group since 31 December 2019.

The table below shows the unobservable inputs used by the Group in the fair value measurement of its investment property.

31 December 2020	Fair value £m	Valuation technique	Unobservable input	Range (weighted average)
Investment property	288.8 ¹	Income capitalisation	Equivalent yield	3.88% - 7.97% (average 5%)
			Estimated rental value per square foot	£1.81 - £35.00 (average £12.34)

Note:

1. The methodology of valuation reflects commercial property held within U K Insurance Limited.

The table below analyses the movement in assets carried at fair value classified as level 3 in the fair value hierarchy.

	Investment property (note 20) £m	Equity investment £m
At 1 January 2020	291.7	–
Additions at cost	10.5	3.2
Decrease in fair value in the period through profit or loss (note 6)	(10.1)	–
At 31 December 2020	292.1	3.2

43. Related parties

Transactions between the Group's subsidiary undertakings, which are related parties, have been eliminated on consolidation and accordingly are not disclosed.

There were no sales or purchases of products and services to or from related parties in the year ended 31 December 2020 (2019: £nil).

Compensation of key management

	2020 £m	2019 £m
Short-term employee benefits	11.9	11.6
Post-employment benefits	0.1	–
Share-based payments	7.6	7.9
Total	19.6	19.5

44. Post balance sheet event

On 10 February 2021, U K Insurance Limited signed a contract in relation to its Bromley site to surrender the current lease and DL Insurance Services Limited signed a contract to purchase the head lease. The cost of surrendering the lease was £91 million and the value of the fixed asset capitalised will be in the region of £17 million. This will reduce the Group's Solvency II own funds by around £85 million.

	Notes	2020 £m	2019 £m
Assets			
Investment in subsidiary undertakings	2	3,305.9	3,137.4
Other receivables	3	335.7	299.1
Current tax assets	4	5.5	3.5
Derivative financial instruments	5	0.1	0.6
Financial investments	6	–	85.0
Cash and cash equivalents	7	266.1	124.2
Total assets		3,913.3	3,649.8
Equity			
Shareholders' equity		2,936.6	2,931.4
Tier 1 notes	9	346.5	346.5
Total equity		3,283.1	3,277.9
Liabilities			
Subordinated liabilities	10	511.9	253.4
Borrowings	11	116.4	116.3
Derivative financial instruments	5	0.1	0.6
Trade and other payables	12	1.1	1.0
Deferred tax liabilities	4	0.7	0.6
Total liabilities		630.2	371.9
Total equity and liabilities		3,913.3	3,649.8

The attached notes on pages 217 to 221 form an integral part of these separate financial statements.

The profit for the year net of tax was £343.0 million (2019: £143.3 million).

The financial statements were approved by the Board of Directors and authorised for issue on 5 March 2021.

They were signed on its behalf by:



PENNY JAMES
CHIEF EXECUTIVE OFFICER
Direct Line Insurance Group plc
Registration No. 02280426

Parent Company Statement of Comprehensive Income

For the year ended 31 December 2020

	2020 £m	2019 £m
Profit for the year attributable to the owners of the Company	343.0	143.3
Other comprehensive loss		
Items that may be reclassified subsequently to income statement		
Loss on fair value through other comprehensive income investments	(0.1)	–
Other comprehensive loss for the year net of tax	(0.1)	–
Total comprehensive income for the year attributable to the owners of the Company	342.9	143.3

Parent Company Statement of Changes in Equity

For the year ended 31 December 2020

	Share capital £m	Capital reserves £m	Share-based payment reserve £m	Fair value through other comprehensive income revaluation reserve £m	Retained earnings £m	Shareholders' equity £m	Tier 1 notes £m	Total equity £m
Balance at 1 January 2019	150.0	1,450.0	(0.6)	–	1,606.4	3,205.8	346.5	3,552.3
Total comprehensive income for the year	–	–	–	–	143.3	143.3	–	143.3
Dividends and appropriations paid (note 13)	–	–	–	–	(420.7)	(420.7)	–	(420.7)
Credit to equity for equity-settled share-based payments	–	–	18.4	–	–	18.4	–	18.4
Shares distributed by employee trusts	–	–	(15.4)	–	–	(15.4)	–	(15.4)
Balance at 31 December 2019	150.0	1,450.0	2.4	–	1,329.0	2,931.4	346.5	3,277.9
Total comprehensive income for the year	–	–	–	(0.1)	343.0	342.9	–	342.9
Dividends and appropriations paid (note 13)	–	–	–	–	(312.5)	(312.5)	–	(312.5)
Shares cancelled following buyback	(1.1)	1.1	–	–	(30.0)	(30.0)	–	(30.0)
Credit to equity for equity-settled share-based payments	–	–	18.5	–	–	18.5	–	18.5
Shares distributed by employee trusts	–	–	(13.7)	–	–	(13.7)	–	(13.7)
Balance at 31 December 2020	148.9	1,451.1	7.2	(0.1)	1,329.5	2,936.6	346.5	3,283.1

The attached notes on pages 217 to 221 form an integral part of these separate financial statements.

Notes to the Parent Company Financial Statements

Financial Statements

1. Accounting policies

1.1 Basis of preparation

Direct Line Insurance Group plc, registered in England and Wales (company number 02280426), is the ultimate parent company of the Group. The principal activity of the Company is managing its investments in subsidiaries, providing loans to those subsidiaries, raising funds for the Group and the receipt and payment of dividends.

The address of the Company's registered office is Churchill Court, Westmoreland Road, Bromley, BR1 1DP.

The Company's financial statements are prepared on the historical cost basis except for financial investments and derivative financial investments, which are measured at fair value.

In accordance with the exemption permitted under section 408 of the Companies Act 2006, the Company's income statement and related notes have not been presented in these separate financial statements.

The Company's financial statements are prepared in accordance with FRS 101 'Reduced Disclosure Framework'.

The Company has taken advantage of the following FRS 101 disclosure exemptions:

- FRS 101.8 (d): the requirements of IFRS 7 'Financial Instruments: Disclosures' to make disclosures about financial instruments;
- FRS 101.8 (e): the disclosure requirements of IFRS 13 'Fair Value Measurement';
- FRS 101.8 (g): the requirements of paragraphs 10(d), 10(f), 16, 36A, 38B, 38C, 111 and 134 - 136 of IAS 1 'Presentation of Financial Statements' to produce a cash flow statement and to make an explicit and unreserved statement of compliance with IFRSs;
- FRS 101.8 (h): the requirements of IAS 7 'Statements of Cash Flows' to produce a cash flow statement and related notes;
- FRS 101.8 (i): the requirements of paragraphs 30 and 31 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' to include a list of new IFRSs that have been issued but that have yet to be applied; and
- FRS 101.8 (k): the requirements of IAS 24 'Related Party Disclosures' to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is party to a transaction is wholly owned by such a member.

Adoption of new and revised standards

Full details of the new and revised standards adopted by the Company are set out in note 1 to the consolidated financial statements.

1.2 Investment in subsidiaries

Investment in subsidiaries is stated at cost less any impairment.

1.3 Financial assets

Financial assets are classified at initial recognition and subsequently measured at amortised cost or fair value through other comprehensive income. The classification of financial assets at initial recognition depends on the financial asset's contractual cash flow characteristics and the Company's business model for managing them.

Amortised cost

Assets which are held to collect contractual cash flows, and with contractual terms which give rise to cash flows which are solely payments of principal and interest on the principal amount outstanding, are classified as financial assets held at amortised cost. The Company initially measures financial assets held at amortised cost at fair value plus transaction costs. They are subsequently measured using the effective interest method where applicable and are subject to impairment. Gains and losses are recognised in the income statement when the asset is derecognised, modified or impaired.

Fair value through other comprehensive income

Assets which are held both to collect contractual cash flows and to sell the financial asset, where the contractual terms of the asset give rise to cash flows which are solely payments of principal and interest on the principal amount outstanding, are measured at fair value through other comprehensive income, unless designated as fair value through profit or loss. The Company's financial assets at fair value through other comprehensive income relate to UK sovereign debt securities. Movements in the carrying amount are taken through other comprehensive income, except for gains or losses recognised in the income statement when the asset is derecognised, modified or impaired.

Impairment

At initial recognition of a financial asset, measured at amortised cost or fair value through other comprehensive income, an expected credit loss assessment is conducted with an impairment loss booked if material. The Company uses judgement in making these assumptions and selecting the inputs to the impairment calculation based on the credit quality and history of the financial asset or group of financial assets, as well as existing market conditions and forward-looking expectations.

At each balance sheet date, the Company assesses on a forward-looking basis whether there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as held at amortised cost or fair value through other comprehensive income is expected. The Company measures the expected loss as the difference between the carrying amount of the asset or group of assets, including the allowance for expected losses at initial recognition, 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.

The Company applies the simplified impairment approach to trade receivables due from subsidiary undertakings.

Impairment losses, including the expected credit allowance, 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 expected impairment allowance reduces, and this can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. A financial asset is written off when there is no reasonable expectation of recovery.

Notes to the Parent Company Financial Statements continued

Hedge accounting

The Company has utilised the transition for hedge accounting option in IFRS 9 to continue applying the hedge accounting requirements of IAS 39.

2. Investment in subsidiary undertakings

	2020	2019
	£m	£m
At 1 January	3,137.4	3,119.0
Additional investment in subsidiary undertakings	168.5	18.4
At 31 December	3,305.9	3,137.4

On 27 March 2020, the Company provided additional funding to its subsidiary, U K Insurance Limited. It purchased one Ordinary Share of £1 nominal value for a consideration of £150 million.

The subsidiary undertakings of the Company are set out in the table below. Their capital consists of Ordinary Shares which are unlisted. In all cases, the Company owns 100% of the Ordinary Shares, either directly or through its ownership of other subsidiaries, and exercises full control over their decision-making.

Name of subsidiary	Company registration number	Date of incorporation and operation	Principal activity
Directly held by the Company:			
Direct Line Group Limited ¹	02811437	United Kingdom	Intermediate holding company
DL Insurance Services Limited ¹	03001989	United Kingdom	Management services
Finure Premium Finance Limited ¹	01670887	United Kingdom	Non-trading company
Inter Group Insurance Services Limited ¹	02762848	United Kingdom	Dormant ⁸
UK Assistance Accident Repair Centres Limited ¹	02568507	United Kingdom	Motor vehicle repair services
UK Assistance Limited ¹	02857232	United Kingdom	Dormant ⁸
U K Insurance Business Solutions Limited ¹	05196274	United Kingdom	Insurance intermediary services
U K Insurance Limited ^{2,3}	01179980	United Kingdom	General insurance
Indirectly held by the Company:			
10-15 Livery Street, Birmingham UK Limited ⁴	JE109119	Jersey	Dormant ⁸
Broily UK Technology Limited ^{1,5}	10134039	United Kingdom	Insurance intermediary services
Churchill Insurance Company Limited ¹	02258947	United Kingdom	General insurance
Direct Line Insurance Limited ¹	01810801	United Kingdom	Dormant ⁸
DL Support Services India Private Limited ⁶	See footnote 6	India	Support and operational services
DLG Legal Services Limited ⁷	08302561	United Kingdom	Legal services
DLG Pension Trustee Limited ¹	08911044	United Kingdom	Dormant ⁸
Farmweb Limited ¹	03207393	United Kingdom	Dormant ⁸
Green Flag Group Limited ²	02622895	United Kingdom	Intermediate holding company
Green Flag Holdings Limited ¹	03577191	United Kingdom	Intermediate holding company
Green Flag Limited ²	01003081	United Kingdom	Breakdown recovery services
Inter Group Assistance Services Limited ¹	03315786	United Kingdom	Dormant ⁸
National Breakdown Recovery Club Limited ¹	02479300	United Kingdom	Dormant ⁸
Nationwide Breakdown Recovery Services Limited ¹	01316805	United Kingdom	Dormant ⁸
The National Insurance and Guarantee Corporation Limited ¹	00042133	United Kingdom	Dormant ⁸
UKI Life Assurance Services Limited ¹	03034263	United Kingdom	Dormant ⁸

Notes:

- Registered office at Churchill Court, Westmoreland Road, Bromley, BR1 1DR.
- Registered office at 22 Grenville Street, St Helier, Jersey.
- U K Insurance Limited has a branch in the Republic of South Africa and a branch in the Republic of Ireland.
- Registered office at 22 Grenville Street, St Helier, Jersey.
- On 15 September 2020, DL Insurance Services Limited acquired 100% of the issued share capital of Broily UK Technology Limited. For the period ended 31 December 2020, it is expected that Broily UK Technology Limited will be exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of section 479 A.
- DL Support Services India Private Limited, 153, 1st & 2nd floor, Okhla Industrial Area Phase-3, New Delhi, 110020, India. Company registration number: U74140DN2014FT265567.
- Registered office at 42 The Headrow, Leeds, LS1 8HZ.
- These entities have not been audited, in accordance with the exemptions available for dormant entities under section 480 of the Companies Act 2006.
- Under the Companies (Jersey) Law 1991, there is no requirement to file individual accounts and audit a private limited company.

3. Other receivables

	2020	2019
	£m	£m
Loans to subsidiary undertakings ¹	322.2	298.6
Trade receivables due from subsidiary undertakings	13.5	—
Other debtors	—	0.5
Total	335.7	299.1
Current	85.7	49.1
Non-current	250.0	250.0
Total	335.7	299.1

Note:

- Included in loans to subsidiary undertakings is a £250 million unsecured subordinated loan to U K Insurance Limited. A loan of £500 million was advanced on 27 April 2012 at a fixed rate of 9.5% with a repayment date of 27 April 2042. On 7 March 2019, £250 million was repaid. All loans are neither past due nor impaired.

4. Current and deferred tax

	2020	2019
	£m	£m
Per balance sheet:		
Current tax assets	5.5	3.5
Deferred tax liabilities	(0.7)	(0.6)

The deferred tax liability is in respect of provisions and other temporary differences.

5. Derivative financial instruments¹

	Notional amount	Fair value	Notional amount	Fair value
	2020	2020	2019	2019
	£m	£m	£m	£m
Derivative assets				
Designated as hedging instruments:				
Foreign exchange contracts ²	4.1	0.1	18.2	0.6
Total	4.1	0.1	18.2	0.6
Derivative liabilities				
Designated as hedging instruments:				
Foreign exchange contracts ²	4.1	0.1	18.2	0.6
Total	4.1	0.1	18.2	0.6

Notes:

- The derivative assets and liabilities are both classified as level 2 within the Group's fair value hierarchy set out in note 42 of the consolidated financial statements.
- The foreign exchange cash flow hedges have been entered into on behalf of the Group's subsidiary companies.

6. Financial investments

	2020	2019
	£m	£m
Fair value through other comprehensive income debt securities¹	—	85.0

Note:

- At 31 December 2019, the fair value through other comprehensive income debt securities are corporate debt securities of £79.9 million classified as level 2 and fixed interest UK sovereign debt of £5.1 million classified as level 1 within the Group's fair value hierarchy which is set out in note 42 of the consolidated financial statements.

7. Cash and cash equivalents

	2020	2019
	£m	£m
Cash at bank and in hand	–	(0.2)
Short-term deposits with credit institutions ¹	266.1	124.4
Total	266.1	124.2

Note:

1. This represents money market funds.

8. Share capital, capital reserves and distributable reserves

Full details of the share capital and capital reserves of the Company are set out in notes 30 and 31 to the consolidated financial statements.

Of the Company's total equity, £1,329.5 million (2019: £1,329.0 million), being the total of its retained earnings, is considered to be distributable reserves.

9. Tier 1 notes

Full details of the Tier 1 notes of the Company are set out in note 32 to the consolidated financial statements.

10. Subordinated liabilities

	2020	2019
	£m	£m
Subordinated Tier 2 notes	511.9	253.4

£250 million 9.25% subordinated Tier 2 notes due 2042

The subordinated guaranteed dated notes with a nominal value of £500 million were issued on 27 April 2012 at a fixed rate of 9.25% and have a redemption date of 27 April 2042. On 8 December 2017, the Company repurchased £250 million nominal value of subordinated guaranteed dated notes for a purchase price of £330.1 million including accrued interest of £2.7 million and associated transaction costs of £0.6 million.

The remaining notes, with a nominal value of £250 million, have a redemption date of 27 April 2042 with the option to repay the notes on 27 April 2022. If the notes are not repaid on that date, the terms of the notes provide that the rate of interest will be reset at a rate of 6-month LIBOR plus 7.91%. If LIBOR has been discontinued by this time, the terms of the notes provide for an ultimate fall-back rate of interest of 9.25% for subsequent interest periods. The terms of the notes do not automatically provide for the transition of LIBOR to SONIA, which would require a separate agreement between the Group and the noteholders.

The notes are guaranteed by U K Insurance Limited, a principal subsidiary of the Company.

£260 million 4.0% subordinated Tier 2 notes due 2032

On 5 June 2020, the Company issued subordinated Tier 2 notes at a fixed rate of 4.0%. The notes have a redemption date of 5 June 2032 and may be redeemed at the option of the Company commencing on 5 December 2031 until the maturity date.

The Company has the option, in certain circumstances, to defer interest payments on the notes but to date has not exercised this right.

The 2032 and 2042 notes are unsecured, and subordinated obligations of the Company and rank *pari passu* and 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 senior creditors have been met and will rank at least *pari passu* with the claims of holders of other Tier 2 capital.

The aggregate fair value of subordinated guaranteed dated notes at 31 December 2020 was £589.0 million (2019: £297.8 million).

11. Borrowings

	2020	2019
	£m	£m
Loans from fellow subsidiaries within the Group¹	116.4	116.3

Note:

1. Included in the above is a loan of £71.4 million (2019: £84.4 million) from UK Assistance Accident Repair Centres Limited. All loans from fellow Group subsidiaries are repayable by 31 December 2024 and are subject to interest on outstanding balances based on the average 3-month LIBOR rate.

12. Trade and other payables

	2020	2019
	£m	£m
Total payables to third parties	1.1	1.0

13. Dividends

Full details of the dividends paid and proposed by the Company are set out in note 14 to the consolidated financial statements.

14. Share-based payments

Full details of share-based compensation plans are provided in note 36 to the consolidated financial statements.

15. Contingent liabilities

The Company will guarantee the debts and liabilities of its UK subsidiary, Brolly UK Technology Limited, at the balance sheet date in accordance with section 479C of the Companies Act 2006. The Company has assessed the probability of loss under this guarantee as remote.

16. Risk management

The risks faced by the Company, arising from its investment in subsidiaries, are considered to be the same as those in the operations of the Group. Details of the key risks and the steps taken to manage them are disclosed in note 3 to the consolidated financial statements. The Company also holds, on behalf of its subsidiaries, designated hedging instruments which relate to foreign currency supplier payments.

17. Directors and key management remuneration

The Directors and key management of the Group and the Company are the same. The aggregate emoluments of the Directors are set out in note 10 to the consolidated financial statements, the compensation for key management is set out in note 43 to the consolidated financial statements and the remuneration and pension benefits payable in respect of the highest paid Director are included in the Directors' Remuneration Report in the Governance section of the Annual Report & Accounts.

Additional Information

Financial calendar¹

2021	
Date	Event
08 March	Preliminary Results 2020 announcement
08 April	"Ex-dividend" date for 2020 final dividend
09 April	Record date for 2020 final dividend
05 May	Final date for election under the Dividend Reinvestment Plan
05 May	Trading update for the first quarter of 2021
13 May	Annual General Meeting
20 May	Payment date for 2020 final dividend
03 August	Half-year Report 2021
12 August	"Ex-dividend" date for 2021 interim dividend
13 August	Record date for 2021 interim dividend
19 August	Final date for election under the Dividend Reinvestment Plan
03 September	Payment date for 2021 interim dividend
09 November	Trading update for the third quarter of 2021

Annual General Meeting

The 2021 AGM will be held at, and broadcast live from, the registered office of the Company at Churchill Court, Westmoreland Road, Bromley, BR1 1DP on 13 May 2021, starting at 11.00 am. All shareholders will receive a separate notice convening the AGM. This will explain the resolutions to be put to the meeting.

The Articles of Association of the Company and the letters of appointment of the Executive Directors, the Chair and the Non-Executive Directors are available for inspection at the Company's registered office and at the offices of Allen & Overy LLP.

Market

The Company has a premium listing on the UK Listing Authority's Official List. The Company's Ordinary Shares (EPIC: DLG) are admitted to trading on the London Stock Exchange.

Note:

1. These dates are subject to change.

Share ownership

Share capital

You can find details of the Company's share capital in note 30 to the consolidated financial statements.

Dividends

The Company pays its dividends in sterling to shareholders registered on its register of members at the relevant record date.

Shareholders can arrange to receive their cash dividend payments in a bank or building society account by completing a dividend mandate form. This is available from the Company's registrar, Computershare Investor Services Plc ("**Registrar**"), in the UK. You can find the Registrar's contact details on page 232. Alternatively, shareholders can access their shareholdings online and download a dividend mandate form from the Investor Centre. You can find details of this below.

Dividend Reinvestment Plan

The Company offers a Dividend Reinvestment Plan. This enables shareholders to use their cash dividends to buy the Company's Ordinary Shares in the market. You can find more details on the Company's website.

Shareholder enquiries

Shareholders with queries about anything relating to their shares can contact our Registrar.

Shareholders should notify the Registrar of any change in shareholding details, such as their address, as soon as possible.

Shareholders can access their current shareholding details online at www.investorcentre.co.uk/directline. Investor Centre is a free-to-use, secure, self-service website that enables shareholders to manage their holdings online. The website allows shareholders to:

- check their holdings;
- update their records, including address and direct credit details;
- access all their securities in one portfolio by setting up a personal account;
- vote online; and
- register to receive electronic shareholder communications.

To access information, the website requires shareholders to quote their shareholder reference number. Shareholders can find this number on their share certificates.

Corporate website

The Group's corporate website is www.directlinegroup.co.uk. It contains useful information for the Company's investors and shareholders. For example, it includes press releases, details of forthcoming events, essential shareholder information, a dividend history, a financial calendar, and details of the Company's AGM. You can also subscribe to email news alerts.

Shareholder warning

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that prove to be worthless or non-existent, or they can offer to buy shares at an inflated price in return for you paying upfront. They promise high profits. However, if you buy or sell shares in this way, you will probably lose your money.

How to avoid share fraud

- Remember that FCA-authorized firms are unlikely to contact you unexpectedly offering to buy or sell shares.
- Do not converse with them. Note the name of the person and firm contacting you, then end the call.
- To see if the person and firm contacting you are authorized by the FCA, check the Financial Services Register at www.fca.org.uk/register.
- Beware of fraudsters claiming to be from an authorized firm; copying its website; or giving you false contact details.
- If you want to phone the caller back, use the firm's contact details listed on the Financial Services Register at www.fca.org.uk/register.
- If the firm does not have contact details on the Register or they tell you the details are out of date, call the FCA on 0800 111 6768.
- Search the list of unauthorized firms to avoid at www.fca.org.uk/consumers/unauthorised-firms-individuals.
- Remember that if you buy or sell shares from an unauthorized firm, you cannot access the Financial Ombudsman Service or Financial Services Compensation Scheme.
- Get independent financial and professional advice before handing over any money.
- If it sounds too good to be true, it probably is.

Report a scam

If fraudsters approach you, tell the FCA using the share fraud reporting form at www.fca.org.uk/consumers/report-scam-unauthorised-firm. You can also find out more about investment scams on the same web page.

You can call the FCA Consumer Helpline on 0800 111 6768.

If you have already paid money to share fraudsters, call Action Fraud on 0300 123 2040.

Tips on protecting your shares

- Keep all your certificates in a safe place. Alternatively, consider holding your shares in the UK's electronic registration and settlement system for equity, called CREST, or via a nominee.
- Keep correspondence from the Registrar that shows your shareholder reference number in a safe place, and shred unwanted correspondence.
- Inform the Registrar as soon as you change your address.
- If you receive a letter from the Registrar regarding a change of address and you have not recently moved, contact them immediately.
- Find out when your dividends are paid and contact the Registrar if you do not receive them.
- Consider having your dividends paid direct into your bank account. You will need to complete a dividend mandate form and send it to the Registrar. This reduces the risk of cheques being stolen or lost in the post.
- If you change your bank account, inform the Registrar of your new account details immediately.
- If you are buying or selling shares, only deal with brokers registered in the UK or in your country of residence; and
- Be aware that the Company will never call you concerning investments. If you receive such a call from a person saying they represent the Group, please contact the Company Secretary immediately, by calling +44 (0)1 132 920 667.

Electronic communications and voting

The Group produces various communications. Shareholders can view these online, download them, or receive paper copies by contacting the Registrar.

Shareholders, who register their email address with our Registrar, or at the Investor Centre, can receive emails with news on events, such as the AGM. They can also receive shareholder communications electronically, such as the Annual Report & Accounts and Notice of Meeting.

Dealing facilities

Shareholders who wish to buy, sell or transfer their shares may do so through a stockbroker or a high street bank; or through the Registrar's share-dealing facility.

You can call or email the Registrar regarding its share-dealing facility using this contact information:

- For telephone sales, call +44 (0)370 703 0084 between 8.00 am and 6.00 pm, Monday to Friday, excluding public holidays, and
- For internet sales, go to www.investorcentre.co.uk/directline. You will need your shareholder reference number, as shown on your share certificate, or your welcome letter from the Chair.

Dividend tax allowance

The dividend tax-free allowance is £2,000 across an individual's entire share portfolio. Above this amount, individuals will pay tax on their dividend income. The rate of this tax depends on their income tax bracket and personal circumstances. The Company will continue providing registered shareholders with a confirmation of the dividends paid. Shareholders should include this with any other dividend income they receive when calculating and reporting total dividend income received to HMRC. The shareholder is responsible for including all dividend income when calculating tax requirements. If you have any tax queries, please contact your financial adviser.

Glossary and Appendices

Term	Definition and explanation
Actuarial best estimate ("ABE")	The probability-weighted average of all future claims and cost scenarios. It is calculated using historical data, actuarial methods and judgement. A best estimate of reserves will therefore normally include no margin for optimism or, conversely, caution.
Annual Incentive Plan ("AIP")	This incentivises the performance of Executive Directors and employees over a one-year operating cycle. It focuses on the short to medium-term elements of the Group's strategic aims.
Assets under management ("AUM")	This represents all assets managed or administered by or on behalf of the Group, including those assets managed by third parties.
Association of British Insurers ("ABI")	The trade body that represents the insurance and long-term savings industry in the UK.
Available-for-sale ("AFS") investments	Available-for-sale investments are non-derivative financial assets that are designated as such, or are not classified as loans and receivables, held-to-maturity, or financial assets at fair value through profit or loss.
Average written premium	The total written premium at inception divided by the number of policies.
Bootstrapping	A statistical sampling technique used to estimate reserve variability around the Actuarial Best Estimate ("ABE"). Results produced from bootstrapping historical data are used to set and inform the level of margin incorporated in the Management Best Estimate ("MBE").
Buy-As-You-Earn Plan	The HM Revenue & Customs approved Buy-As-You-Earn Share Incentive Plan gives all employees the opportunity to become shareholders in the Company.
Capital	The funds invested in the Group, including funds invested by shareholders and Tier 1 notes. In addition, the subordinated liability in the Group's balance sheet is classified as Tier 2 capital for Solvency II purposes.
Carbon emissions	<p>Scope 1 – covers direct emissions from owned or controlled sources, including fuels used in office buildings, accident repair centres and owned vehicles.</p> <p>Scope 2 – covers indirect emissions from the generation of purchased electricity, steam, heating and cooling for office buildings and accident repair centres.</p> <p>Scope 3 under our direct control – includes indirect emissions that occur in the Group's value chain, under its direct control, such as waste disposal and business travel.</p> <p>Total Scope 3 – includes all other indirect emissions that occur in the Group's value chain and purchased goods and services, excluding investments.</p>
Claims frequency	The number of claims divided by the number of policies per year.
Claims handling provision (provision for losses and loss-adjustment expense)	Funds set aside by the Group to meet the estimated cost of settling claims and related expenses that the Group considers it will ultimately need to pay.
Clawback	The Group's ability to claim repayment of paid amounts both cash and equity settled share-based payments.
Combined operating ratio	The sum of the loss, commission and expense ratios. The ratio measures the amount of claims costs, commission and operating expenses, compared to net earned premium generated. A ratio of less than 100% indicates profitable underwriting. Normalised combined operating ratio adjusts loss and commission ratios for weather and changes to the Ogden discount rate. (See page 227 alternative performance measures.)
Commission expenses	Payments to brokers, partners and price comparison websites for generating business.
Commission ratio	The ratio of commission expense divided by net earned premium. (See page 227 alternative performance measures.)
Company	Direct Line Insurance Group plc.
Current-year attritional loss ratio	The loss ratio for the current accident year, excluding the movement of claims reserves relating to previous accident years and claims relating to major weather events. (See page 227 alternative performance measures.)
Current-year combined operating ratio	This is calculated using the combined operating ratio less movement in prior-year reserves. (See page 227 alternative performance measures.)
Current-year normalised operating profit	This is calculated using the normalised operating profit adjusted for prior-year reserve movements. (See page 227 alternative performance measures.)
Deferred Annual Incentive Plan ("DAIP")	For Executive Directors and certain members of senior management, at least 40% of the AIP award is deferred into shares typically vesting three years after grant. The remainder of the award is paid in cash following year end.
Direct own brands	Direct own brands include Home and Motor under the Direct Line, Churchill, Darwin and Privilege brands, Rescue under the Green Flag brand and Commercial under the Direct Line for Business and Churchill brands.

Term	Definition and explanation
Earnings per share	The amount of the Group's profit after deduction of the Tier 1 coupon payments allocated to each Ordinary Share of the Company.
Employee Representative Body ("ERB")	The forum that represents all employees, including when there is a legal requirement to consult employees.
Expense ratio	The ratio of operating expenses divided by net earned premium. (See page 227 alternative performance measures.)
Finance costs	The cost of servicing the Group's external borrowings and including the interest on right-of-use assets.
Financial Conduct Authority ("FCA")	The independent body responsible for regulating the UK's financial services industry.
Financial leverage ratio	Tier 1 notes and financial debt (subordinated Tier 2 notes) as a percentage of total capital employed.
Financial Reporting Council	The UK's regulator for the accounting, audit and actuarial professions, promoting transparency and integrity in business.
Gross written premium	The total premiums from contracts that were incepted during the period.
Group	Direct Line Insurance Group plc and its subsidiaries.
Incremental borrowing rate ("IBR")	The rate of interest that a lessee would have to pay to borrow, over a similar term and security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.
Incurred but not reported ("IBNR")	Funds set aside to meet the cost of claims for accidents that have occurred but have not yet been reported to the Group. This includes an element of uplift on the value of claims reported.
In-force policies	The number of policies on a given date that are active and against which the Group will pay, following a valid insurance claim.
Insurance liabilities	This comprises insurance claims reserves and claims handling provision, which the Group maintains to meet current and future claims.
International Accounting Standards Board ("IASB")	A not-for-profit public interest organisation that is overseen by a monitoring board of public authorities. It develops International Financial Reporting Standards ("IFRSs") that aim to make worldwide markets transparent, accountable and efficient.
Investment income yield	The income earned from the investment portfolio, recognised through the income statement during the period (excluding unrealised and realised gains and losses, impairments and fair value adjustments) divided by the average assets under management ("AUM"). The average AUM derives from the period's opening and closing balances for the total Group. (See page 227 alternative performance measures.)
Investment return	The investment return earned from the investment portfolio, including unrealised and realised gains and losses, impairments and fair value adjustments.
Investment return yield	The investment return divided by the average AUM. The average AUM derives from the period's opening and closing balances. (See page 227 alternative performance measures.)
Long-Term Incentive Plan ("LTIP")	Awards made as nil-cost options or conditional share awards, which vest to the extent that performance conditions are satisfied after a period of at least three years.
Loss ratio	Net insurance claims divided by net earned premium. (See page 227 alternative performance measures.)
Malus	An arrangement that permits unvested remuneration awards to be forfeited, when the Company considers it appropriate.
Management's best estimate ("MBE")	These reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal ABE.
Net asset value	The difference between the Group's total assets and total liabilities, calculated by subtracting total liabilities (including Tier 1 notes) from total assets.
Net earned premium	The element of gross earned premium less reinsurance premium ceded for the period where insurance cover has already been provided.
Net insurance claims	The cost of claims incurred in the period less any claims costs recovered under reinsurance contracts. It includes claims payments and movements in claims reserves.
Net investment income yield	This is calculated in the same way as investment income yield but includes the cost of hedging. (See page 227 alternative performance measures.)
Net promoter score ("NPS")	This is an index that measures the willingness of customers to recommend products or services to others. It is used to gauge customers' overall experience with a product or service, and customers' loyalty to a brand.

Glossary and Appendices *continued*

Term	Definition and explanation
Ogden discount rate	The discount rate set by the Lord Chancellor and used by courts to calculate lump sum awards in bodily injury cases.
Operating expenses	These are the expenses relating to business activities excluding restructuring and one-off costs. (See page 227 alternative performance measures.)
Operating profit	The pre-tax profit that the Group's activities generate, including insurance and investment activity, but excluding finance costs, restructuring and one-off costs. Normalised operating profit is operating profit adjusted for weather and changes to the Ogden discount rate. (See page 229 alternative performance measures.)
Own Risk and Solvency Assessment ("ORSA")	A forward-looking assessment of the Group's risks and associated capital requirements, over the business planning period.
Periodic payment order ("PPO")	These are claims payments as awarded under the Courts Act 2003. PPOs are used to settle certain large personal injury claims. They generally provide a lump-sum award plus inflation-linked annual payments to claimants who require long-term care.
Prudential Regulation Authority ("PRA")	The PRA is a part of the Bank of England. It is responsible for regulating and supervising insurers and financial institutions in the UK.
Reinsurance	Contractual arrangements where the Group transfers part or all of the accepted insurance risk to another insurer.
Reserves	Funds that have been set aside to meet outstanding insurance claims and IBNR.
Restructuring costs	These are costs incurred in respect of the business activities where the Group has a constructive obligation to restructure its activities.
Return on equity	This is calculated by dividing the profit attributable to the owners of the Company after deduction of the Tier 1 coupon payments by average shareholders' equity for the period.
Return on tangible equity ("RoTE")	This is adjusted profit after tax divided by the Group's average shareholders' equity less goodwill and other intangible assets. Profit after tax is adjusted to exclude restructuring and one-off costs and to include the Tier 1 coupon payments. It is stated after charging tax using the UK standard rate of 19%. (See page 228 alternative performance measures.)
Right-of-use ("ROU") asset	A lessee's right to use an asset over the life of a lease, calculated as the initial amount of the lease liability, plus any lease payments made to the lessor before the lease commencement date, plus any initial direct costs incurred, minus any lease incentives received.
Science-Based Targets ("SBT")	Science-Based Targets are a set of goals developed by a business to provide it with a clear route to reduce greenhouse gas emissions. An emissions reduction target is defined as "science-based" if it is developed in line with the scale of reductions required to keep global warming below 2°C from pre-industrial levels.
Scope 1, Scope 2, Scope 3 under our direct control and total Scope 3	Please refer to the glossary definition for carbon emissions on page 224.
Solvency II	The capital adequacy regime for the European insurance industry, which became effective on 1 January 2016. It establishes capital requirements and risk management standards. It comprises three pillars: Pillar I, which sets out capital requirements for an insurer; Pillar II, which focuses on systems of governance; and Pillar III, which deals with disclosure requirements.
Solvency capital ratio	The ratio of Solvency II own funds to the solvency capital requirement.
Tangible equity	This shows the equity excluding Tier 1 notes and intangible assets (for comparability with companies which have not acquired businesses or capitalised intangible assets). (See page 228 alternative performance measures.)
Tangible net assets per share	This shows the amount of tangible equity allocated to each ordinary share (for comparability with companies which have not acquired businesses or capitalised intangible assets). (See page 228 alternative performance measures.)
Total Shareholder Return ("TSR")	Compares share price movement with reinvested dividends as a percentage of the share price.
UK Endorsement Board	The UK Endorsement Board endorses and adopts new or amended International Financial Reporting Standards issued by the International Accounting Standards Board.
Underwriting result profit / (loss)	The profit or loss from operational activities, excluding investment return and other operating income. It is calculated as net earned premium less net insurance claims and total expenses, excluding restructuring and one-off costs.

Appendix A – Alternative performance measures

The Group has identified Alternative Performance Measures (“APMs”) in accordance with the European Securities and Markets Authority’s published Guidelines. The Group uses APMs to improve comparability of information between reporting periods and reporting segments, by adjusting for either uncontrollable or one-off costs which impact the IFRS measures, to aid the user of the annual report and accounts in understanding the activity taking place across the Group. These APMs are contained within the main narrative sections of this document, outside the financial statements and notes, and may not necessarily have standardised meanings for ease of comparability across peer organisations.

Further information is presented below, defined in the glossary on pages 224 to 226 and reconciled to the most directly reconcilable line items in the financial statements and notes. Note 4 on page 185 of the consolidated financial statements presents a reconciliation of the Group’s business activities on a segmental basis to the consolidated income statement. All note references in the table below are to the notes to the consolidated financial statements on pages 162 to 214.

Group APM	Closest equivalent IFRS measure	Definition and / or reconciliation	Rationale for APM
Combined operating ratio	Profit before tax	Combined operating ratio is defined in the glossary on page 224 and reconciled in note 4 on page 185.	This is a measure of underwriting profitability and excludes non-insurance income, whereby a ratio of less than 100% represents an underwriting profit and a ratio of more than 100% represents an underwriting loss.
Commission ratio	Commission expense	Commission ratio is defined in the glossary on page 224 and is reconciled in note 4 on page 185.	Expresses commission expense, in relation to net earned premium.
Current-year attritional loss ratio	Net insurance claims	Current-year attritional loss ratio is defined in the glossary on page 224 and is reconciled to the loss ratio (discussed below) on page 24.	Expresses claims performance in the current accident year in relation to net earned premium.
Current-year combined operating ratio	Profit before tax	Current-year combined operating ratio is defined in the glossary on page 224 and is reconciled on page 24.	This is a measure of underwriting profitability, excluding the effect of prior-year reserve movements.
Current-year normalised operating profit ratio	Profit before tax	Current-year normalised operating profit ratio is defined in the glossary on page 224 and reconciled on page 229.	Expresses a relationship between current-year normalised operating profit and normalised operating profit.
Expense ratio	Total expenses	Expense ratio is defined in the glossary on page 225 and is reconciled in note 4 on page 185.	Expresses underwriting and policy expenses in relation to net earned premium.
Investment income yield	Investment income	Investment income yield is defined in the glossary on page 225 and is reconciled on page 228.	Expresses a relationship between the investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Investment return yield	Investment return	Investment return yield is defined in the glossary on page 225 and is reconciled on page 228.	Expresses a relationship between the investment return and the associated opening and closing assets adjusted for portfolio hedging instruments.
Loss ratio	Net insurance claims	Loss ratio is defined in the glossary on page 225 and is reconciled in note 4 on page 185.	Expresses claims performance in relation to net earned premium.
Net investment income yield	Investment income	Net investment income yield is defined in the glossary on page 225 and is reconciled on page 228.	Expresses a relationship between the net investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Normalised combined operating ratio	Profit before tax	Combined operating ratio and normalised combined operating ratio are defined in the glossary on page 224 and reconciled on page 229.	This is a measure of underwriting profitability excluding the effects of weather, Ogden discount rate changes and restructuring and one-off costs. It also excludes non-insurance income. A ratio of less than 100% represents an underwriting profit and a ratio of more than 100% represents an underwriting loss.
Operating expenses	Total expenses	Operating expenses are defined in the glossary on page 226 and reconciled in note 4 on page 185.	This shows the expenses relating to business activities excluding restructuring and one-off costs.

Appendix A – Alternative performance measures continued

Group APM	Closest equivalent IFRS measure	Definition and / or reconciliation	Rationale for APM
Operating profit	Profit before tax	Operating profit is defined in the glossary on page 226 and reconciled in note 4 on page 185.	This shows the underlying performance (before tax and excluding finance costs and restructuring and one-off costs) of the business activities.
Return on tangible equity	Return on equity	Return on tangible equity is defined in the glossary on page 226 and is reconciled on page 230.	This shows performance against a measure of equity that is more easily comparable to that of other companies.
Tangible equity	Equity	Tangible equity is defined in the glossary on page 226 and is reconciled in note 16 on page 193.	This shows the equity excluding Tier 1 notes and intangible assets for comparability with companies which have not acquired businesses or capitalised intangible assets.
Tangible net asset value per share	Net asset value per share	Tangible net asset value per share is defined in the glossary on page 226 and reconciled in note 16 on page 193.	This shows the equity excluding Tier 1 notes and intangible assets per share for comparability with companies which have not acquired businesses or capitalised intangible assets.
Underwriting profit	Profit before tax	Underwriting profit is defined in the glossary on page 226 and is reconciled in note 4 on page 185.	This shows underwriting performance calculated as net earned premium less net claims and operating expenses, excluding restructuring and one-off costs.

Investment income and return yields¹

	Notes ²	2020 £m	2019 £m
Investment income	6	127.1	146.4
Hedging to a sterling floating rate basis ³	6	(20.3)	(22.1)
Net investment income		106.8	124.3
Net realised and unrealised (losses) / gains excluding hedging		(11.7)	10.3
Investment return	6	95.1	134.6
Opening investment property		291.7	322.1
Opening financial investments		4,673.4	4,737.8
Opening cash and cash equivalents		948.6	1,154.4
Opening borrowings		(52.3)	(62.0)
Opening derivatives asset ⁴		81.8	11.8
Opening investment holdings		5,943.2	6,164.1
Closing investment property	20	292.1	291.7
Closing financial investments	28	4,681.4	4,673.4
Closing cash and cash equivalents	29	1,220.1	948.6
Closing borrowings	29	(51.9)	(52.3)
Closing derivatives asset ⁴		8.0	81.8
Closing investment holdings		6,149.7	5,943.2
Average investment holdings ⁵		6,046.5	6,053.7
Investment income yield¹		2.1%	2.4%
Net investment income yield¹		1.8%	2.1%
Investment return yield¹		1.6%	2.2%

Notes:

1. See glossary on page 225 for definitions.
2. See notes to the consolidated financial statements.
3. Includes net realised and unrealised gains / (losses) on derivatives in relation to AUM.
4. See footnote 1 on page 34 (Investment holdings).
5. Mean average of opening and closing balances.

Normalised combined operating ratio¹

	Home 2020	Home 2019	Commercial 2020	Commercial 2019	Total 2020	Total 2019
Loss ratio	55.6%	46.8%	51.4%	52.7%	57.9%	61.9%
Commission ratio	8.1%	9.7%	18.7%	18.5%	8.6%	7.1%
Expense ratio	23.4%	23.8%	25.4%	24.5%	24.5%	23.2%
Combined operating ratio	87.1%	80.3%	95.5%	95.7%	91.0%	92.2%
Effect of weather						
Loss ratio	3.4%	7.2%	0.4%	3.7%	0.7%	2.0%
Commission ratio	(0.2%)	(0.6%)	–	–	–	(0.1%)
Combined operating ratio normalised for weather	90.3%	86.9%	95.9%	99.4%	91.7%	94.1%
Effect of Ogden discount rate						
Loss ratio	–	–	–	(0.2%)	–	(0.6%)
Combined operating ratio normalised for weather and Ogden discount rate	90.3%	86.9%	95.9%	99.2%	91.7%	93.5%

Note:

1. See glossary on page 224 for definition.

Normalised operating profit¹

	Total 2020 £m	Total 2019 £m
Operating profit	522.1	546.9
Effect of:		
Ogden discount rate	–	16.9
Normalised weather – claims	(20.8)	(59.0)
Normalised weather – profit share	1.3	3.7
Normalised operating profit	502.6	508.5
Prior-year adjustments		
Prior-year reserve movement	173.8	294.5
Ogden discount rate	–	16.9
Prior-year normalised operating profit	173.8	311.4
Current-year normalised operating profit	328.8	197.1
Current-year normalised operating profit ratio	65%	39%

Note:

1. See glossary on page 226 for definition.

Operating expenses¹

	Note ²	2020 £m	2019 £m
Operating expenses (including restructuring and one-off costs)	10	763.8	704.9
Less restructuring and one-off costs	10	(39.4)	(11.2)
Operating expenses	10	724.4	693.7

Notes:

1. See glossary on page 226 for definition.
2. See notes to the consolidated financial statements.

Return on tangible equity¹

	2020	2019
	£m	£m
Profit before tax	451.4	509.7
Add back: restructuring and one-off costs	39.4	11.2
Coupon payments in respect of Tier 1 notes	(16.6)	(16.6)
Adjusted profit before tax	474.2	504.3
Tax charge (2019 and 2020 UK standard tax rate of 19%)	(90.1)	(95.8)
Adjusted profit after tax	384.1	408.5
Opening shareholders' equity	2,643.6	2,558.2
Opening goodwill and other intangible assets	(702.5)	(566.8)
Opening shareholders' tangible equity	1,941.1	1,991.4
Closing shareholders' equity	2,699.7	2,643.6
Closing goodwill and other intangible assets	(786.8)	(702.5)
Closing shareholders' tangible equity	1,912.9	1,941.1
Average shareholders' tangible equity ²	1,927.0	1,966.3
Return on tangible equity	19.9 %	20.8 %

Notes:

1. See glossary on page 226 for definition.
2. Mean average of opening and closing balances.

Forward-looking Statements Disclaimer

This Annual Report & Accounts has been prepared for, and only for, the members of the Company as a body, and no other persons. The Company, its Directors, employees, agents or advisers do not accept responsibility to any other person to whom this document is shown, or into whose hands it may come, and any such responsibility or liability is expressly disclaimed.

Certain information contained in this document, including any information as to the Group's strategy, plans or future financial or operating performance, constitutes "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "aims", "ambition", "anticipates", "aspire", "believes", "continue", "could", "estimates", "expects", "guidance", "intends", "may", "mission", "outlook", "over the medium term", "plans", "predicts", "projects", "propositions", "seeks", "should", "strategy", "targets" or "will" 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 several places throughout this document and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, among other things: the Group'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 and guidance which are contained in this document specifically with respect to the return on tangible equity, solvency capital ratio, the Group's combined operating ratio, percentage targets for current-year contribution to operating profit, prior-year reserve releases, cost reductions, reductions in expense and commission ratios, investment income yield, net realised and unrealised gains, capital expenditure and risk appetite range. By their nature, all forward-looking statements involve risk and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future and/or are beyond the Group's control. Forward-looking statements are not guaranteeing future performance.

The Group'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 document, for example directly or indirectly as a result of, but not limited to:

- United Kingdom ("UK") domestic and global economic business conditions;
- the direct and indirect impacts and implications of the Covid-19 pandemic on the economy, nationally and internationally, on the Group, its operations and prospects, and on the Group's customers and their behaviours and expectations;

- the trade and co-operation agreement between the UK and the European Union ("EU") regarding the terms, following the end of the Brexit transition period, of the trading relationships between the UK and the EU and its implementation, and any subsequent trading and other relationship arrangements between the UK and the EU and their implementation;
- the terms of trading and other relationships between the UK and other countries following Brexit;
- market-related risks such as fluctuations in interest rates and exchange rates;
- the policies and actions of regulatory authorities and bodies (including changes related to capital and solvency requirements or to the Ogden discount rate or rates in response to the Covid-19 pandemic and its impact on the economy and customers) and changes to law and/or understandings of law and/or legal interpretation following the decisions and judgements of courts;
- regulations and requirements arising out of the FCA pricing practices review and changes in customer and market behaviours and practices arising out of that review and such regulations and requirements;
- the impact of competition, currency changes, inflation and deflation;
- the timing, impact and other uncertainties of future acquisitions, disposals, partnership arrangements, joint ventures or combinations within relevant industries; and
- the impact of tax and other legislation and other regulation and of regulator expectations, interventions and requirements and of court, arbitration, regulatory or ombudsman decisions and judgements (including in any of the foregoing in connection with the Covid-19 pandemic) in the jurisdictions in which the Group and its affiliates operate.

In addition, even if the Group'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.

The forward-looking statements contained in this document reflect knowledge and information available as of the date of preparation of this document. The Group and the Directors expressly disclaim any obligations or undertaking to update or revise publicly any forward-looking statements, whether because of new information, future events or otherwise, unless required to do so by applicable law or regulation. Nothing in this document constitutes or should be construed as a profit forecast.

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Contact information

Registered office

Direct Line Insurance Group plc
Churchill Court
Westmoreland Road
Bromley
BR1 1DP

Registered in England and Wales No. 02280426

Company Secretary: Roger C Clifton

Telephone: +44 (0)1132 920 667

Website: www.directlinegroup.co.uk

Registrars

Computershare Investor Services Plc
The Pavilions
Bridgwater Road
Bristol
BS99 6ZZ

Shareholder helpline: +44 (0)370 873 5880

Shareholder fax: +44 (0)370 703 6101

Website: www.computershare.com

Investor Centre

To find out more about Investor Centre, go to
www.investorcentre.co.uk/directline

Auditor

Deloitte LLP
2 New Street Square
London
EC4A 3BZ

Telephone: +44 (0)20 7936 3000

Website: www.deloitte.com

Legal advisers

Allen & Overy LLP
One Bishops Square
London
E1 6AD

Telephone: +44 (0)20 3088 0000

Website: www.allenoverly.com

Slaughter and May
One Bunhill Row
London
EC1Y 8YY

Telephone: +44 (0) 20 7600 1200

Website: www.slaughterandmay.com

Principal banker

Natwest Group plc
250 Bishopsgate
London
EC2M 4AA

Telephone: +44 (0)20 7833 2121

Website: www.natwestgroup.com

Corporate brokers

Goldman Sachs International
Plumtree Court
25 Shoe Lane
London
EC4A 4AU

Telephone: +44 (0)20 7774 1000

Website: www.goldmansachs.com

Morgan Stanley & Co. International plc
25 Cabot Square
Canary Wharf
London
E14 4QA

Telephone: +44 (0)20 7425 8000

Website: www.morganstanley.com

RBC Europe Ltd (trading as "RBC Capital Markets")
100 Bishopsgate
London
EC2N 4AA

Telephone: +44 (0)20 7653 4000

Website: www.rbccm.com

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Registered Office: Churchill Court, Westmoreland Road, Bromley, BR1 1DP

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