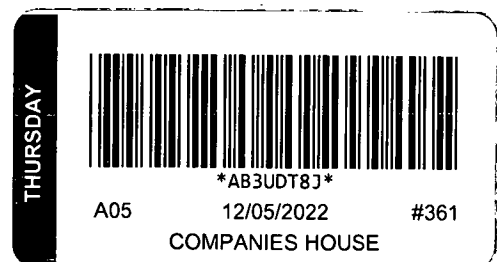




DIRECT LINE INSURANCE GROUP PLC
Company number: **02280426**

Annual Report
and Accounts 2021

*Innovating for
The future*



Financial highlights

Profit before tax

£446.0m

(2020: £451.4m)

Combined operating ratio^{1,2}

90.1%

(2020: 91.0%)

Operating profit¹

£581.8m

(2020: £522.1m)

Return on tangible equity¹

23.6%

(2020: 19.9%)

Solvency capital ratio^{1,3}

176%

(2020: 191%)

Dividends and capital returns⁴

£401.3m

(2020: £595.2m)⁵

MSCI's ESG rating for the Group increased from 'A' to 'AA'

13th on the Inclusive Top 50 UK Employers List

Notes:

1. See glossary on pages 248 to 250 for definitions and Appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.
2. 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 248 for definitions.
3. Estimates based on the Group's Solvency II partial internal model.
4. See pages 38 to 39 for the dividend policy.
5. Includes £195.5m special dividend in 2020 to replace the cancelled 2019 final dividend.

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For more information please visit
www.directlinegroup.co.uk

Innovating for The future

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.

In 2021 we continued transforming our business by using technology, data and digital tools to deliver more for our customers, backed by powerful brands, great service and market-leading claims capabilities.

As we build an insurance company of the future we are putting sustainability at the heart of how we do business because it allows great people to thrive, creates a better corporate culture, drives competitiveness and provides a foundation for long-term rewards for our shareholders.

Our core strengths

Our core strengths, combined with new technology are designed to deliver sustainable growth.

Insurance customers value strong brands, great service and a claims operation that delivers what it promises. These are the core strengths of Direct Line Group.

> For more information, see page 21 for the CEO's review

In an increasingly digital world, future success requires a relentless focus on customer needs, efficiency and innovation, combined with pricing and claims expertise to deliver an exceptional insurance experience.

Our diversified business model ensures that we remain focused on reaching customers through the four main routes to market: direct, price comparison websites, partnerships and brokers. To read more on our channels and powerful brands, see our business model on page 16.

Customer focus

With customers at the heart of all we do, we are passionate about offering great service, unique customer propositions and a highly efficient claims operation. Our powerful brands enable our customers to choose the right cover for their circumstances in order to protect their homes, cars, holidays, businesses and pets. It's why our customer retention rates are high and our net promoter scores (NPS) are strong.

Pricing sophistication

We are transforming our competitiveness with our new tech platforms enabling greater accuracy in pricing in our chosen markets. Our pricing and underwriting teams now have the systems and sophisticated data techniques designed to get products to market faster and target a broader pool of potential customers.

and capabilities

£581.8m

Operating profit

+1.0%

Direct own brands
portfolio growth

2.5%

Reduction in operating
expenses before
restructuring and one-offs

Claims expertise

Our vertically integrated claims model differentiates us and adds value giving the business a competitive advantage. We are fully focused on data, artificial intelligence ("AI") and digital as these are the key capabilities needed to get results. As we further digitalise our claims journey we are aiming for increased simplicity and speed to give our customers peace of mind when they make an insurance claim and need us most.

Efficient cost base

The implementation of our transformation programme is already reducing our cost to serve customers, while at the same time improving customer outcomes. As the business increasingly utilises the new technology we are becoming more efficient, pricing with greater speed and responding to changing market dynamics with greater agility.

Innovating for success

We're innovating across our business – be it offering attractive customer propositions, introducing green solutions to achieve our net zero ambitions or creating our flagship Motor technology centre that puts us at the forefront of repairing advanced car technology. Customers are already benefiting from our technology transformation, receiving enhanced self-service options.

Innovating for The future

During 2021 Direct Line Group (the “Group”) delivered a strong financial performance and completed the main elements of its technology build to deliver greater pricing and data capability across the business.

Financially, our combined operating ratio figure for the year was 90.1% and we have launched a new share buyback programme of up to £100 million. We have also declared a final dividend of 15.1 pence per share, a 2.7% increase over 2020, highlighting our long track record of delivering strong returns to shareholders.

Due to our technology transformation we are deploying pricing with greater accuracy, bringing new offers to market and digitalising our claims operations to better serve our customers at the point when they need us most and by being clear sighted about our sustainability priorities, we are implementing solutions to better position the Group for the long term.

As we embed our tech capability it leaves the Group well positioned to build on our strong 2021 performance to deliver successful outcomes through 2022 and beyond.

Our Stechford accident repair centre

We continued to expand our claims capabilities with the acquisition of our 22nd centre this year supporting our competitive advantage in vehicle repair.

Deploying our new Motor platform

Enhancing our pricing capability

The successful launch of a new Motor platform for our biggest brands – Direct Line, Churchill and Privilege – has improved customer experience and allows greater pricing sophistication. Being cloud-based enables the platform to connect to a greater variety of data sources, enabling us to update our pricing engines at speed.

100%

of Motor claims can now be registered online

72%

of all Motor sales are now completed directly online

Delivering customer benefits

With the major elements of our Motor tech transformation complete, the new platform means:

- choice and efficiency for customers with month-on-month growth in the number of own brand customers using the greater self-service opportunities
- more tasks are now automated, freeing up time for our consultants to focus on customers
- new products get to market faster, books of business can be onboarded quickly and we can focus on new commercial opportunities

Customers are already rating our new platform positively.

92%

of customers who responded score our new Motor platform 9 or 10 out of 10 when rating their customer service experience on a sales or renewal interaction

,

Strengthening Partnerships

Major motor partnership win

In July the Group was delighted to announce a 10-year partnership, from H2 2023, with Motability Operations to provide insurance to customers on the Motability Scheme. The Scheme serves over 640,000 people and is forecast to increase Motor gross written premium by around £500 million each year. The partnership will provide us with extra insight into their fleet of modern vehicles and build further scale to our expert claims management service.

£500m

Motor gross written premium forecast each year from H2 2023

Giving our travel customers flexibility

We extended our Aquarium travel platform this year to reach an extra 1.7 million customers through our partnership with Nationwide. Customers can now manage their insurance digitally and register some claims whilst still abroad, without having to speak to an adviser.

1.7m

travel customers can now manage their insurance digitally

NatWest Group home insurance contract

We have extended our long-term home insurance partnership with NatWest Group to 2027. Building on the success of our existing partnership, we will continue to look after close to half a million of their customers' home insurance needs.

2027

home insurance contract with NatWest Group extended until 2027

Supporting Metro Bank's small and medium-sized enterprises ("SME") customers

In February 2021 Metro Bank announced they would be partnering with Churchill Expert to launch the Bank's first ever insurance offering, a suite of products for their SME customers. Metro Bank said they had chosen to partner with us because of our excellent track record on customer service, as well as our offering of a wide range of 4 and 5 star Defaqto rated products.

SME partner

Metro Bank's partnership with Churchill Expert offers a suite of products for their SME customers

Improving online customer experience

Commercial lines success

Our diversified business model means we aim to reach customers however and wherever they shop. We pride ourselves on offering SMEs tailored insurance so they have the insurance cover they need. This year:

- We continued the rollout of a new pricing and underwriting system across Commercial combined and Fleet, alongside the launch of machine learning pricing models, improving pricing accuracy
- Direct Line for Business continued to deliver double-digit growth within the SME market, supported by 64% growth in Churchill for business
- NIC delivered the highest gross written premium growth in the last 10 years

Overall, during 2021 our Commercial business grew gross written premium by 15%.

15%

gross written premium growth for our Commercial business

Digital support for our customers

We are increasingly using digital tools to interact with customers. This year we resolved 30% of over 2 million online enquiries with our virtual assistant and our webchat channel dealt with around 1.3 million interactions.

30%

of online enquiries resolved via our virtual assistant

Start-up success

Our insurance start-up motor brand Darwin has gone from strength to strength, growing its policy count to over 135,000 by the end of 2021, an increase of over 150% in just a year. Part of its success is based on machine learning which enables competitive pricing to be deployed into the market at speed. It is live on four PCWs and Darwin is already one of the highest-rated motor insurers in the UK on Trustpilot.

+150%

Darwin in-force policy count up by over 150% compared to 2020

Motor claims efficiency

Using our unique damage evaluation calculator we can quickly assess if a customer's vehicle can be repaired before it arrives at one of our garages, by utilising customer supplied images we can order the necessary parts to start repairs immediately. Additionally we have the option to deploy our AI technology that has been trained to use a database of over 2 million images to identify repair issues, which has helped our engineers to settle total loss cases faster, providing certainty for customers on what will happen with their vehicle.

2m+

our AI technology has been trained to use a database of over 2 million images to identify motor repair issues

Innovating for the future

Building a sustainable business

Going green

The Group joined the Race to Zero campaign, committing to set Science-Based Targets, to achieve net zero emissions by 2050. This year we started:

- Testing hydrogenated vegetable fuel oil ("HVO") in our recovery trucks
- Trialling electric spray paint booths
- A new Supply Chain Sustainability Programme

Race To Zero

we joined the Race To Zero campaign to achieve net zero emissions by 2050

Electric made easy

The future of UK motoring is electric and in November we were delighted to launch a new electric vehicle ("EV") offer for our Direct Line brand, aimed at making the transition to electric easy for our Motor insurance customers. It offers all new business customers access to a bundle of electric vehicle charging essentials, as well as an EV concierge service and insurance that covers batteries and charging cables. Using our agile working model, it took less than eight weeks to take the concept off the drawing board and into the market.

22nd

we continue to invest in our capability to repair more advanced and electric vehicles with the acquisition of our 22nd accident repair centre this year

New flagship car technology centre

To prepare for a world of rapidly changing car technology, the Group completed the build of its new tech centre in Stechford, Birmingham. The facility will develop the tools, skills and training to benefit its network, including the ability to test various ADAS (Advanced Driver Assistance Systems) calibration tools and electric vehicle repair methods. As we have the largest insurer-owned garage network in the UK, it will enable the Group to meet evolving customer repair needs particularly as the UK transitions to a green future.

£2m

investment in new car technology centre

Promoting Diversity and Inclusion

In 2021 our Executive Committee has been transformed; for the first time ever a majority of its members are women and two members are from a minority ethnic background. Across the business we are working to drive diversity and inclusion, including this year our first ever social mobility action plan and Black Inclusion report. We know there is much more to do, and were proud to be named 13th most inclusive employer in the UK.

Over 50%

of our ExCo are now women

Investment case

*Improving our competitiveness while
delivering strong shareholder returns*

Delivering strong shareholder returns

We have a track record of delivering strong returns to shareholders, having distributed £2.1 billion¹ over the past five years. In early 2020, we took the difficult decision to cancel the 2019 final ordinary dividend due to the impact of the Covid-19 pandemic at that time; however, this was subsequently paid to shareholders as a special interim dividend in the second half of 2020.

Capital returns (£m)

£2.1bn¹

capital returns in the
last five years

Gross written premiums (£m)

2021: £3,171.6m (2020: £3,180.4m)

Operating profit (£m)

2021: £581.8m (2020: £522.1m)

Notes:

1. Represents capital returns paid and proposed as at the date of publication. Includes 2016 final dividend paid in May 2017.
2. The 2019 dividends and capital returns have been adjusted to remove the cancelled 14.4 pence per share final dividend and £120 million of the share buyback programme as announced in March/April 2020. (The reported number was dividends and capital returns of £447.0 million.) The cancelled 14.4 pence per share dividend was paid as a special interim dividend in the second half of 2020.

Transformation has enabled us to improve the quality of our earnings

Over the last few years we have been transforming our technology and changing the way we work to increase the competitiveness of our business.

This has helped us improve the quality of our earnings and, in 2021, over 50% of our operating profit^{1,2} was from current-year business, in line with the target we set out in 2019, with older reserving years no longer such a significant part of our annual profits.

We are driving to achieve this through our six strategic objectives

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.

Our financial targets

Costs

Expense ratio^{1,3} of 20% in 2023

2021 actual:

23.9%

Normalised current-year operating profit^{1,2}

At least 50% contribution to total operating profit by 2021

2021 actual:

53.3%

Normalised combined operating ratio^{1,4}

Between 93-95% throughout the medium term

2021 actual:

91.1%

Return on tangible equity (RoTE)¹

At least 15% per annum over the long term

2021 actual:

23.6%

Notes:

- See glossary on pages 248 to 250 for definitions and Appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.
- Normalised for weather. Reported contribution 55.6%.
- Applies to operating expenses excluding restructuring and one-off costs.
- Normalised for weather. Reported COR 90.1%.

Business model

*Delivering for all
our stakeholders*

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 its heart.

Motor

Britain's leading private motor insurer represented through our well-known brands Direct Line, Churchill, Privilege and Darwin and also through our partners¹.

Home

One of Britain's leading personal home insurers, represented through our well-known brands Direct Line, Churchill and Privilege, and our partners, including NatWest Group¹.

> Read more about our business segments on pages 46 to 53

Giving customers a choice of brands and channels

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

This is how we create value

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

Diversified model

Our diversified model enables us to generate premiums from a range of brands, products and distribution channels.

Investment return

The premiums we collect from customers are invested in a diversified investment portfolio whilst also ensuring we can support our long-term claim commitments.

> See page 43

A triple win

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

A win for customers

100%

of Motor and Home claims can now be registered online

Notes:

1. © Ipsos 2022, Financial Research Survey (FRS), 6 months ended Jan 2022. 14,218 adults (aged 16+) surveyed across Great Britain with motor insurance, 13,280 with home insurance. Interviews were conducted online and telephone, and weighted to reflect the overall profile of the adult population. Includes Direct Line, Churchill, Privilege, Darwin and partner brands: NatWest, RBS.
2. Mintel Vehicle Recovery – September 2021.
3. Mintel Pet Insurance – 2021.

Rescue and other personal lines

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

Commercial

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

Accident repair centres

We own 22 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 advanced counter-fraud capability.

Costs

We're improving our efficiency through greater use of digital processes and by targeting cost reduction measures to increase our competitiveness.

Tax

We manage our tax obligations responsibly and contributed, either directly or indirectly, £885.1 million in tax to the Exchequer this year.

> See page 45

*A win for our people
and shareholders*

£3.8m

Invested in free
shares for our people

£2.1bn

Capital returns in the last
five years

*A win for society
and the planet*

£1.5m

Donated to charities and good causes
from our Community Fund

Race to Zero

Joined the Race to Zero
campaign to achieve net zero
emissions by 2050

Chair's statement

Working for all our stakeholders

Dear Shareholder,

I am pleased to report that 2021 saw Direct Line Group make significant progress on its strategic transformation at the same time as delivering strong operating profit. We achieved profit before tax of £446.0 million (2020: £451.4 million) and a combined operating ratio of 90.1% (2020: 91.0%).

The work we undertook in 2020 to adapt our operations and evolve the way we do business in response to the Covid-19 pandemic meant that we were well positioned to continue to provide our customers with excellent service, support our people, and push ahead with key strategic initiatives despite entering 2021 in another lockdown and seeing a continuation of pandemic-related restrictions during the year. The Board oversaw the business's preparations for the implementation of the FCA's new general insurance Pricing Practices Review regulations, which came into force on 1 January 2022, which involved a large-scale programme of activity and the deployment of considerable resources to meet the requirements of the new regulations within an ambitious timeframe during 2021. We believe that our multi-brand, multi-channel strategy places the Group in a strong position to deliver sustainable growth under the new pricing rules.

Danuta Gray
Chair of the Board

We have also made good progress on key sustainability initiatives, details of which are set out in this report, that we believe will contribute to the long-term sustainability of the business and its ability to deliver for our many stakeholders.

Dividend and capital management

The Board has recommended a final ordinary dividend of 15.1 pence per share, making a total of 22.7 pence per share, an increase of 2.7% over the 2020 total ordinary dividend.

Following the £100 million share buyback programme in 2021 and reflecting the strength of our capital position, we intend to commence a further share buyback programme of up to £100 million split into two tranches of up to £50 million each, the first in H1 and the second scheduled for H2.

After the proposed final dividend and £100 million share buyback programme, the estimated solvency capital ratio was 176% as at 31 December 2021. We have outstanding Tier 2 debt issued in 2012 with nominal value of £250 million which can first be called from 27 April 2022. Excluding this debt, the adjusted solvency ratio after the proposed final dividend and share buyback would be 160% which is in the middle of our stated risk appetite range of 140% to 180% of solvency capital requirement.

We have a track record of returning capital to shareholders, with £2.1 billion returned over the last five years, whilst also improving our capital structure with issues of Restricted Tier 1 and Tier 2 debt. Furthermore, over the last two Motor reinsurance renewals we have reduced the amount of excess of loss reinsurance purchased as increasing reinsurance prices has made it less effective economically. Looking forward, we have a strong balance sheet with further opportunities to reduce capital intensity and increase flexibility.

Board and leadership changes

There have been several changes in our Board and leadership teams since the time of our last Annual Report. In May, we announced that Tim Harris had decided to retire as Chief Financial Officer ("CFO") in order to prioritise supporting a family member who was undergoing medical treatment. On behalf of the Board and all our colleagues, I would like to thank Tim for the exceptional contribution he made as CFO since 2019 and to wish him and his family the very best. Following Tim's decision, Neil Manser (who had performed the role of Acting CFO since January 2021) was appointed as CFO on a permanent basis. Neil has a proven track record in the business, previously having held the roles of Chief Strategy Officer, Managing Director of our commercial business, NIG, and Director of Investor Relations. I am pleased that our strong internal talent pipeline and succession planning enabled a smooth transition of the finance leadership to such a high-calibre, capable candidate and am delighted by the invaluable contribution that Neil has already made to the Board during the year.

In November, we were also delighted to welcome Tracy Corrigan to the Board as a Non-Executive Director. Tracy's broad understanding of capital markets and the digital economy, and first-hand experience of driving digital transformation, cultural change and customer-focused innovation, has put her in a strong position to support the Board and our executive team in delivering our ambitious strategy.

There were also some exciting appointments to our Executive Committee. Promotion of internal talent resulted in the appointment of Jessie Burrows as Managing Director, Customer Sales, Service & Claims and Jazz Gakhil as Managing Director, Motor. In addition, Aureole Lecanon joined us as Chief Risk Officer and Ash Johnoo as Chief Information Officer. These appointments strengthen our capabilities in the key areas of data, customer and technology and support our drive to increase the diversity of our workforce at all levels.

More information about leadership changes in 2021 can be found on page 96.

Sustainability and culture

Our vision is to create a world where insurance is personal, inclusive and a force for good. This means we want to do business in a way that benefits all our stakeholders and has a positive impact on society. We have lots of exciting and ambitious initiatives in place to help us achieve this, but just as importantly, we have a culture that places huge value on "doing the right thing" and encourages and empowers our people to do so. The Sustainability section of the Strategic report shows how we are embedding sustainability into our business with greater confidence, in a way that underpins our strategy and is reflected in the way we behave. In the Corporate Governance report, we show how the Board has engaged with our stakeholders, including our shareholders, and how it has adapted its own ways of working to support and sustain the Group's culture and connect with our wider management team.

Our customers

During the year, our strategic technology transformation delivered some material improvements to the way we interact with our customers. We successfully rolled out our new Motor platform to our biggest brands (Direct Line and Churchill) and we continued to find new opportunities for innovation, including an online customer claims portal, which enables digital claims management, and a new cloud-based telephony system in Green Flag, which enables enhanced customer service and more efficient claims handling.

2021 also saw us announce a new partnership with Motability, made possible by our investment in business and technology transformation, which has created the capability for us to be a service provider of scale. We will provide insurance and vehicle repairs to the Motability scheme, supporting its more than 640,000 customers. The scheme helps people with disabilities achieve greater independence by leasing a new car, scooter or powered wheelchair in exchange for their mobility allowance. This partnership aligns with our purpose of helping people carry on with their lives, giving them peace of mind now and in the future, and I look forward to seeing how Motability's customers can benefit from our investments in vehicle repair and customer service.

Planet

During 2021, we continued to make good progress in respect of the "planet" pillar of our sustainability strategy. Our Sustainability report and Climate Change Action report for 2021 are available on the Group's corporate website. Highlights during 2021 included joining the "Race to Zero" Campaign and the launch of our first electric vehicle bundle for new Direct Line customers. More information about these initiatives can be found on pages 70 to 75.

In this report we also publish our second Task Force on Climate-related Financial Disclosures report, which sets out the progress the Group has made in setting Science-Based Targets, which will strengthen our disclosures across Scope 1, Scope 2 and Scope 3 emissions.

Society

We aim to use our expertise to improve outcomes for society and the communities we serve. One of the key ways we see that we can make a positive impact on society is through promoting social mobility through the Opportunity Action Plan that we have launched in partnership with the Social Mobility Pledge. This year, we have looked to harness the benefits of remote working by targeting recruitment in social mobility cold spots and holding insight days for bright students from less-advantaged backgrounds. We have continued to use our Community Fund to prioritise social causes, including marginalised groups and loneliness, mental health and wellbeing and food poverty. More information on this work can be found on page 67.

People

In 2021 we continued to support our people through the pandemic and look for ways to support our colleagues' wellbeing and safety in the new hybrid working environment. Our flexible approach to remote working has proven valuable in enabling us to access a wider and more diverse talent pool. We have listened to our colleagues' views, expressed through our regular engagement surveys and our Employee Representative Body, and taken action where we have seen opportunities to make things better (see pages 64 and 111). We continued to show strong commitment to our diversity and inclusion agenda, publishing our first Black Inclusion report and committing that from 2022 we will voluntarily publish our ethnicity pay gap. We hope this transparency will lead us to understand better where to focus future diversity and inclusion initiatives, because we know there is always much more to do.

I would like to end my statement by thanking our people for their continued commitment and dedication to our business. It is through their hard work that we enter 2022 with a sustainable business, ready to compete under new pricing rules and poised to use our new data and technology capabilities to grow the business, deliver great outcomes for customers and achieve our purpose of helping people carry on with their lives, giving them peace of mind now and in the future.



DANUTA GRAY
Chair of the Board

Chair's statement *continued***Section 172(1) statement**

The Board of Direct Line Insurance Group plc ("**Direct Line**") confirms that during the year under review, it has acted in the way it considers would be most likely to promote the long-term success of the Company for the benefit of its members as a whole, whilst having regard to the matters set out in Section 172(1)(a)-(f) of the Companies Act 2006 ("**Section 172(1)**").

Purpose and Vision

The matters set out in Section 172(1) underpin Direct Line's purpose and vision and form the foundation for the Board's considerations and decision making. Our purpose – to help people carry on with their lives, giving them peace of mind now and in the future – is centred on customers and their long-term interests. Our vision – to create a world where insurance is personal, inclusive and a force for good – reflects our desire to do business in a way that benefits all stakeholders, the environment and wider society.

Stakeholders

Information on Direct Line's key stakeholders is set out in the Sustainability section of the Strategic report on the following pages: Customers, 58 to 60; People, 61 to 65; Society, 66 to 69 and Environmental, 70 to 75. The diagram on page 55 sets out factors that we have assessed as being important to our stakeholders.

Engagement

The Board recognises that our stakeholders have diverse and sometimes competing interests that need to be finely balanced, and that these interests need to be heard and understood in order for them to be effectively reflected in decision making. Information about how the Board has engaged with stakeholders during the year and outcomes of that engagement can be found on pages 109 to 110 in the table titled "How the Board engages with stakeholders".

Board decisions and oversight

Examples of how stakeholder engagement and Section 172(1) matters have influenced Board discussion and decision making during the year can be found in the table titled "Consideration of Section 172(1) factors by the Board" on page 108. The table covers a number of key topics including: the return of capital to shareholders; the future of Direct Line's workplace and culture; and the implementation of rules resulting from the FCA's Pricing Practices Review. The metrics and processes which the Board looks at to ensure that business practices and behaviours reflect the Company's culture, purposes and values, including the impact of decisions on key stakeholders, are set out under "Culture and purpose" on page 105. Information about Board oversight of environmental matters can be found on page 76 in the TCFD Report.

The below table sets out where key disclosures in respect of each of the Section 172(1) matters can be found.

Section 172(1) factor	Relevant disclosures
(a) the likely consequences of any decision in the long term	Innovating for the future (pages 1 to 13) Vision, purpose, strategic objectives (page 23) Consideration of Section 172(1) factors by the Board (page 108)
(b) the interests of the company's employees	Key Performance Indicators – Colleague engagement scores (page 31) Outcome of employee engagement surveys (page 65) Diversity and Inclusion (pages 61 to 64) Employee Representative Body (page 111) How the Board engages with stakeholders (pages 109 to 110)
(c) the need to foster the company's business relationships with suppliers, customers and others	Key Performance Indicators – NPS and customer complaints metrics (page 31) Supporting customers (pages 58 to 60) Supply Chain Sustainability Programme (page 82) How the Board engages with stakeholders (pages 109 to 110)
(d) the impact of the company's operations on the community and the environment	External ratings, memberships and benchmarks (page 57) Social Mobility Action Plan (page 67) Community Fund 2021 (page 68) Science-Based Targets setting (page 86) TCFD disclosures (pages 76 to 87) How the Board engages with stakeholders (pages 109 to 110) Sustainability Committee Report (pages 130 to 131)
(e) the desirability of the company maintaining a reputation for high standards of business conduct	Our values (page 62) Internal controls (pages 117 to 118) The role of the Board – Culture and Purpose (page 105)
(f) the need to act fairly between members of the company	Capital returns (page 14) How the Board engages with stakeholders (pages 109 to 110) Annual General Meeting (page 97) Shareholder voting rights (pages 161 to 162)

An exciting point for the business

As I reflect on 2021, I am delighted by the Group's strong performance. I feel proud of the way we have navigated the complexities and uncertainties of a challenging market, impacted by the pandemic. Commercial, Home own brands and Rescue have grown, benefiting from the investments we have made in recent years in technology and pricing, whilst in Motor we have prepared for future growth while steering a smart path through a period of falling premium and uncertain claims frequency as the market seeks to predict the shape of the pandemic and its effect on customer driving behaviour.

Penny James
Chief Executive Officer

At the same time we have made brilliant strategic progress. After several years replacing the technology across the business, introducing agile ways of working and building our data foundations, we are nearing the completion of our technology transformation phase.

Through that transformation we have improved the profitability of the business we write, with releases from older reserve years no longer such a significant part of our annual profits. We have delivered performance across the business, including the quality of claims management, pricing and improvements in our cost efficiency. We anticipate further progress in all these areas through 2022 and 2023.

So, as I look ahead, I see 2022 as the year we pivot to focusing on driving the business forward. 2021 has been dominated by delivering the transformation to enable future growth and preparing for one of the biggest changes the market has seen with the introduction of the FCA's new Pricing Practices Review regulations. As we tune and embed the systems we have built and plan for Home to join Motor on them, we also look ahead with excitement as we are able to focus on driving our performance in this new market.

As we look to make this shift, I have focused on making sure we have the right leadership to make us successful. Several members of our executive team have changed and we now have a team brimming with the customer and insurance experience that has driven our past success, but also the technology, digital and data skills we want to become the data- and technology-driven insurance company of the future.

We start from a position of strength, of course, with a track record of strong returns, having delivered a return on tangible equity of over 19% for each of the last five years and having returned over £2.1 billion of capital to shareholders over the same period, including the final dividend and share buyback programme announced today. This is possible due to our scale and expertise across our diversified business model, with market-leading brands across multi-products and multi-channels. These sustained returns, combined with our new tech capability, give us a platform for future success.

Chief Executive Officer's review *continued*

Our customer-obsessive mindset is intent on delivering long-term sustainable growth. We are a business that puts data at the heart of what it does and we are working to have it at everyone's fingertips – with the agility to create and tailor innovative solutions and give customers the flexible, modular and on-demand insurance products that give them control. It is why I am so excited by the progress we have made, having now rolled out our largest brands, Direct Line and Churchill, onto our new Motor platform.

This transformation builds on our existing core strengths of great customer service, strong brands and expert claims capability which look to harness the best of technology to make every customer interaction effortless, instant and transparent, however customers come to us. Our diversified business model gives us the platform to be the best at direct and win through price comparison websites ("PCWs"), partners and brokers. The technology transformation enables a step change in our pricing capability and operational efficiency which is designed to further increase our competitiveness.

As we move to embed and leverage what we have built, we believe there is plenty more to come:

- Step changes in our use of pricing and data, which are already beginning to improve our competitiveness in Motor, and we will continue to refine and enhance our pricing models and capabilities as we move through the year.
- The next sweep of our brand advertising, building on the success of the 'superheroes' and Churchill campaigns.
- Improvements in our customer service and costs efficiency through material increases in straight-through processing.
- Over 640,000 Motability Operations customers who are scheduled to join us in 2023 in a deal focused on providing brilliant customer service and claims in a capital-efficient manner with 80% reinsured.
- And we are delighted to have extended our contract with NatWest Group to continue looking after their customers' Home insurance needs, a contract built on our ability to deliver great service for their customers through brilliant use of digital and data capability.

So, as we enter 2022, we are initially focused on understanding the new dynamics in the marketplace, where renewal and new business pricing are linked. It's early days but the market appears to be responding rationally and we are taking time to understand how customers will behave in the new pricing practices world and how to balance product, pricing and distribution to the best effect. The next phase is optimising for growth as we embed and tune the technology we've built.

We believe passionately that delivering sustainable growth in the long run means our customers, society and the planet need to thrive and we have a role to play in helping to ensure that is the case. In essence we need to do the right thing for our customers, our people and the planet. We are making our business an inclusive and rewarding place to work, where brilliant, skilled people can deliver in a high-performance culture. We are investing in the skills that our business will need for its future success and are offering training programmes to enable people who want to reskill to do so.

We have also made further strides to embed sustainability initiatives by prioritising actions which are good for the long-term interests of the business and which bring wider societal benefits. You can see this most strongly in the steps we are taking to protect our business from the impact of climate change and to give back more to the planet than we take out. Our decision this year to join the Race to Zero – committing to set Science-Based Targets to reduce emissions based on a 1.5°C pathway – reflects that ambition. But we also recognise our role in supporting customers to go green and delivering our new Direct Line electric vehicle proposition is another sign of our ability to innovate in an agile way.

This is a business I love, brimming with people who share my view and go the extra mile to support customers and one another. 2021 has been far from an easy year. Change is never comfortable and is rarely predictable. The results and progress are the outcome of the sheer dedication of our amazing people and their determination to succeed despite the challenges and strains of a pandemic. So, the most important thing I can do here is thank each one of them for sharing this journey with me.

Forging ahead with our strategy

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

Our values

**Do the right
thing**

Aim higher

**Take
ownership**

**Say it like
it is**

**Work
together**

**Bring all
of yourself
to work**

Our strategic objectives

Best at direct

**Win on price comparison
websites**

Extend our reach

Technical edge

Nimble and cost efficient

Great people

> See pages 15 and 26 for further information

Our sustainability pillars

Customers

People

Society

Planet

Governance

> See page 54 for further information

Our brands

Chief Executive Officer's review *continued*

Preparing for the future

As one of the largest motor insurers in the UK we have 22 garages. As car technology rapidly changes, we are continuing to invest in our repair capability so we can meet future customer needs with the aim of achieving efficient repair.

This is why we possess the ability to test and calibrate ADAS (Advanced Driver Assistance Systems) and are training more of our technicians in electric vehicle repair, as this is expected to be a growing market and we need to be ready. Our new technology centre is a further sign of our repair capability and is designed to help build in-house knowledge and inspire the next generation.

New Motor insight

We are delighted to announce a new 10-year Motor partnership with Motability Operations from 2023.

It is expected to give the Group further insight on a fleet of modern vehicles as the scheme serves some 640,000 people, and is further evidence of the quality of our customer service, vehicle repair expertise and digital claims capability.

New car technology centre

As the largest insurer-owned garage networks in the UK we pride ourselves in efficient repair. To strengthen the Group's repair capability further we have invested in a new car technology centre in Birmingham.

£2m

investment in new car technology centre

Business performance

We are already beginning to see some financial benefits of our transformation, with another strong financial performance in 2021, growing our own brand policy count, delivering a combined operating ratio of 90.1% and increasing operating profit year on year by 11.4% to £581.8 million. This has enabled us to declare a final dividend of 15.1 pence, a 2.7% increase over 2020, and announce a share buyback programme of up to £100 million.

We grew direct own brand in-force policies by 1.0% driven by Commercial direct and Green Flag Rescue, our two divisions furthest through their transformation, and Home where we traded well in a buoyant new business market.

We continued to make progress on our cost agenda, with operating expenses reducing £18 million to £706 million and the expense ratio falling 0.6 percentage points to 23.9%. Whilst we saw levies increase by 11% during 2021, alongside heightened inflation in wage costs, these impacts were more than offset by lower technology costs, savings from our property strategy and a 9% reduction in headcount. We also incurred lower Covid-19 related costs.

The combined operating ratio at 90.1%, normalised for weather at 91.1%, was better than our medium-term target of 93% to 95% and in line with our mid-year stated revised expectation of between 90% and 92%. We achieved an excellent underwriting profit for the year with increased prior-year reserve releases and Motor claims frequency remaining below pre-pandemic levels in H1 2021.

This, together with a strong investment result, meant operating profit increased from £522.1 million in 2020 to £581.8 million in 2021. We have been focusing on improving the amount of our operating profit that comes from the current year and in 2021 met our target of at least 50%.

Impact of Covid-19

Whilst in 2020 we saw a modest indirect economic benefit from the Covid-19 pandemic in our results, during 2021 the impact was less marked. Within Motor we saw similarly low levels of claims frequency across the first half of 2020 and 2021 and with restrictions easing across H2 2021 we saw claims frequency increase back to expected levels. Throughout 2021 motor market premiums reduced, in part reflecting this trend and offsetting the financial impact.

Outside of Motor the impact of Covid-19 was even less significant. Rescue saw lower new business shopping during lockdown restrictions, whilst claims experience in Home and Commercial was not significantly affected.

In our Travel business, lower customer travel levels continued to reduce gross written premium below pre-pandemic levels and claims volumes reduced in 2021 following the non-repeat of Covid-19 related claims in 2020.

Strategy update

Valuable customer relationships

Following the implementation of the FCA Pricing Practices regulatory changes at the start of 2022, the importance of strong customer relationships has never been higher.

Strong brands and great customer service have always been core strengths of our business and that has been consistently demonstrated by our high Net Promoter Scores and retention rates across both Home and Motor.

Throughout our technology transformation, we have always started with the customer. Our new technology architecture has delivered a step change in our digital capabilities, enabling our customers to deal with us however they wish. We have seen customer use of our digital channels increasing month on month throughout 2021, with 100% of Motor and Home claims now able to be registered online.

Our diversified business model also means that customers can deal with us through a range of recognised brands across a number of products. This enables us to support a real breadth of different customers.

Darwin, a new brand we set up in 2019, is a great example of our diversified approach. It uses machine learning to leverage our existing data resource and counter-fraud expertise to offer customers a low-cost digital product. In just two years it has increased to over 135,000 policies, is ranked in the top 10 on TrustPilot and provides us another powerful brand in the PCW channel.

Finally, our transformation has enabled us to improve our competitiveness through increased accuracy and agility in our pricing, as well as increasing the breadth of propositions that we can offer. During 2021 we rolled out our new electric vehicle proposition, building on our expertise in this growing market and helping our customers make the switch to electric vehicles.

“Our diversified business model also means that customers can not only deal with us through whichever channel they wish, but also via a range of recognised brands across a number of products.”

Growing the portfolio

Commercial and Green Flag Rescue are the areas of our business that are furthest through their transformation and they demonstrate what can be achieved when we combine our existing strengths in claims management, customer service and strong brands, with a new technology infrastructure and agile ways of working.

Between them they drove strong gross written premium growth of 13.9% in 2021 and gained share in their respective markets. We are adopting similar approaches in Motor and Home and are seeking to grow our share over time.

Longer term, we believe our brand strength enables us to extend into broader products and services to meet customers' needs. Direct Line has recently launched a standalone cyclist product to take advantage of this growing market and to attract new customers to other more established products; our electric vehicle proposition is designed to help customers transition to electric vehicles and is only one part of a wider ecosystem; and Green Flag, by changing its operating model, can now offer more assistance to customers during a vehicle recovery. These are all examples of how we are broadening our propositions and products to deliver for more customers.

Chief Executive Officer's review *continued*

Strategic objectives

Overall, in 2021, we made great progress on our path to building the insurance company of the future – technology and data led but with a customer-obsessive mindset. We not only completed the main elements of our technology build but have also made great progress against our six strategic objectives;

Objective	Progress to date
Best at direct	– Launched a new Direct Line proposition helping to make the transition to electric vehicles easier for customers by providing free access to a bundle of electric vehicle-related services, including discounted home charging installation. – Green Flag delivered a new cloud-based policy platform for online sales and relaunched the way it operates, enabling it to offer more services alongside roadside recovery. – Launch of Direct Line cyclist product as we extend our products and services in order to meet broader customer needs.
Win on PCWs	– Successfully rolled out our new Motor platform, which delivers greater pricing sophistication using third-party data and speed to market. We saw the benefits of this in improved Motor competitiveness in the second half of the year. – Continued to deliver strong growth in Darwin as we enhanced pricing across the four main PCWs, growing policy count to over 135,000, an increase of over 150% compared to the end of 2020. – Churchill business delivered 64% growth in gross written premiums in 2021.
Extend our reach	– We announced our new partnership with Motability Operations, demonstrating our core strengths in delivering great customer service and efficient car repairs. The partnership is anticipated to increase Motor gross written premiums by around £500 million each year from H2 2023. – Agreed a long-term extension to our Home partnership with NatWest Group. – U K Insurance Business Services Limited expanded into subscription insurance with a new partnership with Cazoo. – Green Flag renewed partnerships with Caravan and Motorhome Club, Zurich and Virgin Money.
Nimble and cost efficient	– Progressed our site strategy, purchasing our head office and rationalising our footprint at two regional offices, overall reducing our site footprint by 30% since 2019 and delivering savings in excess of £10 million per year. – Expanded digital customer journeys, including 100% of all Home and Motor claims now able to be registered online and with end-to-end digital journeys for certain claims types, delivering reduced demand into our contact centres. – Technology transformation reducing ongoing run costs through rationalisation of legacy systems, including the decommissioning of two data centres and reducing system support costs.
Technical edge	– We continued to expand our claims capabilities through the acquisition of our 22nd DLG Auto Services accident repair centre. This acquisition supports our competitive advantage in vehicle repairs and we continued to invest in capability to repair more advanced and electric vehicles. – Commercial continued the rollout of its new pricing and underwriting system across Commercial combined and Fleet, alongside the launch of machine learning pricing models, dramatically improving pricing accuracy. – Integration of digital journeys into our new fraud decision engine.
Great people	– We have refreshed our leadership, with an Executive Committee team which has the brilliant mix of digital, customer, data, insurance and agile skills we need to grow our business, leveraging the technology we have built. – The Group ranked 13th in The Inclusive Top 50 UK Employers list for 2021/22. – Published our Black Inclusion report and signed up to 10,000 Black interns programme. – Continued to embed Agile operating models across our trading and technology teams, enabling increased pace and efficiency of change.

“We take our environmental obligations seriously and this year joined the Race to Zero – committing to set Science-Based Targets to reduce emissions based on a 1.5°C pathway.”

Sustainability strategy progress

We have continued to make progress on our sustainability strategy this year, improving our MSCI ESG rating from an 'A' to 'AA', and have published our second Task Force on Climate-related Financial Disclosures ("TCFD") report outlining our strategic response to climate change in this Annual Report. We have also participated in the Bank of England's Climate Biennial Exploratory Scenario ("CBES"), providing a clearer assessment of climate-related implications for the Group. We take our environmental targets seriously and this year joined the Race to Zero – committing to set Science-Based Targets to reduce emissions based on a 1.5°C pathway. While we finalise our submission to the Science Based Target Initiative ("SBTi") for approval, we are clear-sighted that setting ambitious targets requires practical measures to help reduce our emissions.

Colleagues have been innovating and trialling solutions to guide our emission reduction strategy, including launching a Supply Chain Sustainability Programme and piloting measures in our garage network because these are some of our most carbon-intensive operations. Part of our strategic response also means helping to make it easy for our customers to go green so that we can both contribute to and benefit from accelerating the transition. As a major motor insurer we are determined to make it easy for customers to insure electric vehicles, while aiming to fix them in the most energy-efficient repair network in the UK. That's why our new electric vehicle proposition for Direct Line customers is such an exciting development and a sign of how we can take long-term sustainable decisions which are good for the planet and our business.

UK weather

During February 2022, the UK experienced three significant storms: Dudley, Eunice and Franklin. To date, we have already helped over 10,000 customers across Home and Commercial and estimate claims to be between £30 million and £40 million. This is an early estimate and is within our annual weather budget assumption for 2022.

Ukraine conflict

We are deeply saddened and shocked by the conflict in Ukraine and have made an immediate donation from the Group's Community Fund to the UK's DEC Ukraine Humanitarian Appeal. As a UK-based business, there has been no direct impact from the conflict in Ukraine that started in February 2022. The investment portfolio has no direct exposure to Russia or Ukraine.

Outlook

Our strong strategic progress and disciplined approach to trading throughout 2021 meant we were well placed as we entered 2022 and began the implementation of the FCA Pricing Practices regulatory changes.

These are early days but we have seen positive new business premium inflation across the Home and Motor markets in January and February 2022, with search volumes higher but with switching reduced when compared to the same period in 2021. Our retention levels in Motor and Home have remained strong. These movements are within the range of outcomes we had projected and prepared for.

Our initial focus was on aiming to safely land the changes compliantly, while seeking to understand both market and consumer behaviour in the new environment. Our multi-brand portfolio sets us up well as it enables us to both protect value and be competitive in new business. This will enable us, as we move through the year, to optimise for growth and shareholder value whilst all the time delivering great outcomes for customers.

There are a range of inflationary pressures currently being seen within our market. Our claims expertise, including our repair cost advantage in Motor, puts us in a good position to manage these. Elsewhere, we have delivered absolute reductions in our overall cost base and we plan to reduce costs further during 2022.

Reflecting this, as well as our long-term confidence underpinned by our strategic transformation, we reiterate our combined operating ratio target range of 93% to 95%, normalised for weather, in 2022 and over the medium term. We also reiterate our expense ratio target of 20% for 2023, assuming modest premium growth, and our ongoing target of achieving at least a 15% return on tangible equity each year.

Having completed the main elements of our technology build we have complemented our strengths in strong brands, fantastic customer service and market-leading claims capabilities with a step change in our pricing capability, greater digitalisation and improved efficiency.

Whilst we are already seeing some of the benefits of this new capability coming through, the full benefits are yet to be realised, which leaves us well positioned to build on this strong performance through 2022 and beyond.



Penny James
Chief Executive Officer

Market overview

Consumer trends

In 2021 we witnessed consumer trends further align with our strategy, consistent with our technology transformation:

- More customers taking advantage of our digital capability where we are providing greater flexibility for people to manage their insurance how they want, whether it is amending policy cover or making a claim. It is part of our aim to use the best technology to make every customer interaction effortless, instant and transparent however customers come to us.
- A desire for trusted, famous brands offering distinctive customer offers and insurance propositions. We want to create and tailor solutions and give customers the flexible, modular and on-demand products that give them control. We were delighted to launch our new electric vehicle proposition for our Direct Line brand in 2021.
- Car technology is increasingly sophisticated and as the green transition picks up pace, electric vehicles are becoming more popular in the UK. Owning our garage network gives us beneficial commercial insights on vehicle technology, alongside upskilling our technicians in electric vehicle repair.
- The Covid-19 pandemic has changed consumer travel patterns, as more people work from home meaning fewer people are using cars in peak commuting hours, impacting claims behaviour. Insurers will need to adapt to this new environment and our ability to deploy more sophisticated pricing, as a result of our new motor platform, gives the Group greater competitiveness as the UK emerges from the pandemic.
- Increasingly people are taking advantage of partnerships where they can access insurance products. We are aiming to be the insurance partner of choice because it allows us to reach new sets of customers, which is why we are delighted to be partnering with Motability. Our new Direct Line electric vehicle proposition offers a free bundle of services from our partner, Zoom EV, and our Commercial business is working with Cazoo, providing motor insurance to customers within their monthly car subscription.

Financial Conduct Authority Pricing Practices Review

In May 2021 the FCA published its General Insurance Pricing Practices Final Policy Statement outlining the implementation timetable for the reforms. Following the Final Policy Statement, the Group successfully met the product governance deadline at the end of September 2021, as well as implementing the pricing reforms which came into effect on 1 January 2022.

We have been supportive of the reforms since the FCA announced its intention for firms to equalise customer prices by offering a renewal price no higher than the equivalent new business price through the same sales channel for motor and home policies.

For several years, before the FCA announced its intention to reform the market, we have taken a proactive approach to reduce the pricing differential between new business and renewal customers, including reviewing customers' renewal prices when they reach their five-year anniversary.

As the market rebalances, in line with the FCA's rule changes, we believe customers will continue to look for both value for money and trusted brands, especially those with a reputation for excellent customer service, market-leading customer offers in terms of what people receive with their cover and a strong track record in claims handling, which are where we have fundamental strengths. We remain confident that our core strengths will assist in helping the Group to navigate this new market with the aim of delivering the right outcomes for our customers and shareholders.

“We have been supportive of the reforms since the FCA announced its intention for firms to equalise customer prices by offering a renewal price no higher than the equivalent new business price through the same sales channel for motor and home policies.”

Inflation

The Group is not immune from global inflationary pressures which became more pronounced in the UK during the second half of 2021. Like other insurers, heightened inflation in construction materials such as concrete and lumber has impacted home claims. Meanwhile, motor claims inflation has trended upwards largely due to the limited global supply of new vehicles increasing costs for second-hand vehicles, impacting total loss settlements. In Motor we continued to focus on maintaining the quality of our book and continued to price for claims inflation at a time when we believe market pricing was not reflective of observed claims inflation.

While inflation is expected to persist throughout 2022 we believe the Group has strengths which can help navigate an increasingly inflationary environment. Owning the largest garage network of any insurer allows us to repair vehicles effectively and economically, enabling us to mitigate some inflationary pressures. Whilst we have a large home business, construction materials only make up a small amount of our claims costs, with a greater proportion relating to labour costs and decorating materials meaning we are insulated from certain inflationary pressures partially caused by supply chain disruption. If supply chain delays reverse as a result of a relaxation of Covid-19 restrictions we could see some of these impacts unwind.

“While inflation is expected to persist throughout 2022 we believe the Group has strengths which can help navigate an increasingly inflationary environment.”

Climate

Climate change affects the Group in several ways and, like other companies, the Group is focusing its efforts on how to manage the transition to a low-carbon future. In October 2021 the Chancellor published the 'Greening Finance' roadmap, setting out plans for new Sustainability Disclosure Requirements to create a framework for sustainability disclosures across the economy, building on TCFD to integrate global standards.

The Group has taken a number of steps in recent years to publish its energy usage and emissions transparently. It continues to develop risk-mitigation measures to reduce operational emissions and has enhanced its assessments of climate-related risks to our business.

This year the Group has published its second TCFD-aligned disclosure (see page 76) which sets out our strategic response to climate change. We have also continued to publish our Scope 1 and 2 emissions as well as Scope 3 emissions¹ with greater clarity of the activities under our direct control. We are now also publishing our Scope 3 supply chain emissions as well as, for the first time, our homeworking emissions following the Group's adoption of a mixed (remote and site-based) working model (see page 64).

In 2021 the Group joined the Race to Zero committing to set Science-Based Targets to reduce our emissions based on a 1.5°C pathway. We are in the process of setting Science-Based Targets, which will guide the Group to reduce our emissions as part of the Science Based Target initiative (“SBTi”), where we are aiming for a validated set of targets¹ in 2022. This will cover our operational emissions (Scope 1 and 2 emissions), as well as our Scope 3 emissions including our supply chain and investments. In recognition that our carbon reduction strategy will take time we remain a carbon neutral business through offsetting.

“Alongside our climate change scenario analysis we are focused on supporting customers to make sustainable choices.”

Understanding climate-related risks is important because we manage insurance risks presented by weather-related events, such as flooding and storm damage. The Group continues to evaluate the risks presented by climate change and last year we participated in the Bank of England's Climate Biennial Exploratory Scenario (“CBES”).

Alongside our climate change scenario analysis we are focused on supporting customers to make sustainable choices. In 2021 we launched our electric vehicle offer for our Direct Line brand and our commercial business partnerships are offering customers the flexibility to try electric vehicles.

UK economy and Brexit

The UK's new international trading relationships may have had an impact on claims inflation and may still do so, although the Covid-19 pandemic continues to mask the effects of these relationships. Certain risks related to Brexit could still occur or be exacerbated and we continue to be alert to possible developments.

1. Excluding investments

Our key performance indicators

Combined operating ratio ¹ ("COR") (%)	Definition	Aim	Remuneration
	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.	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 35	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 135 and 141
Basic earnings per share ¹ (pence)	Definition	Aim	Remuneration
	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 38	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 pages 135 and 141
Capital returns ² (£m)	Definition	Aim	Remuneration
	The amount of cash paid in dividends to shareholders and amount of share buybacks funded from the Group's retained profits. (See page 213 for dividend breakdown).	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 38	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 135 and 145
Return on tangible equity ¹ (%)	Definition	Aim	Remuneration
	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 38	We base the LTIP awards partly on adjusted RoTE over a three-year performance period. > For additional information see pages 135 and 145

Notes:

- See glossary on pages 248 to 250 and Appendix A – Alternative performance measures on pages 251 to 255 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 represented 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^{3,4} (%)**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%.

> For additional performance information see page 39

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 information see page 135

Colleague engagement (%)

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

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

> For additional performance information see page 61

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

> For additional information see pages 135 and 143

Net Promoter Score^{5,6} (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 NPS over time.

> For additional performance information see page 58

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

> For additional information see pages 135 and 142

Customer complaints⁶ (%)

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 135 and 142

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.

Finance review

A strong financial performance

Financial highlights

Direct own brands in-force policies grew 1.0% with growth across Commercial direct (7.5%), Green Flag Rescue (5.8%) and Home (2.3%). Motor direct own brands in-force policies were stable in H2 2021 with a reduction of 1.9% over the year. Direct own brands gross written premium was 0.8% lower and grew 0.7% in H2 2021.

Operating profit increased to £581.8 million (2020: £522.1 million) driven by an increase in underwriting profit and a strong investment return result. Current-year contribution to operating profit, normalised for weather, was 53% (2020: 65%), in line with the Group's 2021 target of at least 50%.

Combined operating ratio improved to 90.1% (2020: 91.0%). Normalised for weather, the combined operating ratio was 91.1%, ahead of our medium-term target of 93% to 95% and in line with the expectation of between 90% and 92% for 2021 we stated at half year.

Profit before tax of £446.0 million was £5.4 million lower than 2020 as the increase in operating profit was offset by a £62.1 million increase in restructuring and one-off costs primarily reflecting restructuring of the property portfolio, including the purchase of the Bromley office in early 2021 as previously announced.

Proposed final ordinary dividend of 15.1 pence per share, making a total of 22.7 pence per share, an increase of 2.7% over the 2020 total ordinary dividend, and announcing a £100.0 million share buyback programme. Strong capital position with an adjusted solvency capital ratio of 160%.

Neil Manser
Chief Financial Officer

Financial summary

	FY 2021 £m	FY 2020 £m
In-force policies (thousands)	14,565	14,615
Of which: direct own brands (thousands)	7,529	7,454
Gross written premium	3,171.6	3,180.4
Of which: direct own brands	2,207.6	2,225.6
Net earned premium	2,957.4	2,960.5
Underwriting profit	291.5	267.8
Instalment and other operating income	144.0	159.2
Investment return	146.3	95.1
Operating profit	581.8	522.1
Restructuring and one-off costs	(101.5)	(39.4)
Operating profit after restructuring and one-off costs	480.3	482.7
Finance costs	(34.3)	(31.3)
Profit before tax	446.0	451.4
Tax	(102.3)	(84.2)
Profit after tax	343.7	367.2
Key metrics		
Current-year attritional loss ratio ^{1,2}	65.5%	62.3%
Loss ratio ^{1,2}	58.1%	57.9%
Commission ratio ^{1,2}	8.1%	8.6%
Expense ratio ^{1,2}	23.9%	24.5%
Combined operating ratio ^{1,2}	90.1%	91.0%
Return on tangible equity ²	23.6%	19.9%
Investment income yield ²	1.9%	2.1%
Net investment income yield ²	1.7%	1.8%
Investment return yield ²	2.4%	1.6%
Basic earnings per share (pence)	24.5	25.8
Diluted earnings per share (pence)	24.1	25.5
Return on equity	12.5%	13.1%
Dividend per share – interim (pence)	7.6	7.4
– final (pence)	15.1	14.7
– total ordinary (pence)	22.7	22.1
– special (pence) ³	–	14.4
Share buyback	100.0	100.0
	FY 2021	FY 2020
Net asset value per share (pence)	193.6	199.7
Tangible net asset value per share (pence)	131.2	141.5
Solvency capital ratio post-dividends and share buyback ⁴	176%	191%
Adjusted solvency capital ratio ⁵	160%	172%

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. See glossary on pages 248 to 250 for definitions.
2. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.
3. 2020 special dividend paid in lieu of the cancelled 2019 final dividend.
4. Estimates based on the Group's Solvency II partial internal model.
5. Adjusted solvency capital ratio excluding Tier 2 debt which can first be called from 27 April 2022. See appendix A – Alternative performance measures on page 251 for definition and on page 255 for reconciliation to financial statement line items.

Finance review *continued*

Performance

Operating profit

	FY 2021 £m	FY 2020 £m
Underwriting profit	291.5	267.8
Instalment and other operating income	144.0	159.2
Investment return	146.3	95.1
Operating profit¹	581.8	522.1

Note:

1. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

In 2021 we delivered a strong financial performance, growing our own brand policy count, delivering a combined operating ratio of 90.1% and increasing operating profit year on year by 11.4%. This enabled us to declare a final dividend of 15.1 pence, a 2.7% increase over 2020, and announce a further share buyback programme of up to £100 million.

We delivered operating profit of £581.8 million, an increase of £59.7 million over 2020, driven by increased underwriting profit and a strong investment return, partially offset by lower instalment and other operating income. Current-year contribution to operating profit, normalised for weather, was 53% (2020: 65%), in line with our target of at least 50%.

Underwriting profit increased by £23.7 million, with increases in prior-year reserve releases and lower operating costs being partially offset by higher claims frequency in Motor. Increases in prior-year reserve releases benefited from favourable development across several perils in Home and large bodily injury reserves development in Motor as uncertainty arising from Covid-19 and Brexit reduced. The combined operating ratio at 90.1%, normalised for weather at 91.1%, was better than our medium-term target of 93% to 95% and in line with our stated mid-year revised expectation for 2021 of between 90% and 92%.

Lower average premiums in Motor and lower claims volumes across the whole year drove a reduction in instalment and other income to £144.0 million (2020: £159.2 million).

Investment return increased by £51.2 million in 2021 following £43.6 million of realised and unrealised gains across our investment property and credit portfolios (2020: £11.7 million of net realised and unrealised losses).

During 2021, the impact of Covid-19 was less significant than in the previous year where it caused a modest overall indirect economic benefit. Whilst Motor claims frequency remained below pre-pandemic levels in H1, it increased back to expected levels during H2 and Motor saw elevated severity inflation in damage claims throughout the year.

In-force policies and gross written premium

In-force policies (thousands)

	31 Dec 2021	31 Dec 2020
Direct own brands	3,869	3,943
Partnerships	102	118
Motor	3,971	4,061
Direct own brands	1,879	1,837
Partnerships	788	801
Home	2,667	2,638
Rescue	3,417	3,400
Travel	3,445	3,499
Pet	138	145
Other personal lines	56	61
Rescue and other personal lines	7,056	7,105
Of which: Green Flag direct	1,179	1,114
Direct own brands	602	560
NIG and other	269	251
Commercial	871	811
Total in-force policies	14,565	14,615
Of which: direct own brands	7,529	7,454

Direct own brand policies grew 1.0% to 7.5 million with growth in Commercial, Green Flag Rescue and Home offsetting declines in Motor. Total in-force policies were broadly stable at 14.6 million (31 December 2020: 14.6 million) as the increases in direct own brand and Commercial NIG in-force policies were offset by lower partnership and Travel volumes.

Gross written premium

	FY 2021 £m	FY 2020 £m
Direct own brands	1,515.2	1,567.6
Partnerships	45.6	49.3
Motor	1,560.8	1,616.9
Direct own brands	416.7	411.6
Partnerships	161.1	166.3
Home	577.8	577.9
Rescue	170.0	166.7
Travel	92.3	134.0
Pet	71.4	72.8
Other personal lines	46.3	44.3
Rescue and other personal lines	380.0	417.8
Of which: Green Flag direct	88.3	83.1
Direct own brands	187.4	163.3
NIG and other	465.6	404.5
Commercial	653.0	567.8
Total gross written premium	3,171.6	3,180.4
Of which: direct own brands	2,207.6	2,225.6

Direct own brands gross written premium reduced by 0.8% to £2,207.6 million (2020: £2,225.6 million) where strong growth in Commercial and Green Flag Rescue was offset by lower volumes and lower average premiums in Motor. Total gross written premium of £3,171.6 million (2020: £3,180.4 million) reduced by 0.3% with strong growth in Commercial NIG offset by the small reduction in own brands and a reduction in Travel.

Underwriting profit and combined operating ratio¹

	FY 2021	FY 2020
Underwriting profit (£ million)	291.5	267.8
Loss ratio	58.1%	57.9%
Commission ratio	8.1%	8.6%
Expense ratio	23.9%	24.5%
Combined operating ratio	90.1%	91.0%

Note:

- See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

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 2021						
Net earned premium	4	1,473.3	553.4	369.5	561.2	2,957.4
Net insurance claims	4	947.0	280.4	185.3	306.0	1,718.7
Prior-year reserve releases	35	127.1	45.8	23.8	61.4	258.1
Major weather events		n/a	(18.3)	n/a	(19.2)	(37.5)
Attritional net insurance claims		1,074.1	307.9	209.1	348.2	1,939.3
Loss ratio – current-year attritional		72.9%	55.7%	56.5%	62.0%	65.5%
Loss ratio – prior-year reserve releases		(8.6%)	(8.3%)	(6.4%)	(10.9%)	(8.7%)
Loss ratio – major weather events ¹		n/a	3.3%	n/a	3.4%	1.3%
Loss ratio – reported	4	64.3%	50.7%	50.2%	54.5%	58.1%
Commission ratio	4	3.3%	6.9%	11.4%	20.0%	8.1%
Expense ratio	4	24.8%	22.5%	25.3%	21.7%	23.9%
Combined operating ratio ²	4	92.4%	80.1%	86.9%	96.2%	90.1%
Current-year combined operating ratio ²		101.0%	88.4%	93.3%	107.1%	98.8%
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	35	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 ²	4	87.7%	87.1%	102.0%	95.5%	91.0%
Current-year combined operating ratio ²		94.5%	89.0%	103.3%	106.9%	96.9%

Notes:

- Home and Commercial claims for major weather events, including inland and coastal flooding and storms.
- See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

Overall underwriting profit increased to £291.5 million (2020: £267.8 million) with an improvement in the combined operating ratio to 90.1% (2020: 91.0%).

The loss ratio edged up slightly to 58.1% (2020: 57.9%) driven by increases across Motor and Commercial more than offsetting improvements in Home and Rescue and other personal lines.

The small deterioration in the loss ratio was more than offset by a lower commission ratio. The commission ratio reduced primarily due to reduced profit share payments, particularly on packaged bank accounts and Home partnerships, partially offset by increased commission payments in Commercial.

The expense ratio reduced by 0.6 percentage points to 23.9% as operating expenses reduced following progress on our cost saving initiatives, partially offset by increased levies and depreciation and amortisation charges relating to the launch of our new technology platforms.

Finance review *continued*

Ratio analysis by division (%)

The current-year attritional loss ratio excludes prior-year reserve releases and claims costs from major weather events and is therefore an indicator of underlying accident year performance. Our current-year attritional loss ratio of 65.5% increased by 3.2 percentage points compared to 2020, with increases in loss ratio in Motor, Home and Commercial partially offset by a reduction in Rescue and other personal lines.

Prior-year reserve releases increased in 2021 to £258.1 million (2020: £173.8 million), equivalent to 8.7% of net earned premium (2020: 5.9%) and were concentrated towards more recent accident years. Prior-year reserve releases were higher across all categories, including in Home, which benefited from favourable experience across several perils, in line with expectations, and Motor, which benefited mainly from large bodily injury reserve development as uncertainty arising from Covid-19 and Brexit reduced.

Our current-year combined operating ratio increased by 1.9 percentage points to 98.8% (2020: 96.9%) as a 3.2 percentage point increase in the current-year attritional loss ratio was partially offset by a 0.6 percentage point improvement in the expense ratio, a 0.5 percentage point decrease in the commission ratio and a 0.2 percentage point reduction in claims due to major weather.

Operating expenses before restructuring and one-off costs

	Note	FY 2021 £m	FY 2020 £m
Staff costs ¹		261.0	255.6
IT and other operating expenses ²		147.7	196.0
Marketing	10	112.0	106.6
Sub-total		520.7	558.2
Insurance levies	10	89.0	80.4
Depreciation and amortisation ^{3,4}	10	96.6	85.8
Total operating expenses before restructuring and one-off costs		706.3	724.4

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.
- For the year ended 31 December 2021, depreciation and amortisation includes a £2.1 million impairment charge (2020: £6.6 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to the development of new systems, and a £0.5 million impairment charge (2020: £nil), which relates to ROU property assets.
- Includes depreciation on right-of-use assets of £10.8 million (2020: £14.8 million).

We continued to reduce our operating expenses as we move towards our target of a 20% expense ratio in 2023. Overall operating expenses before restructuring and one-off costs reduced by £18.1 million to £706.3 million (2020: £724.4 million) and resulted in a decrease in the expense ratio of 0.6 percentage points to 23.9% (2020: 24.5%).

Costs before insurance levies, depreciation and amortisation were 6.7% (£37.5 million) lower at £520.7 million reflecting lower costs in relation to the Covid-19 response and reductions arising from the Group's cost-saving initiatives. We have also made good progress on our property strategy, completing the acquisition of our Bromley office and we have disposed of a further property in 2022.

Instalment and other operating income

	Note	FY 2021 £m	FY 2020 £m
Instalment income		97.3	109.3
Other operating income:			
Revenue from vehicle recovery and repair services	7	19.7	24.0
Vehicle replacement referral income	7	13.1	12.2
Legal services income	7	7.2	8.8
Other income ¹	7	6.7	4.9
Other operating income		46.7	49.9
Total instalment and other operating income		144.0	159.2

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 £15.2 million to £144.0 million. Instalment income fell primarily due to lower Motor gross written premium, whereas other operating income reduced due primarily to a reduction in external Motor repair income and lower recovery after accident volumes.

Investment return

	Note	FY 2021 £m	FY 2020 £m
Investment income		116.0	127.1
Hedging to a sterling floating rate basis		(13.3)	(20.3)
Net investment income		102.7	106.8
Net realised and unrealised gains/(losses) excluding hedging		43.6	(11.7)
Total investment return	6	146.3	95.1

Investment yields

	FY 2021	FY 2020
Investment income yield ¹	1.9%	2.1%
Net investment income yield ¹	1.7%	1.8%
Investment return yield ¹	2.4%	1.6%

Note:

1. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

Total investment return increased by £51.2 million to £146.3 million (2020: £95.1 million) primarily reflecting positive fair value adjustments in investment properties in 2021 versus write downs in 2020, as well as increasing the gains from debt security disposals year on year. Lower investment rates, driven by central banks' policy actions in 2020, led to a lower net investment income yield of 1.7% (2020: 1.8%).

In 2021 net investment income has been modestly ahead of expectations mainly due to good performance on the high yield portfolio and rising risk-free rates. For 2022 we expect net investment income yield to be in the region of 1.7%, increasing to between 1.8% and 1.9% in 2023, based on current yield curves.

Our 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 ("PPO") and non-PPO liabilities in an optimal manner; and
- to deliver a suitable risk-adjusted investment return commensurate with our risk appetite.

Reconciliation of operating profit

	Note	FY 2021 £m	FY 2020 £m
Motor	4	314.8	363.5
Home	4	141.8	101.4
Rescue and other personal lines	4	64.8	6.8
Commercial	4	60.4	50.4
Operating profit	4	581.8	522.1
Restructuring and one-off costs	4	(101.5)	(39.4)
Finance costs	11	(34.3)	(31.3)
Profit before tax	4	446.0	451.4
Tax	12	(102.3)	(84.2)
Profit for the year attributable to the owners of the Company		343.7	367.2

Operating profit by segment

All divisions contributed significant profit in 2021, demonstrating the diversity of our multi-product, multi-brand and multi-channel portfolio. Motor operating profit decreased as claims frequency increased back to expected levels as Covid-19 lockdown measures have been progressively relaxed across H2 2021, partially offset by an increase in prior-year reserve releases following favourable development of large bodily injury reserves as uncertainty arising from Covid-19 and Brexit reduced. Home operating profit increased primarily due to lower weather-related costs and higher prior-year reserve releases on escape of water, flood and fire perils. Rescue and other personal lines profit increased significantly following the non-repeat of the 2020 impact of the Covid-19 pandemic on Travel. Commercial operating profit increased due to improvements in underlying motor and liability claims costs, offsetting higher property claims costs, and increased gross written premium. Rescue operating profit of £55.0 million (2020: £51.2 million) is included in the Rescue and other personal lines result.

Restructuring and one-off costs

We incurred £101.5 million of restructuring and one-off costs in 2021, with £89 million of these costs relating to our site strategy, including £83.9 million in relation to the purchase of the lease of our Bromley office. The remainder are in respect of redundancy programmes and one-off costs. The Group may incur additional costs in 2022 if further opportunities are found as part of the Group's site strategy.

Finance costs

Finance costs increased to £34.3 million (2020: £31.3 million) primarily due to the full-year effect of interest payments on the £260 million Tier 2 subordinated debt issued in June 2020 included in the 2021 figure, partially offset by reductions of lease interest payable following the purchase of the lease of our Bromley office.

Effective corporation tax rate

The effective tax rate for 2021 was 22.9% (2020: 18.7%), higher than the standard UK corporation tax rate of 19.0% (2020: 19.0%) driven primarily by the non-deductible payment to terminate the lease on the Bromley property, and other disallowable expenses partly offset by tax relief for the Tier 1 coupon payments. The Effective Tax Rate is higher than for 2020 due to the Bromley lease payment and is expected to return to a more normal level in future years, subject to any future one-off disallowable items.

Finance review *continued*

Profit for the year and return on tangible equity¹

Profit before tax of £446.0 million was £5.4 million lower than for 2020 as the increase in operating profit was offset by a £62.1 million increase in restructuring and one-off costs as we continued to make progress in our property site strategy.

Profit for the year ended 31 December 2021 decreased by £23.5 million to £343.7 million (2020: £367.2 million) as an increase in operating profit was partially offset by a £62.1 million increase in restructuring and one-off costs and finance costs.

Return on tangible equity increased to 23.6% (2020: 19.9%) due primarily to the higher operating profit. 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 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

Earnings per share

Basic earnings per share decreased by 5.0% to 24.5 pence (2020: 25.8 pence). Diluted earnings per share decreased by 5.5% to 24.1 pence (2020: 25.5 pence) mainly reflecting a reduction in profit after tax.

Cash flow

The Group's cash and cash equivalents reduced by £271.7 million during the year (2020: £271.9 million increase) to £896.5 million.

The Group generated operating cash flows before movements in working capital of £435.9 million (2020: £394.5 million), an increase of £41.4 million; a reduction in profit for the year was more than offset by an increase in adjustments for non-cash movements. After taking into account movements in working capital, the Group generated £390.1 million (2020: £402.6 million), a decrease of £12.5 million. The Group has considerable assets under management; the cash generated from these reduced by £148.7 million to £167.2 million following reductions in the Group's assets under management, as a result of dividend payments. Net cash generated from operating activities was £439.0 million (2020: £584.7 million).

Net cash used in investing activities of £138.7 million reflected the Group's continuing investment in its major IT programmes (2021: £109.4 million, 2020: £140.7 million).

Net cash used in financing activities of £572.0 million included £317.4 million (2020: £312.5 million) in dividends and Tier 1 capital coupon payments in the year, £101.0 million in share buybacks (2020: £30.0 million) and £101.9 million (2020: £12.5 million) lease principal payments. The amount in 2020 included net proceeds of £257.2 million relating to Tier 2 subordinated debt issued in June 2020. Dividends paid in the year comprised the 7.6 pence first interim dividend announced in the half-year results in 2021 and the 14.7 pence per share final dividend announced in March 2021.

Net cash used in financing and investing activities more than offset the £439.0 million generated from operating activities and resulted in a net decrease in cash and cash equivalents of £271.7 million (2020: £271.9 million increase) to £896.5 million (2020: £1,168.2 million). The levels of cash and other highly liquid sources of funding that the Group holds to cover its claims obligations are continually monitored to ensure that the levels remain within the Group's risk appetite.

Net asset value

At 31 December	Note	2021 £m	2020 £m
Net assets ¹	16	2,550.2	2,699.7
Goodwill and other intangible assets	16	(822.5)	(786.8)
Tangible net assets	16	1,727.7	1,912.9
Closing number of Ordinary Shares (millions)	16	1,317.3	1,351.8
Net asset value per share (pence)	16	193.6	199.7
Tangible net asset value per share (pence)	16	131.2	141.5

Note:

1. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

Net assets at 31 December 2021 decreased by £149.5 million to £2,550.2 million (31 December 2020: £2,699.7 million) and tangible net assets decreased to £1,727.7 million (31 December 2020: £1,912.9 million) following the payment of the 2020 final dividend, 2021 interim dividend and the completion of the share buyback programme, a reduction in available-for-sale reserves and additional expenditure on intangible assets as we 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 15.1 pence per share (2020: 14.7 pence), an increase of 0.4 pence per share (2.7%). This reflects the Board's continued confidence in the Group's capital position and the sustainability of its earnings.

After the dividend and proposed share buyback programme, the estimated solvency capital ratio was 176% as at 31 December 2021. The Group has outstanding Tier 2 debt issued in 2012 with nominal value of £250 million which can first be called from 27 April 2022. Excluding this debt, the Group's adjusted solvency ratio would have been 160% as at 31 December 2021.

The final dividend will be paid on 17 May 2022 to shareholders on the register on 8 April 2022. The ex-dividend date will be 7 April 2022.

The Group uses reinsurance extensively to mitigate the impact of individual large claims and the aggregation of claims. At the 1 January 2022 renewal for its Motor excess of loss reinsurance, the Group chose to retain additional risk and increased the retention for each individual claim to £5 million (2021: £1 million with 75% placement).

Looking forward, we have a strong balance sheet with further opportunities to reduce capital intensity and increase flexibility.

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 2021.

Capital position

At 31 December 2021, the Group held a Solvency II capital surplus of £1.03 billion above its regulatory capital requirements, which was equivalent to an estimated solvency capital ratio of 176%, after the proposed final dividend and share buyback programme. Excluding the Group's outstanding Tier 2 debt the Group would have had a Solvency II capital surplus of £0.81 billion, equivalent to a solvency capital ratio of 160%.

Movement in capital surplus (£bn)

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

At 31 December	2021	2020
Solvency capital requirement (£ billion)	1.35	1.34
Capital surplus above solvency capital requirement (£ billion)	1.03	1.22
Solvency capital ratio after proposed final dividend and share buyback	176%	191%
Adjusted solvency capital ratio ¹	160%	172%

Note:

- Adjusted solvency capital ratio excluding Tier 2 debt which can first be called from 27 April 2022.

Movement in capital surplus

	2021 £bn	2020 £bn
Capital surplus at 1 January	1.22	0.85
Capital generation excluding market movements	0.40	0.59
Market movements	(0.03)	(0.02)
Capital generation	0.37	0.57
Change in solvency capital requirement	(0.01)	(0.02)
Surplus generation	0.36	0.55
Capital expenditure	(0.12)	(0.16)
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)	(0.10)
Ineligible Tier 3 capital ³	(0.03)	–
Net surplus movement	(0.19)	0.37
Capital surplus at 31 December	1.03	1.22

Notes:

- Relates to the cancellation of the 2019 cash dividend (£197 million) and share buyback (£120 million); offset by the special dividend subsequently declared at half-year 2020.
- 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.
- The amount of Tier 2 and Tier 3 capital permitted under the Solvency II regulations is 50% of the Group's SCR.

Finance review *continued*

In 2021, the Group generated £0.37 billion of Solvency II capital, of which £0.06 billion related to a change in the Group's deferred tax rate, following the change to the UK corporation tax rate from 19% to 25% with effect from 1 April 2023. Restructuring costs in relation to the purchase of the Bromley office lease reduced capital generation by £83.9 million. This was offset by a £0.01 billion change in the SCR, £0.12 billion of capital expenditure, dividends of £0.30 billion and share buybacks of £0.10 billion. At 31 December 2021 there was £0.03 billion of ineligible capital relating to deferred tax assets. Capital expenditure levels are expected to remain around £120 million in 2022.

Change in solvency capital requirement

	2021 £bn
Solvency capital requirement at 1 January	1.34
Model and parameter changes	(0.05)
Exposure changes	0.06
Solvency capital requirement at 31 December	1.35

The Group's SCR has increased by £0.01 billion in the year. Exposure changes resulted in a £0.06 billion increase, which was partially offset by a decrease of £0.05 billion relating to model and parameter changes.

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 2021. The impact on the Group's solvency capital ratio arises from movements in both the Group's SCR and own funds.

Scenario	Impact on solvency capital ratio ¹	
	31 Dec 2021	31 Dec 2020
Deterioration of small bodily injury motor claims equivalent to that experienced in 2008/09	(5pts)	(6pts)
One-off catastrophe loss equivalent to the 1990 storm "Daria"	(9pts)	(8pts)
One-off catastrophe loss based on extensive flooding of the River Thames	(9pts)	(8pts)
Increase in Solvency II inflation assumption for PPOs by 100 basis points ²	(9pts)	(10pts)
100bps increase in credit spreads ³	(8pts)	(9pts)
100bps decrease in interest rates with no change in the PPO real discount rate	(2pts)	(2pts)

Notes:

- 2021 figures exclude from own funds the value of the £250 million Tier 2 subordinated debt which can first be called from 27 April 2022. The comparative period has been represented on this basis, with the only change being the interest rate sensitivity which was reported as (3pts) at 31 December 2020.
- The PPO inflation assumption used is an actuarial judgement which is reviewed annually based on a range of factors including the economic outlook for wage inflation relative to the PRA discount rate curve.
- Only includes the impact on 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 eligible own funds by tier on a Solvency II basis.

At 31 December	2021 £bn	2020 £bn
Tier 1 capital before foreseeable distributions	1.66	1.84
Foreseeable dividend and share buyback	(0.30)	(0.30)
Tier 1 capital – unrestricted	1.36	1.54
Tier 1 capital – restricted	0.36	0.38
Less reclassified restricted Tier 1 debt ¹	(0.02)	–
Tier 1 capital	1.70	1.92
Tier 2 capital – reclassified restricted Tier 1 debt and Tier 2 subordinated debt ¹	0.53	0.53
Tier 3 capital – deferred tax	0.18	0.11
Ineligible Tier 3 capital ²	(0.03)	–
Total eligible own funds	2.38	2.56

Notes:

- As at 31 December 2021 £19 million (2020: £nil) of the Group's restricted Tier 1 capital was reclassified as Tier 2 due to Solvency II tiering restrictions.
- The amount of Tier 2 and Tier 3 capital permitted under the Solvency II regulations is 50% of the Group's SCR.

During 2021, the Group's eligible own funds reduced from £2.56 billion to £2.38 billion. Eligible Tier 1 capital after foreseeable distributions represents 71% of own funds and 126% of the estimated SCR. Tier 2 capital relates to the Group's £0.51 billion subordinated debt and £0.02 billion of ineligible Tier 1 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.

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%. The Group has Tier 2 plus Tier 3 ineligible own funds of £0.03 billion.

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

Reconciliation of IFRS shareholders' equity to Solvency II eligible own funds

At 31 December	2021 £bn	2020 £bn
Total shareholders' equity	2.55	2.70
Goodwill and intangible assets	(0.82)	(0.79)
Change in valuation of technical provisions	(0.01)	0.04
Other asset and liability adjustments	(0.06)	(0.11)
Foreseeable dividend and share buyback	(0.30)	(0.30)
Tier 1 capital – unrestricted	1.36	1.54
Tier 1 capital – restricted	0.36	0.38
Less reclassified restricted Tier 1 debt ¹	(0.02)	–
Tier 1 capital	1.70	1.92
Tier 2 capital – reclassified restricted		
Tier 1 debt and Tier 2 subordinated debt ¹	0.53	0.53
Eligible Tier 3 capital – deferred tax	0.18	0.11
Ineligible Tier 3 capital ²	(0.03)	–
Total eligible own funds	2.38	2.56

Notes:

- As at 31 December 2021 £19 million (2020: £nil) of the Group's restricted Tier 1 capital was reclassified as Tier 2 due to Solvency II tiering restrictions.
- The amount of Tier 2 and Tier 3 capital permitted under the Solvency II regulations is 50% of the Group's SCR which resulted in ineligible capital of £31 million.

Leverage

The Group's financial leverage increased by 1.0 percentage point to 25.2% (2020: 24.2%). The increase was primarily due to a decrease in shareholder's equity following the payment of the 2020 final dividend, 2021 interim dividend and the Group's £100 million share buyback programme, partially offset by 2021 profits.

At 31 December	2021 £m	2020 £m
Shareholders' equity	2,550.2	2,699.7
Tier 1 notes	346.5	346.5
Financial debt – subordinated debt	513.6	516.6
Total capital employed	3,410.3	3,562.8
Financial-leverage ratio¹	25.2%	24.2%

Note:

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

Credit ratings

Moody's Investors Service provides insurance financial-strength ratings for U K Insurance Limited, our principal underwriter. Moody's rates U K Insurance Limited as 'A1' for insurance financial strength (strong) with a stable outlook.

Reserving

We make provision for the full cost of outstanding claims from the 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. We consider 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.

We seek 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.

Claims reserves net of reinsurance 2021 (£m)

£2,548.4m

Claims reserves net of reinsurance 2020 (£m)

£2,591.7m

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 minus 1.75% in Northern Ireland.

We reserve our large bodily injury claims at the relevant discount rate for each jurisdiction, with the overwhelming majority now case 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 for the 2014 to 2020 underwriting years. We have reduced the level of Motor reinsurance purchased from 2021 which will have an impact on future reserving.

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 we make assumptions about the likelihood that claimants will opt for a PPO. This is known as the PPO propensity.

Higher claims inflation remains a risk, given the continuing rise in consumer prices and wage inflation. Consumer prices inflation is at its highest level for the past decade and is not expected to decline until 2023. Pressure is likely to remain strong on wages, with potential implications for the cost of care. Global supply chain issues remain problematic, resulting in a risk of price increases for products and components in short supply. A range of general and specific claims inflation scenarios for goods and services have therefore been considered in the reserving process.

Prior-year reserve releases were £258.1 million (2020: £173.8 million) concentrated towards more recent accident years, with good experience in Home and with Motor large bodily injury claims in later accident years also being a key contributor as uncertainty arising from Covid-19 and Brexit reduced.

Looking forward, we expect to continue setting our 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.

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.

	Increase / (decrease) in profit before tax ¹	
At 31 December	2021	2020
	£m	£m
PPOs²		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	43.0	45.9
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(58.9)	(62.7)
Ogden discount rate⁴		
Impact of the Group reserving at a discount rate of 0.75% compared to minus 0.25% (2020: 0.75% compared to minus 0.25%)	42.5	43.7
Impact of the Group reserving at a discount rate of minus 1.25% compared to minus 0.25% (2020: minus 1.25% compared to minus 0.25%)	(59.4)	(61.1)
Claims inflation		
Impact of a decrease in claims inflation by 100 basis points for two consecutive years	37.3	32.4
Impact of an increase in claims inflation by 100 basis points for two consecutive years	(37.6)	(32.2)

Notes:

- These sensitivities are net of reinsurance and exclude the impact of taxation.
- These sensitivities reflect one-off impacts at the balance sheet date and should not be interpreted as predictions.
- The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the real 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.
- 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. We will consider the statutory discount rate when setting the 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 2021. 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 £150 million and cover is placed annually on 1 July up to a modelled 1-in-200 year loss event of £1,150 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 £5 million per claim 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 2022.
- Commercial property risk reinsurance to protect against large individual claims with a retained deductible of £4 million which renews annually on 1 July.

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 benchmarks for U K Insurance Limited are detailed in the following table:

	Benchmark holding 2021	Actual holding 2021	Benchmark holding 2020	Actual holding 2020
Investment-grade credit ¹	66.0%	65.7%	66.0%	63.8%
High yield	3.0%	1.7%	6.0%	6.0%
Investment-grade private placements	6.0%	6.1%	3.0%	1.8%
Credit	75.0%	73.5%	75.0%	71.6%
Sovereign	3.0%	0.6%	3.0%	0.4%
Total debt securities	78.0%	74.1%	78.0%	72.0%
Infrastructure debt	4.0%	4.5%	4.0%	4.5%
Commercial real estate loans	6.5%	3.6%	6.5%	3.5%
Cash and cash equivalents	6.0%	12.1%	6.0%	15.0%
Investment property	5.5%	5.7%	5.5%	5.0%
Total investment holdings	100.0%	100.0%	100.0%	100.0%

Finance review *continued*

Investment holdings and yields

	2021			2020		
	Allocation (£m)	Income (£m)	Yield (%)	Allocation (£m)	Income (£m)	Yield (%)
Investment-grade credit ¹	3,721.1	70.9	1.9%	3,736.6	76.2	2.1%
High yield	342.1	17.5	5.1%	349.0	18.7	5.1%
Investment-grade private placements	91.2	2.4	2.5%	103.9	2.7	2.6%
Credit	4,154.4	90.8	2.2%	4,189.5	97.6	2.3%
Sovereign	35.7	0.1	0.2%	25.5	0.7	1.1%
Total debt securities	4,190.1	90.9	2.2%	4,215.0	98.3	2.3%
Infrastructure debt	250.8	4.4	1.7%	264.5	5.8	2.1%
Commercial real estate loans	200.8	6.1	2.9%	206.7	6.7	3.3%
Cash and cash equivalents ²	896.5	0.1	0.0%	1,168.2	2.6	0.2%
Investment property	317.0	14.5	4.8%	292.1	13.7	4.7%
Equity investments ³	6.2	–	0.0%	3.2	–	0.0%
Total Group	5,861.4	116.0	1.9%	6,149.7	127.1	2.1%

Notes:

1. Asset allocation at 31 December 2021 includes investment portfolio derivatives, which have a mark-to-market asset value of £14.2 million included in investment-grade credit and £0.1 million in sovereign debt (31 December 2020: mark-to-market asset value of £7.7 million and £0.3 million 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. An insurtech-focused equity fund which is valued based on external valuation reports received from a third-party fund manager.

At 31 December 2021, total investment holdings of £5,861.4 million were 4.7% lower than at the start of the year. Total debt securities were £4,190.1 million (31 December 2020: £4,215.0 million), of which 2.1% were rated as 'AAA' and a further 54.7% were rated as 'AA' or 'A'. The average duration at 31 December 2021 of total debt securities was 2.5 years (31 December 2020: 2.8 years).

At 31 December 2021, total unrealised gains, net of tax, on available-for-sale ("AFS") investments were £9.0 million (31 December 2020: £83.9 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:

www.directlinegroup.co.uk/en/sustainability/reports-policies-and-statements.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 2021, the sum of taxes either paid or collected across the Group was £885.1 million. The composition of this between the various taxes borne and collected by the Group is shown below.

Total taxes borne

At 31 December	2021 £m
Current-year Corporation Tax charge	102.6
Irrecoverable Value Added Tax incurred on overheads	83.5
Irrecoverable Value Added Tax embedded within claims spend	149.1
Employers' National Insurance contributions	41.0
Other taxes	8.5
Total	384.7

Total taxes borne by tax type (£m)**£384.7m****Total taxes collected**

At 31 December	2021 £m
Insurance Premium Tax	391.1
Value Added Tax	10.1
Employees' Pay As You Earn and National Insurance contributions	99.2
Total	500.4

Total taxes collected by tax type (£m)**£500.4m**


Neil Manser
Chief Financial Officer

Operating review

Motor

“I've got an electric vehicle and need an insurer who will continue to offer a good deal.”

Jane, Motor customer

Motor: key highlights

Own brand in-force policies reduced by 1.9% with an overall reduction in in-force policies of 2.2% to 4.0 million.

Own brand gross written premium reduced by 3.3%, overall gross written premium reduced by 3.5%.

Operating profit of £314.8 million was £48.7 million lower than the prior year, as claims frequency increased to more normal levels, partially offset by stronger prior-year reserve releases.

Gross written premium by channel

	2021	2020
In-force policies (thousands)	3,971	4,061
Of which direct own brands	3,869	3,943
Gross written premium	£1,560.8m	£1,616.9m
Of which direct own brands	£1,515.2m	£1,567.6m
Loss ratio	64.3%	59.8%
Commission ratio	3.3%	3.2%
Expense ratio	24.8%	24.7%
Combined operating ratio	92.4%	87.7%
Operating profit	£314.8m	£353.5m

Overview

In 2021 the UK motor market continued to experience disruption driven by Covid-19 lockdowns. Claims frequency remained below pre-pandemic levels and there were fewer new drivers entering the market. Alongside the implementation of the Government's Whiplash reform in May 2021, these trends resulted in deflationary market conditions. According to the ABI¹, average motor premiums fell by 7% in 2021.

New car registrations were relatively flat year-on-year, with vehicle manufacture being impacted by a global shortage of semiconductors. However, there was an acceleration in registrations of plug-in hybrid and fully electric vehicles which is good for the industry, the consumer, and the environment.

Claims severity inflation increased in 2021, particularly for damage claims, reflecting the increasing sophistication of car technology as well as the UK's new international trading relationships and Covid-19 related effects, such as second-hand car prices and additional cleaning costs.

Note:

- <https://www.abi.org.uk/news/news-articles/2022/02/2021-motor-premium-tracker/>

Performance

Motor in-force policies reduced by 2.2% to 4.0 million compared to 2020, with own brand in-force policies down by 1.9% at 3.9 million. Gross written premium reduced by 3.5% to £1,560.8 million in the same period, with Motor own brand average premium reducing 2.5% during 2021.

There were two major trends in the motor market during 2021. Firstly, against the backdrop of deflationary market conditions driven by claims frequency remaining below pre-pandemic levels and the impact of the Whiplash reforms, we remained disciplined and focused on maintaining target loss ratios. Secondly, following the implementation of the Motor platform we saw improved competitiveness, enabling us to hold policy count flat across H2 despite our average premiums² reducing 2.5% in 2021 compared to the market reducing 7%.

We offered premium refunds to customers where miles driven were expected to be lower than anticipated at policy inception. In particular, we continued our "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.

Motability: Strengthening our Motor capabilities

We are planning for providing insurance to customers of the Motability scheme from H2 2023. The scheme provides mobility to over 640,000 disabled people and their families allowing them to lease a new car, powered wheelchair or scooter. Our digital capabilities and strength in vehicle repair, particularly our focus on being able to repair electric vehicles and future motor technologies, are a great fit for Motability Operations' fleet of around 625,000 modern vehicles.

Motor's current-year attritional loss ratio rose 6.3 percentage points to 72.9% (2020: 66.6%) driven predominantly by a reduction in the severity of lockdowns in 2021 compared to 2020. Whilst the Motor current-year loss ratio in H1 2021 was modestly higher than for H1 2020, it increased in H2 as lockdown restrictions were eased and claims frequency increased back to expected levels. In addition, claims severity inflation was slightly above our medium-term 3% to 5% per year inflation expectations during 2021, due to high levels of inflation in second-hand vehicles and additional Covid-19 related cleaning costs. Our vertically integrated business, including the largest insurer-owned networks of vehicle repair centres, has continued to provide us with a competitive advantage and mitigate some of this inflationary pressure.

In total, prior-year reserve releases were £26.5 million, higher year-on-year at £127.1 million reflecting primarily, favourable development of large bodily injury claims reserves as uncertainty arising from Covid-19 and Brexit reduced.

Overall, Motor's reported combined operating ratio increased by 4.7 percentage points to 92.4% (2020: 87.7%). A 1.8 percentage point increase in prior-year reserve releases was offset by a 6.3 percentage point increase in the current-year attritional loss ratio. There were marginal increases in the expense ratio and the commission ratio.

Note:

- Average incepted written premium excluding IPT for Motor direct own brands for the year ending 31 December 2021.

Operating review *continued*

Home

**“Policy was
a great price
and website
very easy
to follow.”**

Michelle, Home customer

Home: key highlights

Total in-force policies 1.1% higher at 2.7 million. Own brand policies were 2.3% higher at 1.9 million, as retention remained high whilst new business grew across both direct and PCW channels.

Total gross written premium was stable at £578 million. Own brand gross written premium was 1.2% higher.

Total operating profit was £40.4 million higher than 2020, following a reduction in claims from weather events and an increase in prior-year reserve releases.

Gross written premium by channel

	2021	2020
In-force policies (thousands)	2,667	2,638
Of which direct own brands	1,879	1,837
Gross written premium	£577.8m	£577.9m
Of which direct own brands	£416.7m	£411.6m
Loss ratio	50.7%	55.6%
Commission ratio	6.9%	8.1%
Expense ratio	22.5%	23.4%
Combined operating ratio	80.1%	87.1%
Operating profit	£141.8m	£101.4m

Overview

In the first half of 2021, the stamp duty holiday on property sales led to a buoyant new business market in home insurance. The shift towards buying home insurance through price comparison websites continued.

Towards the end of 2021, the market became increasingly competitive in advance of the implementation of the new FCA Pricing Practices Review regulations. This led to premium deflation as many insurers attempted to grow policy count ahead of the new rules coming into force on 1 January 2022.

According to the ABI¹ the average premium for combined, buildings only and contents only cover were stable in 2021.

There were a couple of named weather events in 2021. Storm Christoph brought exceptionally wet weather to North Wales and Northern England in January. In November a windstorm, Storm Arwen, affected thousands of homes across Scotland, Northern England and parts of Wales, leaving many homes without power.

Note:

1. <https://www.abi.org.uk/news/news-articles/2022/02/2021-motorpremium-tracker/>

Performance

In-force policies for Home's own brands increased by 2.3% compared to 2020 to 1.9 million policies. Retention levels remained high, whilst new business sales grew across our direct channels reflecting improved competitiveness in a strong new business market in H1. The market became increasingly competitive across H2 as we approached the implementation of the Pricing Practices Review regulations. Against this deflationary backdrop, we maintained our discipline in relation to new business particularly in the PCW channel.

Own brands gross written premium increased by 1.2%, whilst overall gross written premium remained stable between 2020 and 2021. Partnership volumes reduced by 1.6%; Prudential and Sainsbury's partnerships are closed to new business and continued to run off in line with expectations.

Own brands average premium¹ reduced by 1.6% compared to 2020, reflecting a change in mix towards lower risk policies, alongside risk-adjusted prices reducing by 1.0%. This followed pricing actions earlier in the year to capitalise on a buoyant new business market and to support retention, more than offsetting underlying inflationary price increases.

The current-year attritional loss ratio, excluding major weather event claims, was 3.0 percentage points higher than prior year at 55.7% as we took pricing actions to

Supporting customers during Storm Arwen

Storm Arwen brought widespread disruption across the UK at the end of 2021 and we responded to those who needed assistance, increasing the number of call centre agents available and on one day during this period answering close to 3,500 calls, which was eight times as many as the number of calls usually received.

support retention and to capitalise on a buoyant new business market in H1, alongside some large fire claims and freeze events. The reported loss ratio was 4.9 percentage points better than 2020, with increases in prior-year reserve releases, following favourable experience on escape of water, flood, storm and fire perils, and a reduction in major weather claims more than offsetting the increase in attritional loss ratio. Claims severity inflation remained within our 3% to 5% medium-term expectations and claims frequency remained within normal levels.

The commission ratio of 6.9% was 1.2 percentage points lower than in 2020 due to lower profit share payments to partners.

Home's combined operating ratio improved by 7.0 percentage points to 80.1% (2020: 87.1%). This was driven primarily by a 6.4 percentage point improvement as a result of higher prior-year reserve releases and a 1.5 percentage point improvement resulting from fewer major weather events, as well as improvements in commission and expense ratios, offset in part by an increase in the current-year attritional loss ratio. Normalised for weather, the combined operating ratio was 5.1 percentage points better than for 2020 at 85.2% (2020: 90.3%).

For 2022, it is expected that the normalised combined operating ratio will return to levels similar to the 2020 normalised performance.

Note:

1. Average incepted written premium excluding IPT for Home own brands for the year ending 31 December 2021.

Rescue and other personal lines

“Once I reported the breakdown I was frequently kept updated. A mechanic arrived in a short time and sorted the problem.”

Geoffrey, Rescue customer

Rescue and other personal lines: key highlights

Gross written premium by product

The Group's direct Rescue brand, Green Flag, grew in-force policies by 5.8% and gross written premiums by 6.3% in the year.

Total in-force policies and gross written premium reduced by 0.7% and 9.0% respectively, primarily reflecting lower premium from Travel, offset by higher premium in Green Flag.

Operating profit of £64.8 million included £55.0 million (2020: £51.2 million) profit for Rescue.

	2021	2020
In-force policies (thousands)	7,056	7,105
Of which Green Flag direct	1,179	1,114
Gross written premium	£380.0m	£417.8m
Of which Green Flag direct	£88.3m	£83.1m
Loss ratio	50.2%	61.7%
Commission ratio	11.4%	16.4%
Expense ratio	25.3%	23.9%
Combined operating ratio	86.9%	102.0%
Operating profit	£64.8m	£6.8m

Overview

Rescue

The new business market remained below pre-pandemic levels throughout 2021, in part due to Covid-19 related lockdowns.

Claims frequency also remained below pre-pandemic levels, benefiting from benign weather and was broadly in line with 2020.

Travel

As a result of the Covid-19 pandemic, non-essential international travel from the UK was illegal between January and May 2021. However, the demand for travel insurance increased during the second half of 2021 as travel restrictions were eased, although the volume of travel remained below pre-pandemic levels.

Pet

It has been reported that at least 3.2 million households¹ have acquired a pet since the start of the pandemic, with around 12 million dogs and 12 million cats¹ now living in UK homes. This has driven increased demand in the Pet Insurance market.

Note:

1. <https://www.bbc.co.uk/news/business-56362987>

Performance

The combined operating ratio for Rescue and other personal lines improved by 15.1 percentage points to 86.9% (2020: 102.0%) due to the non-repeat of the 2020 Covid-19 related claims in Travel and to improvements in Rescue.

Rescue

Rescue in-force policies increased by 0.5% to 3.4 million and gross written premium increased by 2.0% to £170.0 million compared to 2020.

Green Flag Rescue continued to grow its higher average premium direct business during 2021, increasing in-force policies by 5.8% to 1.2 million and gross written premium by 6.3% to £88.3 million compared to 2020. 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 2.1% and 2.3% respectively.

In 2022, Green Flag is developing its customer proposition. As a result, the amount new customers pay will be split between premium and a service fee, which could result in up to approximately £10 million being recognised as other income instead of premium.

Making travel insurance digital

Since March an additional 1.7 million of our travel customers have been offered the convenience of managing their insurance digitally as our partner Nationwide was switched over to our Aquarium travel system. Amongst the advantages offered to those choosing to upgrade their policy is the ability to make a claim for items such as a lost bag whilst still abroad without having to speak to an adviser.

The combined operating ratio for Rescue of 74.8% was 1.7 percentage points better than 2020's ratio of 76.5%. This reflected an improved expense ratio, due predominantly to reduced marketing expenditure, and a lower commission ratio following lower profit shares with partners.

Other personal lines

Other personal lines (comprising Travel, Pet and other) in-force policies reduced by 1.8% to 3.6 million compared to 2020 primarily due to reductions in travel partnerships volumes. Gross written premium for Other personal lines decreased by 16.4% with reductions across all lines except policies tailored to mid- to high-net worth customers, where premium levels grew by 7.0%. In Travel, gross written premium was down 31.1% reflecting lower upgrade premium, lower partnership volumes and reduced partnership pricing that reflected lower claim expectations in 2021.

Other personal lines combined operating ratio improved by 21.7 percentage points compared to 2020 to 96.8%. The improvement is primarily due to the non-repeat of 2020 Covid-19 related claims in Travel.

Commercial

“The main reason I renewed my policy was the way my claim was dealt with.”

Peter, Commercial customer

Commercial: key highlights

Total gross written premium increased by 15.0%, with direct own brands increasing by 14.8%.

Strong performance in both Direct Line for Business and Churchill as they continued to focus on micro business tailored propositions.

NIG and other gross written premium grew by 15.1%, continuing to benefit from improvements arising from re-platforming of its products, including Vans, on its electronic trading platform.

Gross written premium by channel

	2021	2020
In-force policies (thousands)	871	811
Of which direct own brands	602	560
Gross written premium	£653.0m	£567.8m
Of which direct own brands	£187.4m	£163.3m
Loss ratio	54.5%	51.4%
Commission ratio	20.0%	18.7%
Expense ratio	21.7%	25.4%
Combined operating ratio	96.2%	95.5%
Operating profit	£60.4m	£50.4m

Overview

The SME commercial market saw premium increases across all property and casualty products, with significant increases in certain sectors, while motor rates stayed low. There was an increase in risk sharing between insurers as they sought to limit exposures alongside strong market conditions and high inflation. Consolidation in the broker market showed no signs of abating and brokers continued to seek out good service and efficiencies from key partners.

Small, entrepreneurial businesses were more aware of the need for insurance following the disruption caused by the Covid-19 pandemic. Insurance demand from tradespeople began to grow as pandemic-related restrictions were lifted.

There was a marked increase in home-based start-ups and the continued move towards buying insurance online, which helped to drive growth in the direct channel.

The commercial market was also impacted by the storms that swept across the UK during 2021 (see Home section for more details).

Performance

Commercial in-force policies of 871,000 increased by 7.4% compared with 2020, reflecting strong growth in both Commercial direct own brands and NIG and other. Commercial gross written premium grew by 15.0% to £653.0 million (2020: £567.8 million).

Commercial direct own brands grew in-force policies by 7.5% and gross written premium increased by 14.8% to £187.4 million, with increases across all Commercial direct product lines. We continued to see the benefits of our technology transformation driving growth in SME trading on both the Direct Line for Business platform and Commercial's Churchill brand.

NIG and other in-force policy numbers were 7.2% higher than in 2020 and gross written premium grew by 15.1% to £465.6 million. This reflected growth across all major categories as the book continued to benefit from improvements arising from the re-platforming of its products, improved pricing sophistication and growth on its award-winning electronic trading platform.

The current-year attritional loss ratio in Commercial increased by 2.4 percentage points to 62.0% in 2021 due, predominantly, to elevated large fire claims partially offset by an improvement in underlying loss ratio in motor and liability.

Commercial growth

Our Commercial business has introduced new systems architecture delivering a step change in the way our business performs. Our data and modelling teams have reduced the amount of time spent on data collation and preparation, focusing more on pricing analysis and insight.

We have increased the suite of models available from 15 to over 90, improving pricing accuracy and driving the growth seen in 2021.

Total prior-year reserve releases increased by 8.1% to £61.4 million (2020: £56.8 million).

Overall, the combined operating ratio for Commercial increased by 0.7 percentage points to 96.2% (2020: 95.5%), with the 3.1 percentage point increase in reported loss ratio and a 1.3 percentage point increase in commission ratio partially offset by a 3.7 percentage point decrease in expense ratio reflecting good cost control.

Sustainability

Building a sustainable business

In 2021 we continued to embed initiatives with greater confidence across our five-pillar sustainability strategy. We are aiming to take the long-term decisions that deliver benefits for our business and wider society. Looking after customers, employing great people and ensuring they flourish, tackling climate change, operating within a strong society and having a reputation for high standards of governance are not nice-to-haves, they are foundations of our future success.

Sustainability pillars

Customers	People	Society	Planet	Governance
Earn our customers' trust by demonstrating how we are acting in their 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.
Our customers are at the heart of everything we do. Our reputation for excellent customer service contributes to winning new business, and delivering on that customer service year-on-year is why we have high rates of customer retention. Ensuring we continue to see the high levels of customer satisfaction in the interactions they have with us is critical to our future success.	Our business depends on having the best people delivering the best service for customers. Our increasingly diverse workforce gives us insights and perspectives that allow us to understand and serve our diverse customer base. Having a reputation for excellence as an employer, that is matched by the experience of working for the Group, allows us to attract, recruit and retain the people we need.	As a business, we benefit from strong local communities where people and businesses flourish. Our stakeholders want us to make a positive contribution to the society around us. Our vision is to be a force for good; the ways in which we deliver on this area include the tax contribution we make, the charitable donations we give, the volunteering we undertake and the campaigns and policy debates to which we lend our expertise.	Tackling climate change requires everyone to play their part. As an insurer we are passionate about our role, whether it is reducing our carbon footprint as the UK economy transitions to a net zero future, providing insight on weather-related events such as flooding and storm damage, or developing products that make it easier for customers to go green.	Being able to demonstrate exemplary governance is of increasing importance in attracting both customers and investors. In the future, maintaining our reputation for high standards of business conduct, meeting our legal obligations and behaving ethically will be essential to doing business successfully.

Transforming our business for the better

We are very proud to have produced our second ever Sustainability Report in 2021, highlighting the progress made across our five sustainability pillars.

> Read our 2021 Sustainability Report
at https://www.directlinegroup.co.uk/2021_Sustainability_Report

The sustainability priorities of our stakeholders and business

When we created our sustainability strategy two years ago, our work was informed by an analysis of the issues affecting our business and a survey of our stakeholders' opinions as to the relative importance of each of those issues. The stakeholders included customers, suppliers, investors, commercial partners, non-governmental organisations and policymakers. The diagram below highlights the priorities identified within each sustainability pillar.

Our sustainability strategy is always evolving to meet future challenges and we are committed to enhancing our approach, so that we take into account the expectations of external stakeholders and the needs of the business.

United Nations Sustainable Development Goals

The United Nations created a number of Sustainable Development Goals ("**SDGs**") in 2015 focused on achieving a better and more sustainable future for all. The goals address numerous global issues such as fighting inequality, helping to end poverty and tackling climate change.

Aligned with our sustainability pillars, we contribute to several of the SDGs through our work across the Group.

Customers	People	Society	Planet	Governance

External ratings, memberships and benchmarks

We support various initiatives aligned to our five pillar sustainability strategy, including a range of external partnerships where we play an active role and also receive performance ratings.

The Carbon Disclosure Project is a globally recognised platform measuring reporting performance and this year the Group achieved a B- rating based on 2021 activity.

We were again ranked as an ESG leader out of all companies assessed in the Property and Casualty insurance sector and maintained our top decile position in the broader insurance industry group of 261 companies.

Our rating was upgraded from 'A' to 'AA' in 2021. We were recognised for our improvement in underwriting practices, our focus on climate change as an emerging risk and climate risk modelling, our efforts to integrate ESG principles into our investment decisions, alongside some of our HR initiatives.

We were awarded the EcoVadis Gold medal for Sustainability Performance in 2021. The Group is in the top 10% of companies rated by EcoVadis in the Insurance, reinsurance and pension funding (except compulsory social security) industry.

We support the Get Nature Positive campaign, focused on restoring nature and biodiversity. In line with this aim, we announced a partnership with the nature recovery charity Heal, providing a £3 million loan facility that can support the purchase of two initial sites.

As part of HRH The Prince of Wales's Sustainable Markets Initiative, we signed up to the Terra Carta Charter, supporting a roadmap towards a sustainable future, harnessing the power of nature, innovation and resources of the private sector. We are an active participant in the Sustainable Markets Initiative Insurance Taskforce.

We support the UN-backed Race To Zero campaign and are committed to tackling climate change by setting Science-Based Targets to a 1.5°C emissions scenario.

We are a supporter of the Social Mobility Pledge which encourages organisations to support social mobility through access, outreach and recruitment initiatives.

We are a signatory to HM Treasury's Women in Finance Charter. We are proud that the majority of our Executive Committee are women.

Customers

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

We are one of the UK's leading insurers, providing general insurance products to millions of customers through our well-known brands, including Direct Line, Churchill, Privilege and Green Flag.

Our aim has always been to understand customer expectations, anticipate future trends and deliver exceptional service, underpinned by a quality claims service, because this is how we hope to earn trust and customer loyalty. It is one part of how we are striving to make a sustainable business.

Net Promoter Score

We maintained a strong Net Promoter Score in 2021 and our performance over the last few years has shown that customers are willing to recommend our Direct Line brand to others.

Net Promoter Score¹ – Direct Line brand

Customer Pillars

Expectations

Manage and exceed my expectations

Ease

Make it as effortless as possible for me

Fix-it

Identify the issue, own it and fix it

Trust

Earn my trust

Personalisation

Treat me like a real person and not like a process

Empathy

Understand me and work hard to build a relationship

Note:

1. Please see Net Promoter Score KPI on page 31 for further information.

Mileage refunds

From the start of Covid-19 we have been clear we wanted to do right by our customers, so we have taken a number of steps in response to the changes we've seen in driving behaviour.

During the first lockdown in 2020 we offered refunds to all Motor customers, recognising significantly reduced driving levels due to the restrictions and in 2021 we did the same again.

Our Direct Line customers continue to benefit from our Mileage MoneyBack offer, where they can get money back if they drive less than the expected mileage they registered when taking out the policy¹.

For our other Motor brands, Churchill, Privilege and Darwin, customers have been offered refunds which could either be paid to them or donated to charity. Our customers were outstandingly generous and their combined donations led to significant sums being donated to NSPCC, Mind and UK Sepsis Trust.

£411k	£381k	£167k
NSPCC	Mind	Sepsis Trust

Supporting customers

CONNECT training

We have an established training programme called CONNECT to help our consultants respond with empathy to differing customer needs, while also taking responsibility and accountability. This is particularly important for customers who may be experiencing issues such as illness, bereavement or vulnerability. Based on the CONNECT training, those people who successfully demonstrate high levels of customer service receive a certificate of accreditation from the Institute of Customer Service. In 2021, over 1,700 of our customer-facing and support staff have received new additional training to recognise, engage and support our vulnerable customers.

"In 2021, over 1,700 of our customer-facing and support staff have received new additional training to recognise, engage and support our vulnerable customers."

Bereavement team

We are proud of our established team of consultants who are skilled in dealing with queries when someone loses a loved one because we know that managing financial matters can be the last thing on people's minds following a death. All queries are dealt with sensitively and in one place, to provide peace of mind at a difficult time for customers.

Recognising differing customer needs

We know some customers find it difficult, upsetting or simply time consuming to disclose their vulnerability each time they are in contact with us. That's why we ask them if they are happy to have details of how best we can support them recorded on our system. If they agree, we tag their record with a heart, so colleagues dealing with that individual in the future know to read the details of the specific case and the support that may be required. If someone says they do not want it recorded on their file, we don't record it.

Green Flag

In our Green Flag business we offer roadside rescue and recovery services, recognising that some customers require assurance that we are on the way. Our customer-facing teams therefore actively prioritise customers who might need immediate support, such as lone or vulnerable travellers on the roadside at night or families with young children.

Building a quality claims experience

In a normal year, we handle around 1 million claims, fix approximately 200,000 cars and pay out claims totalling in the region of £1.8 billion.

To make claiming easier we are increasingly digitalising the customer journey, providing peace of mind when our customers need it most:

- **100%** of Motor and Home claims can now be registered online
- **Reducing the time to settle** total loss claims in our Motor business by developing our own in-house damage evaluation tool that identifies how best to support customers by either fixing their vehicle or providing a cash settlement
- **Whole process online** for simple Home claims so customers can complete their claim without needing to call us if they don't want to

Note:

1. At the end of the policy year, once they are sent their renewal invite, the customer is required to submit a new mileage reading. The mileage driven is then compared to the estimated mileage on the policy with a 2% refund for every 1,000 miles driven under the estimate up to a maximum of 20%.

Sustainability *continued***Communicating clearly with customers**

In line with our company behaviour to 'Encourage simplicity', this year we collaborated with Plain Numbers, an organisation which aims to change the way numbers are presented to improve comprehension, particularly for vulnerable customers.

In the Plain Numbers trial alongside the Bank of England and other major companies, we used the Plain Numbers approach to reduce technical language, define complex terms more simply, and place numbers that were less important further down a page to avoid confusion.

The trial showed that using the approach improved the number of people who could understand individual communications.

We are now reviewing the results and beginning to consider how some of the changes can be added into the current design of documents to help customer understanding and will be looking to train staff in the Plain Numbers approach.

We are also evaluating changes across the multiple channels we use and the online content we produce, to ensure that communications and language are clear across the Group.

People

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

At DLG we believe that the best way to serve our customers is by having the best possible people. Our millions of customers have individual needs and we know that we will understand them better if our workforce reflects that diversity.

It's why we work hard to attract, develop and retain excellent people from a diverse range of backgrounds. We do this by offering rewarding and enjoyable careers, with the scope to learn new skills, contribute new ideas and work with great colleagues.

We look after our people and reward them for their hard work with a generous range of benefits.

Supporting our people through the pandemic

Across 2021 we continued to support our people through the pandemic. From working at home, to ensuring as safe an environment as possible for those colleagues who continued to physically come into work, from allowing people time off for vaccinations, to offering flexibility for those having to home-school and then working to make time in the office feel secure. We've been supporting and caring for each other every step of the way.

A diverse workforce

We are proud to be one of only four companies in the FTSE 350 that has both a female CEO and a female Board Chair¹. This year the diversity of our Executive Committee has been transformed; its composition is now six women and five men. Two of our Executive Committee are from a minority ethnic background. You can't be what you can't see, so we hope our diverse leadership team will inspire more colleagues to aspire to the top roles.

But we know that inspiration is not enough, which is why we are offering our people the practical support they need to succeed and removing barriers to their success.

We have introduced new recruitment principles for senior roles, including anonymised CVs², a stronger focus on diverse shortlists and panel-based assessment to help protect against bias.

"This year the diversity of our Executive Committee has been transformed; its composition is now six women and five men."

Notes:

1. Source: <https://www.gov.uk/government/news/sea-change-in-uk-boardrooms-as-women-make-up-nearly-40-of-ftse-100-top-table-roles>
2. Anonymised CVs do not apply to Executive Committee and Board Roles.

Sustainability *continued***Our values****Do the right thing**

Build sustainable outcomes not processes. Think commercially and choose the right path for our customers, our people and wider stakeholders.

Aim higher

Be ambitious to achieve even better results. Have confidence, innovate and try new things. Embrace change to deliver for each other, our customers and our shareholders.

Take ownership

Own our success by getting things done. Take the initiative and be accountable. Be curious and own your development and performance.

Say it like it is

Challenge drives progress. Your input matters so have the courage to say what you think and the patience to listen to others. Keep it simple and customer-focused.

Work together

Nobody has all the answers. Collaborate and draw upon the diverse skills across our business. Trust each other and focus on customer outcomes to win against our competitors.

Bring all of yourself to work

Diversity delivers better outcomes. Be the real you and celebrate difference. Respect others, have fun and make this a great place to be.

Bring your whole self to work

We know we will never be an inclusive and diverse workforce if people don't feel free to be themselves. That's why "bring all of yourself to work" is one of our core values. To bring this to life we have a thriving Diversity Network Alliance (DNA), run by our people, with communities of colleagues that champion diversity and inclusion within our business.

This year each strand has delivered an extensive programme of activity to build greater empathy and understanding around the things that matter to the communities they represent.

This has included people stories, vodcasts, panel discussions and external speakers, which have helped to raise awareness of issues and drive more open conversations.

REACH (Race, ethnicity, and cultural heritage)

Neurodiversity and Disability

Belief

Social Mobility

LGBT+

Thrive (gender)

Life (working families and carers)

The Inclusive Top 50 UK Employers List

This year we were listed 13th on the Inclusive Companies Top 50 UK Employers List, which recognises those companies that promote inclusion throughout each level of employment within their organisation.

The Charter for Faith & Belief Inclusion

In 2021 we signed up to The Charter for Faith & Belief Inclusion, which aims to help create understanding between people of different faiths and beliefs and a society which is fair to people of all backgrounds – religious and non-religious.

Gender

Our long-term focus on investing in women means we have been able to significantly strengthen representation at the most senior levels of our business. Our Women in Finance figures, FTSE Leaders figures and breakdown by levels within the organisation each cut the data in different ways.

Women in Finance

Having achieved our Women in Finance target for 30% of women in senior leadership roles back in 2019 we chose to push ourselves further by targeting reaching 35% by the end of 2022. At the end of 2021, representation of women in senior leadership roles has risen to 32.8%.

FTSE Women Leaders Review

Last year we exceeded the Hampton-Alexander Review's 2020 target for FTSE 350 companies to have at least 33% representation of women on their Board and in their Executive Committee and direct reports. We are pleased that for 2021, we have reported 40% women on our Board and 40.5% women in leadership roles in the FTSE Women Leaders Review, placing us 18th in the FTSE 250 and 3rd in life and non-life insurance sector¹ and meeting the new FTSE Women Leaders Review recommendations on gender balance and women in the most senior board and leadership roles.

Senior women representation (%)

Pay Gap Reporting

Our gender pay gap continues to be low compared with the broader financial services sector, but we know there is still more to do. We're comfortable that we don't pay people differently because of their gender and believe that the way to reduce the gap in the medium- to long-term is to take concerted action now to address the disproportionate representation of women across certain areas and levels of the business.

This year we announced that from 2022 we will also voluntarily publish our ethnicity pay gap, showing the difference in average pay between our ethnic minority and white colleagues across the whole organisation.

Notes:

1. Board representation at 10 January 2022 and Executive Committee & direct report representation at 31 October 2021 as per FTSE Women Leaders Review data sourcing
2. Percentage of women in roles reporting directly to ExCo, excluding administrative and support staff.
3. Percentage of women in roles two reporting levels below ExCo, excluding administrative and support staff.

Ethnicity

Across 2021 we have continued to focus on delivering the targets we set ourselves in 2020 to increase ethnic minority and Black representation in leadership by the end of 2022 (leadership roles are defined and fixed as those above a certain level in our internal grading structure). We know more needs to be done and are committed to building on progress year on year:

- **Growing ethnic minority representation from 10% to 13% – increasing roles at this level by around a third**

At the end of 2021, representation of ethnic minority colleagues in leadership roles has risen to 11.7%.

- **Growing Black representation from 0.5% to 1.5% – quadrupling roles at this level**

At the end of 2021, representation has increased to 0.9% of Black colleagues in leadership roles.

To hold ourselves to account internally, we produced a specific report detailing the steps the Group has taken across 2020-21 towards "Building a diverse business; improving Black inclusion" in October to coincide with Black History Month.

In addition we have signed up to:

Business in the Community's Race at Work Charter, which commits us to act and take positive action towards supporting ethnic minority representation and inclusion.

The If Not Now, When? campaign for Black inclusion within business, calling for organisations to commit to sustainable and long-term actions on Black inclusion in the workplace.

The 10,000 Black interns programme, which aims to transform the prospects of young Black people across the UK through paid internships across a range of industries. We will be welcoming our first interns in Summer 2022.

The 5% Club

This year we joined the 5% Club, committing that within five years 5% of our workforce will be apprentices, graduates and sponsored students.

Sustainability *continued***Gender diversity of our board****Gender diversity of senior leadership**

Gender diversity of senior leadership figures based on 2021 Women in Finance reporting

Gender diversity of all employees

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

Ethnicity of all employees

Excludes 8.4% of colleagues who have not submitted an option for ethnicity

> For more information on leadership gender diversity, including gender diversity of the Board see page 114

Looking after our people**Mixed model working**

During the pandemic, the Group moved quickly to enable over 9,000 of its staff to work from home. Over the following 18 months we learnt that we can serve our customers effectively and deliver big transformation projects while giving our people the flexibility they've told us they want.

Therefore we have chosen to move to a mixed model that combines remote working with using our offices in a different way. Trusting our people to get the job done wherever they are working from. From September 2021, our people have been able to come into the office for collaboration, training and team building and continue to log on from home to do computer and phone work. We believe this offers our people the best of both worlds and it helps to maintain the culture our people enjoy.

Early careers

We have always been a great place for people to start their career. We now want to build on the early career opportunities it offers, playing our part in improving the career prospects and enhancing the skills of the UK's young people.

Making Flexible Work Charter

This year we signed up to the Association of British Insurers 'Making Flexible Work' Charter because we know one size does not fit all. We are actively looking at

how we can build on the flexible options we already offer.

Mental health

We strongly encourage our people to be open about how they feel and that's never been more important than during Covid-19 with all the additional pressures and concerns that have arisen. We have a cohort of colleagues who are trained as mental health first aiders that people can reach out to, as well as a confidential external service that they can call for help, support and advice.

Employee Representative Body (ERB)

Our ERB meets regularly, has an engaged membership and is much valued by our people. It brings colleagues together from across the business to discuss and input into proposals and initiatives that may affect our future and impact our people. It also offers the opportunity for individuals, via their ERB reps, to feed in their views and suggestions. More information on the work of the ERB can be found in the Corporate Governance report on pages 109 and 111.

Pensions

We want to support our people to save for their retirement. That's why all our people are offered an additional 9% on top of their salary a year to go into their pension.

Rewarding our people

Our people work hard on behalf of our customers so it's only right they should receive proper financial reward for their contribution. In 2021 salary increases were awarded of between 1.5% to 2% and, in addition, a £400 one-off "thank you" bonus was given in April 2021 to everyone who is not usually eligible for a bonus.

In April 2021 all eligible colleagues received £350 of free shares, making this our sixth award of free shares since 2012. These shares are now worth £2,059 or £2,888 inclusive of dividends received¹.

Minimum salaries

We strive to ensure that our colleagues are rewarded for the contribution they make to our success. While we seek to ensure the pay proposition is good for all our people, we have shown a clear commitment to lifting the salaries of our lowest-paid colleagues. We have done this through ensuring the minimum pay ranges are ahead of the National Living Wage and the Real Living Wage.

During 2021 the minimum salary was £19,500 for a 37.5 hour week. This was 11% above the Government's statutory National Living Wage (April 2021 figure for those aged 23 or over), and 5% above the Living Wage Foundation's Real Living Wage (November 2020 figure for roles outside London).

The business has announced that from 1 April 2022 our minimum salary will rise by 6.7%, seeing pay for a 37.5 hour week rise to £20,800². This will be 12.3% above the Government's statutory National Living Wage (April 2022 figure for those aged 23 or over), and 7.7% above the Living Wage Foundation's Real Living Wage (November 2021 figure for roles outside London). In keeping with our learning culture the decision has also been taken that apprentices will be paid our minimum salary rate from that date³.

Human rights

As we work to become increasingly sustainable we want our people to both flourish and to build a reputation for ethical business and this drives our commitment to have employment practices and policies that exceed those in the Universal Declaration of Human Rights. We are committed to ensuring modern slavery is not present in our supply chain. Our risk profiling, including specific requirements within our due diligence and assurance processes, incorporates the Modern Slavery Act 2015.

Listening and responding to our people

It's important to us to understand how our people are feeling so we can take action, which is why we conduct regular employee engagement surveys. This year we have improved our capability by bringing in a new survey platform which provides enhanced functionality. This has made it even easier for colleagues to give feedback and for people leaders to understand the results.

In response to 2021 survey findings, we have focused on supporting a successful transition to mixed model working by:

- **Creating an intranet hub** which provides our people access to all the practical guidance and support materials they need for a successful transition to mixed model working. It is regularly updated with new information in response to colleagues' requirements
- **Delivering new technology bundles**, direct to colleagues' homes, equipping them with the right tools to work at their best, both at home or when on the move
- **Keeping people involved and in touch** and building a real sense of connectivity with ExCo members, participating in regular interactive "ask anything" sessions including virtual townhalls, business update calls and getting to know you online 'cuppas'.

Notes:

1. Based on the share price at 31 December 2021.
2. Subject to satisfactory performance and excluding apprentices in DLG Auto Services who receive different rates of pay.
3. DLG Auto Services apprentices will receive a different level of pay for the course of their apprenticeship.

Society

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

We know that being a force for good means more than just providing great customer service. Our stakeholders expect us to make a positive contribution to the society around us and we do this in many ways, whether it is the causes our Community Fund supports, the campaigns we run on issues like social mobility, or the tax contribution we make.

As a business we aim to have a wider impact on the communities we serve and society as a whole. This has been particularly important in 2021, as many people continued to live with the impact of Covid-19. In response, colleagues across the business have found new ways to support families and individuals via our Community Fund, driven by our Diversity Network Alliance ("DNA") and Community and Social Committees ("CASCs").

"Our colleagues across the business have found new ways to support families and individuals via our Community Fund, driven by our Diversity Network Alliance and Community and Social Committees."

This year we have made further progress on our social mobility journey and in driving inclusion for left-behind groups. We have provided chances for young people still at school to broaden their understanding of the opportunities available within financial services, offering more apprenticeships as a route in, and helping our Social Mobility Employee Network to provide support, broaden understanding and advocate for change.

Social Mobility Action Plan

Getting In, Getting On, Getting Ahead

In partnership with the Social Mobility Pledge, we launched our Opportunity Action Plan setting out a series of recommendations the Group can implement to strengthen our contribution to addressing social mobility within the UK. Recommendations included:

- Targeting efforts towards areas around the Group's sites with the widest inequalities and maximising remote working opportunities
- Utilising our Community Fund to prioritise social mobility causes in partnership with charities and organisations that aim to make positive change
- Monitoring and tracking employee data to understand potential barriers for colleagues and gain better insight into how people are progressing to senior positions within the Company
- Evaluating over time how the Group's actions can be measured to quantify impact

Targeting social mobility cold spots

Coming out of the pandemic we want to harness the benefits of remote working, because we recognise we can offer opportunities in areas of the country where we have traditionally been unable to recruit. At the start of the year we piloted a remote customer service apprentice scheme, targeting social mobility cold spots in Derby, Mansfield, Hastings and Crawley where we relaxed traditional recruitment criteria so that we assessed candidates on panel-based assessment, rather than on professional experience.

Social mobility insight days

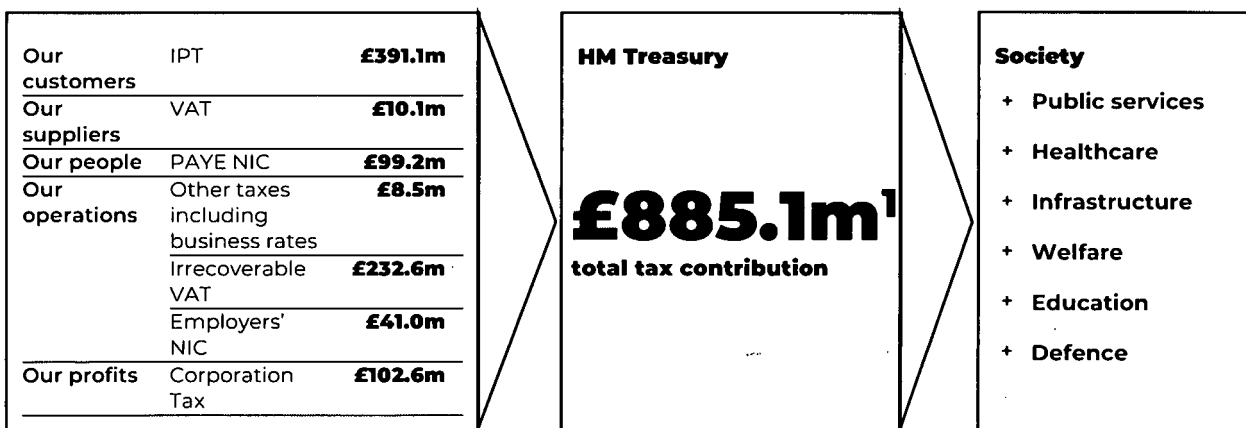
Building on the success of last year, we held two insight days in 2021 in conjunction with the Social Mobility Business Partnership and the Social Mobility Foundation, for bright students from less-advantaged backgrounds, to break down barriers around careers in insurance and to develop their skills.

We've also partnered with Teach First and Envision to support training and provide mentoring through colleagues across our business.

Read more about our Opportunity Action plan at www.directlinegroup.co.uk/en/sustainability/our-society/

Our 2021 tax contribution

We ensure that we are compliant with all applicable tax laws and regulations and that we meet our responsibilities both as a contributor of corporate taxes and as a collector of taxes on behalf of HMRC. For 2021, our total tax contribution was £885.1 million which included the Group's direct and indirect taxation.



Note:

1. The Group's total tax contribution in 2021, including direct and indirect tax contributions.

Community Fund 2021

Our Community Fund has gone from strength to strength in 2021. We continued to work with a number of the charities where we had pre-existing relationships and forged new partnerships by addressing three priority areas:

1. Marginalised Groups and Loneliness

13%

56%

2. Mental Health and Wellbeing

3. Food Poverty

31%

Some of the charities and organisations we have donated to are:

Kids Out

We delivered over 300 laptops and tablets for 100 refugees throughout the UK. The funding supports vulnerable schoolchildren, many of whom have fled domestic violence and on average spend at least three to four months in refuge accommodation where over 50% do not attend school for fear of meeting their abuser. Colleagues also dedicated their time to call refugees and identify what individual sites' needs were so they could receive the right equipment.

Sepsis Trust

We helped raise awareness of the condition sepsis through our customer newsletter which reached over 2 million people. Amazingly, one of our customers recognised the signs in her partner after reading the newsletter and he managed to receive lifesaving treatment as a result of our partnership.

DNA strands

We empowered our DNA network to nominate several charity partners to support, helping us to bring to life the 'personal and inclusive' element of our vision. In total, £100,000 was distributed to a number of organisations.

> [Read more about our DNA Strands on page 62](#)

Sprintathon

We continued to support Stand up to Cancer with colleagues completing as many 100m legs of a 400 metre track as possible within an hour. In total, we raised over £125,000 to help accelerate life-saving research and cancer treatments.

£1.5m

given out in 2021

£225k

donated for laptops
and tablets

£120k

for emergency funding
and equipment supplies
in UK hospices

Community Fund 2022

We are incredibly proud of what the Community Fund has managed to achieve over the last two years. It has been a huge success from delivering immediate support to those who needed it the most to empowering colleagues to be at the heart of decision making.

Looking to 2022, we want to capitalise on these building blocks and focus the Community Fund on improving social mobility and driving inclusion in the UK.

NSPCC

During the pandemic, through our Mileage MoneyBack scheme, we offered customers the opportunity to donate their mileage refund to a number of charities including NSPCC. Over the last year our customers gave £411,000 to NSPCC, helping to keep children safe across the country.

Mind

Building on the great work of our partnership from last year, we continued to train mental health first aiders and break down barriers so that colleagues feel empowered to discuss mental health issues. We additionally delivered pro-bono support for Mind's operations and ran a graduate fundraising initiative.

Community and Social Committees

Our employee-led CASCs, which involve colleagues across all of our sites to co-ordinate local volunteering and charitable giving, delivered over £100,000 in funding for IT equipment to schools during the height of lockdown and £100,000 to food banks and local causes during Christmas time.

Green Flag community deliveries

From March 2021, with the support of Business in the Community, our Green Flag recovery drivers have helped to deliver food parcels, laptops and other essential items to families, children, and local councils across the country.

Planet

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

We view the climate emergency as a race to find solutions. Across the business we are focused on climate risk mitigation and playing our part in accelerating the transition to a low-carbon future. There are three steps to our plan:

Greenhouse gas emissions (tCO₂e)^{1,2,3}

Energy consumption (kWh)^{2,3}

	2021	2020
Electricity	14,856,315	16,669,842
Gas	24,286,023	21,699,765
Total	39,142,338	38,369,607

Step 1

Disclose to track progress

We have done a lot of work to understand where the most carbon-intensive areas of our business are, because only by understanding and reporting our carbon footprint can we find solutions.

We have measured and disclosed our Scope 1 and 2 emissions and certain Scope 3 emission categories since 2013. In recent years, we have expanded the categories we report under Scope 3 to include some of the Green House Gas Protocol categories which are material to our business operations. We have also measured and disclosed our Supply Chain emissions since 2020 and this year, for the first time, we are disclosing our Homeworking emissions in recognition of more colleagues working from home.

In regards to progress made, we have:

- Reduced our energy consumption by 45% since 2013⁴
- Procured 100% renewable electricity for our operations since 2014
- Diverted 100% of our office waste from landfill

We are focused on providing greater transparency and want to now go further in our disclosures which is why we report our office, accident repair centre and supply chain emissions to guide our carbon reduction strategy going forward.

Step 2

Commit to tangible actions

Target setting

We have committed to set Science-Based Targets for Scope 1, 2 and 3 emissions via the Science Based Targets initiative ("SBTi") and this year joined the Race to Zero because we recognise our role in taking a leadership position as we reduce emissions. It means we will set targets in line with a 1.5°C emissions scenario where we are aiming to achieve net zero emissions by 2050 at the latest.

As we work to set targets, the most carbon-intensive areas of our business – our accident repair centres, supply chain and investments – are already starting to put in place plans.

Establishing Strategic Management Actions

In 2021, we established the following Strategic Management Actions which business areas are now prioritising:

- **Electric vehicles** – improving our capability and understanding to support the transition to EVs.
- **Supply chain** – implementing a Supply Chain Sustainability Programme to engage and influence suppliers.
- **Flood resilience** – engaging with policymakers on the importance of flood defences and helping to shape thinking around resilient repairs.
- **Underwriting footprint** – evaluating the impact of climate change on our underwriting footprint so that we can manage risks to our business and help inform strategic decision making.

> Read more about DLG Auto Services on page 74

Step 3

Offset while we reduce

We know that it will take time to reduce emissions and facilitate the transition to net zero, whilst we enhance our approach to sustainability across the Group and set Science-Based Targets.

Last year we took the step to become a carbon neutral business by offsetting our Scope 1 and 2 emissions as well as elements of our Scope 3 emissions under our direct control by partnering with ClimateCare, an organisation that is dedicated to tackling climate change and improving lives by financing, developing and managing carbon reduction projects across the world.

From November 2020 to November 2023, we've pledged support to carbon offsetting projects which will deliver high social impact benefits to communities and environments in three countries.

> See page 73 for more information on our offsetting projects

Notes:

1. Total Scope 1 and 2 emissions. The 2020 result of 11,697 tCO₂e differs from the reported result of 12,137 tCO₂e in the 2020 Annual Report and Accounts following recalculation.
2. 100% of the GHG emissions and energy consumption reported relates to operations all of which are based in the UK.
3. Data is reported in compliance with the SECR requirement to disclose annual global GHG emissions and annual global energy consumption (see page 87).
4. Reduction in energy consumption is reported on a like-for-like basis.

Sustainability *continued*

Group emissions

We believe accurate measurement and transparency can guide the business in making targeted interventions as part of our carbon reduction strategy. We implemented a number of test and learn activities, and continue to innovate and explore a range of solutions. We have provided a comparison of emissions data for Scope 1, 2 and 3 with greater clarity of the activities under our direct control, as well as our supply chain emissions. 100% of the emissions reported relates to operations all of which are based in the UK. The data is reported in compliance with the SECR requirement to disclose annual global GHG emissions (see page 87 for more information).

Definitions

Scope 1: This covers direct emissions from owned or controlled sources. For example, our office sites throughout the UK using gas boilers, the paint booths in our Auto Services sites currently relying on gas powered processes and our fleet vehicles.

Scope 2: These are indirect emissions. They are emissions associated with the production and transmission of energy we eventually use as a company across our office and Auto Services sites. For example, the production of the electricity we buy to heat and cool our buildings generates emissions.

Scope 3: These are indirect emissions that occur in the value chain to support our company operations. For example, employee commuting, activities related to the disposal of waste and the goods and services we purchase to fulfil customer claims as part of our supply chain. It will also include our investment portfolio which we are currently evaluating as we work to set Science-Based Targets.

Reporting methodology

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.

Our carbon emissions are calculated by an external third party and reviewed internally. The calculation method used for 2021 remains consistent with prior periods and with the reporting standards stated above.

Scope 1	2021		2020		2019 baseline	
Office sites ¹	1,220		1,339		1,881	
Auto Services ¹	6,777		6,472		7,838	
Total (tCO₂e)¹	7,997		7,811		9,719	
Scope 2	2021		2020		2019 baseline	
	Location-Based ²	Market-Based ²	Location-Based ²	Market-Based ²	Location-Based ²	Market-Based ²
Office sites	1,372	0	2,176	0	4,516	0
Auto Services	1,783	0	1,710	0	2,093	0
Total (tCO₂e)	3,155		3,886		6,609	
Total Scope 1&2 (tCO₂e)¹	11,152		11,697		16,328	
Of which: office sites (tCO ₂ e) ¹	2,592		3,515		6,397	
Of which: Auto Services (tCO ₂ e) ¹	8,560		8,182		9,931	
Scope 3 emissions under our direct control	2021		2020		2019 baseline	
Fuel and energy related activities	2,586		2,332		2,465	
Waste generated in operations	474		413		1,245	
Business travel – air travel	28		198		928	
Business travel – hotel night stays	34		75		469	
Business travel – rail	29		63		410	
Employee commuting ^{3,4}	5,962		1,450		4,599	
Of which: homeworking emissions ⁴	5,501		–		–	
Upstream leased assets ⁵	110		63		193	
Upstream transportation and distribution of auctioned vehicles	655		625		912	
Total (tCO₂e)	9,878		5,219		11,221	
Total emissions under our direct control (tCO₂e)^{1,6}	21,030		16,916		27,549	
Scope 3 – supply chain	2021		2020		2019 baseline	
Total procured goods and services (tCO₂e)⁷	217,062		144,114		249,929	
Direct Line Group carbon footprint (operational control)	2021		2020		2019 baseline	
Total (tCO₂e)¹	238,092		161,030		277,478	
Of which: under our direct control ^{1,4}	21,030		16,916		27,549	

Notes:

- The 2020 Scope 1 total of 7,811 tCO₂e (office sites: 1,339 tCO₂e, Auto Services: 6,472 tCO₂e) differs from our previously reported figures of 8,251 tCO₂e (office sites: 1,432 tCO₂e, Auto Services: 6,819 tCO₂e) in the 2020 Annual Report and Accounts following recalculation.
- 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.
- 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.
- In line with the GHG Protocol standards our homeworking emissions are reported under the Scope 3 category 'Employee Commuting'. Prior period measurement is not available.
- 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.
- Total of Scope 1 & 2 emissions and Scope 3 emissions under our direct control.

Intensity metric

We monitor the intensity metric of emissions¹ 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.

Year	Emissions per £ million of net earned premium ²
2021	3.8
2020 ³	4.0
2019	5.5
2018	5.4
2017	5.5
2016	6.4
2015	7.7
2014	9.1
2013	9.5

Notes:

1. Scope 1 and 2 emissions.
2. 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.
3. The 2020 result of 4.0 differs from the previously reported result of 4.1 in the 2020 Annual Report and Accounts following recalculation of our Scope 1 emissions (see footnote 1, page 72).

Offsetting projects

We supported three high-impact projects in Kenya, Bangladesh and Brazil to reduce carbon and support communities for a cleaner future. Over the last year, activity has progressed on all these projects, as they have not only reduced emissions, but delivered a range of benefits for people and planet.

Water filters, Kenya

We have provided funding which has helped the continued manufacture and distribution of Aqua Clara water filters.

Our support has contributed to the provision of over 8 million litres of safe water to Kenyan schools and households and is enabling future growth of the programme through further training and expanding distribution.

Clean cookstoves, Bangladesh

Through our support of this Gold Standard-verified project, we have contributed financing to subsidise the manufacture, distribution and after-sales support of Bondhu Chula cookstoves throughout local communities in Bangladesh, improving air quality and lowering household costs.

Our help has contributed to the distribution of almost 6,000 cookstoves, lowering fuel costs and improving household air quality for over 25,000 people.

Rainforest protection, Brazil

Our financial assistance for this project is helping to provide benefits to the local ecosystem by providing jobs in forest conservation and training in agroforestry techniques, in addition to protecting multiple vulnerable species that live within the region.

Local communities are empowered by offering land use and tenure rights in exchange for positive conservation results. This provides access to loans from development banks in Brazil, which can deliver a transformative impact on the area.

Notes (continued):

7. In accordance with the GHG Protocol under which we report, the following are excluded from the total:
 - a. operational control activities already detailed under 'Scope 3 emissions under our direct control';
 - b. cash payments to customers or other insurance companies / legal firms as compensation;
 - c. intragroup transfers between our operating companies for financial accounting purposes as the actual purchase of goods and services to our third-party suppliers is already captured; and
 - d. reinsurance costs to third-party reinsurers as this is a financing transaction.

Sustainability *continued***DLG Auto Services**

Direct Line Group writes close to 4 million in-force motor insurance policies, and customers are supported by our 22 Auto Services accident repair centres throughout the UK. We have the largest insurer-owned body shop business in the UK, and operate a partnership network with other body shop suppliers around the country.

Our Auto Services are fundamental to our claims and supply chain operation, but we also recognise they are one of the most carbon-intensive areas of the business. We are exploring a range of solutions to embed our environmental goals as part of our emissions reduction strategy:

Moving away from reliance on gas powered repair processes

Paint booths that currently rely on gas could be switched to electricity derived from renewable sources. We are trialling this in our Birmingham site.

Taking advantage of innovative products

Working collaboratively with commercial partnerships can realise environmental benefits. For instance, new paint technologies might reduce or remove the need to cure paint used on vehicles, thereby reducing energy consumption.

“As a major UK motor insurer we believe our ‘green’ USP should be to insure and fix electric vehicles, while aiming to do this in the most energy-efficient repair network in the UK.”

Green parts

Offering customers the option of ‘green’ parts could reduce the need for new replacement parts. It could also provide confidence about what can be recycled from salvage operations if motorists select this option when fitting parts to their vehicle.

Using alternative fuels

Testing the viability of alternative fuels, such as hydrogenated vegetable oil (“HVO”), to power recovery trucks which play an important part in servicing customer motor claims.

Energy-efficient lighting

Introducing LED lighting is more energy efficient and is preferred by our technicians who can see jobs more clearly. Our Weybridge site is enabling energy savings of up to 60% and a reduction in maintenance costs over a projected lifespan of 10 to 20 years.

Continuing with our energy efficiency activities

This year we continued to invest in energy-efficient measures in both our office estate and our Auto Services sites. In particular:

- We've continued with the project to replace the gas heating system in Bromley with a new Variable Refrigerant Flow ("VRF") and Smart Cool Energy-saving devices. The VRF system is a fully electric heating and cooling system delivering a 36% energy efficiency compared to the old gas boilers and electric chillers;
- Replaced the Fan Coil Units ("FCUs") in our Leeds Wharf office with new energy-efficient FCUs delivering an improved energy efficiency of 57%;
- Installed Power Factor Correctors in our Crawley Auto Services site to maximise the efficiency of our electrical supply onsite, delivering energy efficiency of 13%. This was a successful trial, and the plan is to assess the power efficiency of the rest of the Auto Services sites this year; and
- We're trialling hydrogenated vegetable oil ("HVO") in our recovery trucks at our Stechford Auto Services site delivering a GHG emissions reduction of over 90% compared to diesel.

In comparison, last year the delivery of energy-efficient activities in our office and Auto Services sites was heavily impacted by the Covid-19 pandemic. However, we delivered the following energy efficiency projects in 2020:

- New air conditioning and LED lighting systems and environmental sensors in the Bromley office enabling a reduction in gas usage and better maintainability; and
- New and more efficient LED lighting systems in our Birmingham and Glasgow offices, as well as sections of our Doncaster office, and at the Weybridge Auto Services site.

Giving back to the planet

This year we became a supporter of the Get Nature Positive campaign where we will play our part, alongside other likeminded companies, to restore nature and biodiversity.

We also announced a partnership with the nature recovery charity Heal, providing a £3 million loan facility that can support the purchase of their initial two sites.

Our investments

All external investment managers are signatories of the United Nations Principles for Responsible Investment ("UN PRI"), which ensures that Environmental, Social, and Governance criteria is integrated into the investment process. For investment-grade corporate bond portfolios, as an added measure we require that managers maintain an average MSCI ESG rating of "A" or higher.

As part of our Group commitment to set Science-Based Targets, we are also required to set targets for in-scope asset classes in the investment portfolio which is a key initiative for 2022. We have committed that the investment portfolio will be net zero emissions by 2050 and have developed a climate framework for corporate bond portfolios that was initiated in 2021 and includes the below criteria and commitments:

- A 50% reduction in weighted average greenhouse gas emission intensity for corporate bond portfolios by 2030 versus a FY2020 baseline;
- A requirement for portfolios to be tilted towards companies taking Positive Climate Action ("PCA")¹;
- The exclusion of any companies with a low-carbon transition score indicating assets could be economically stranded;
- The exclusion of companies involved in thermal coal activity, either mining or power generation at greater than 5% of revenues²;
- In support of our RE100 membership, no investment in firms opening new thermal coal mines or power stations; and
- Managers instructed to prefer investments in green bonds where the risk return characteristics are similar to conventional bonds.

In setting Science-Based Targets, we recognise that some of the existing investment portfolio targets may need to be amended, or new targets added, in order to meet the criteria set.

Using our influence

Using our influence to be a force for good, we played an active role in a number of climate-related groups where we contributed to a number of cross-sector solutions. These include:

- Electric Vehicle Fleet Accelerator
- ABI Climate Change Roadmap
- Sustainable Markets Initiative

Notes:

1. PCA firms are those that have either committed to set Science-Based Targets for emissions reduction or have a 2 degree or better carbon performance alignment from the Transition Pathway Initiative. Portfolio tilt refers to a requirement that the market weight of portfolios to companies taking PCA should be greater than respective benchmark weight and is a requirement for all portfolios except two active strategies where a slightly lower threshold is required.
2. Waivers are granted for issuers that generate greater than 5% of revenue from thermal coal activity if they are taking PCA or if the particular bond issuance is defined as a green bond.

Task Force on Climate-related Financial Disclosures

Introduction

We welcome the reporting framework established by the Task Force on Climate-related Financial Disclosures ("TCFD"). The framework continues to enhance our reporting as we make further progress on our approach to evaluating and managing climate-related risks and opportunities and as we strengthen our strategic response to one of the biggest challenges facing the world today.

The Group has complied with the requirements of Listing Rule 9.8.6R by including climate-related financial disclosures consistent with the TCFD recommendations and recommended disclosures including the supplemental guidance for all sectors and insurance companies (see pages 76 to 87).

Governance

Our approach

The Group's approach to the governance of its sustainability strategy is underpinned by our Vision and Purpose (see page 23) and a clear commitment from the Board and senior management to align sustainability goals with the Group's strategy and encourage accountability across the business.

Our five-pillar sustainability strategy, endorsed by the Board, aims to foster the highest standard of Environmental, Social and Governance 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").

Boards 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 requiring robust governance to empower business areas in the management of climate-related risks and opportunities.

It starts with the Group's Board, which seeks to underpin all of the Group's activities with the highest standards of corporate governance. The Board has oversight on two key aspects of the Group's approach:

- 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.
- 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.

2021 highlights

- **Joined the Race to Zero**, committing to set Science-Based Targets that reduce our emissions based on a 1.5°C pathway.
- **Launched our first electric vehicle insurance package**, supporting the transition to a low-carbon economy and making it easier for customers to insure electric vehicles.
- **Announced our Supply Chain Sustainability Programme**, outlining our plan for the next ten years to engage and influence suppliers so we can make the transition to a pathway consistent with a 1.5°C scenario.

Committees

- The **Audit Committee** meets a minimum of four times a year and is responsible for overseeing the Group's financial statements and non-financial disclosures, including any climate-related financial disclosures.
- The **Board Risk Committee** oversees all aspects of financial, regulatory and operational risk, including the long-term risk to the Group from climate change. It meets a minimum of four times a year and receives reports on stress testing of long-term climate change scenarios, discusses strategies for managing the associated risks and considers emerging risks twice a year, recently involving a review of climate change.
- The **Sustainability Committee** supports the strategy by scrutinising progress against the plan to ensure that our Planet, People and Society pillars' activity continues moving forward. It meets a minimum of four times a year.
- The **Investment Committee** meets a minimum of four times a year and considers the strategy for incorporating ESG factors into the Group's investment management which has seen our credit portfolios tilted to issuers with higher sustainability weightings.
- The **Nomination and Governance Committee** meets a minimum of three times a year, monitoring the Board's overall structure, size, composition, and balance of skills. This Committee also works to understand and integrate investors' ESG expectations.

The Group's **Sustainability Committee** considers the work of the Planet pillar, alongside the Group's wider sustainability strategy. The Committee has taken a keen interest in the process towards setting Science-Based Targets, external activity undertaken by the Group to influence climate debates including the ABI's Climate Change Roadmap and the Sustainable Markets Initiative Insurance Task Force. The Committee has also discussed prominent public policy challenges such as flooding and accelerating the transition to electric vehicles.

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 CFO is responsible for overseeing the implementation of 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 Investment Committee and the CEO, CRO and the Director of Investment Management & Treasury are attendees.

To support the Sustainability Committee's oversight and in recognition of the Group's increased focus on climate-related activity the Group formed a **Climate Executive Steering Group** which reports into the Sustainability Committee. Chaired by Tim Harris, our former CFO, the Climate Executive Steering Group consists of members representing various teams from across the business to assess potential impacts of climate change with the aim of ensuring risks are identified and managed effectively. The Steering Group's responsibilities include:

- prioritising the Group's focus on preparation for submitting Science-Based Targets;
- overseeing input in the Group's business development and strategic processes to make sure climate is given appropriate consideration in long-term strategy and planning; and
- considering the risk management challenges presented by climate change including financial risk related to underwriting and investments.

Group Audit

Group Audit provides 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 climate-related reviews.

Strategy

There is strong empirical evidence and scientific consensus that human activity is causing an increase in global temperature. The impact has far-reaching implications for economies and societies around the world. If further warming was to continue the physical and economic impacts that could result may be significant, with the extent of these impacts dependent on the action taken to tackle climate change.

The insurance industry is not immune and for general insurers there are specific risks and opportunities at play. We want to contribute to a long-term sustainable future and know that through our actions as a business we can contribute to climate risk mitigation.

As a major motor insurer, we recognise our position in the motor eco-system and that we have a part to play in reducing the impact motor vehicles have on climate change.

The adoption of electric vehicles continues to increase and we are providing our customers access to insurance solutions that support this transition. In 2021, we released our first ever electric vehicle insurance package for new Direct Line policyholders (see page 81), a proposition that makes it easier for customers to insure electric vehicles, while aiming to fix them in the most energy-efficient repair network in the UK.

Our new electric vehicle proposition is only one of a number of initiatives that are now underway across the organisation, supporting our aim of protecting our business from climate change and giving back more to the planet than we take out.

Climate change risks and opportunities

We recognise that the long term and forward-looking nature of climate-related risk is complex to manage, and that the risk the Group is exposed to could vary in materiality depending on product, business area or investment. The specific impacts of climate change on our business fall into three broad categories:

- **physical risks and opportunities** resulting from the physical effects of climate change;
- **transition risks and opportunities** arising from the transition to a lower-carbon economy; and
- **liability risks** arising when parties who have suffered losses from climate change seek to recover them from those they believe may have been responsible.

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.

Task Force on Climate-related Financial Disclosures *continued*

Whilst such risks can create uncertainty that we must continue to manage, we also recognise the transition to a low-carbon future creates opportunities to help accelerate the transition and contribute to a sustainable economy. For more information on how we are mitigating risks and harnessing opportunities across our underwriting, operational and investment activities see pages 81 to 83.

During 2021, we took action to examine how we define the time horizons relating to climate risk and opportunity. We consider the following to broadly describe the climate-related risks and opportunities impacting the Group over the short, medium and long term. We have aligned the time frames closely to pathways representing possible future climate-related scenarios over a thirty-year plus time horizon. Specific issues alongside the associated time horizons are discussed throughout the TCFD disclosure.

Short (1 – 10 years) The frequency and severity of natural catastrophes and other weather-related events in the UK could increase, adversely impacting insurance liabilities. The speed of transition to a low-carbon economy could also increase, supported by changes in technology and policy, including the planned ban of new petrol and diesel car sales in the UK from 2030, as announced by the UK Government in November 2020. Throughout these initial stages of transition, we intend to ensure product offerings and capabilities provide insurance solutions that best meet our customers' evolving needs, for example, as seen through the launch of our electric vehicle insurance package for new Direct Line customers in November 2021. On page 81 we report the key risks and opportunities relating to our underwriting activities which includes how we view the potential impacts the transition to electric-powered vehicles could have.

Medium (10 – 30 years) The transition towards a low-carbon economy continues to prompt a strategic and operational response. As consumers become more widely impacted by the transition and further changes in policy and technology are implemented we may see changes to risk nature and profile, and more acute weather-related events in the UK could occur if global temperatures were to continue rising (see page 81 for more information). We aim to enable consumers access to insurance that supports low-carbon choices and that reflects the green transition shift by utilising data and capability generated in the earlier stages of transition. We also plan to reduce climate-related risk exposure in our investment portfolio, which includes the target of ensuring our entire investment portfolio is net zero emissions by 2050 (see pages 83 and 86).

Long (30+ years) If further warming was to continue and no action taken to curb the longer-term impacts of climate change on our planet, the physical impacts could intensify. If chronic risks such as changes in precipitation patterns and extreme variability in weather-related events were to occur, we could see significant changes in the Group's underwriting criteria to maintain risk appetite. We may also see a shift in dynamics within the markets we operate and invest in, creating both risk and opportunity.

Financial planning

We acknowledge that there are risks posed by climate change that could potentially have impacts on financial performance and financial position.

As an underwriter, we actively measure climate-related risk through climate risk modelling due to the nature of the Group's products (see page 84). Climate risk is also integrated into the Group's overall approach to risk management (see page 84). We also undertake scenario analysis to enhance management of longer-term climate-related financial risks (see pages 79 and 80).

We recognise our prices, products and operations will evolve as climate change influences manifest themselves through changing loss patterns, however, a failure to understand the scale of change in market demand for products and services due to climate-related policy, technology and consumer preference, could have adverse impacts on revenue.

We are already experiencing increased climate-related operating costs and capital expenditure, seen, for example, through the ongoing investments we make to reduce the overall GHG emissions in our office estate and repair centres. We are aware, however, of the longer-term benefits such investments can bring in enhancing operational efficiency and resilience whilst also reducing impact on the environment.

Our financial investments represent one of the largest assets on our balance sheet. The impacts of potential physical and transition risks arising in the wider economy could have an impact on our investment portfolio, through their influence on the value of assets. See pages 83 and 86 for further information on how we are integrating climate-related considerations into our long-term investment management strategy to develop resilience against this risk.

As the potential for increasing adverse physical impacts due to climate change exists, we, as a general insurer, are aware that insurance liabilities could be impacted as more acute, and potentially more chronic, weather-related events are experienced in the UK. Approaches to understand this impact further are discussed throughout the TCFD disclosure.

Establishing Strategic Management Actions

Alongside science-based target setting we have also established Strategic Management Actions which business areas are now prioritising. These include actions on electric vehicles, our supply chain, flood resilience and underwriting footprint. For more information please see page 71.

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. The move to low-carbon vehicles, particularly electric-powered cars, also presents new challenges from which the Group could benefit, for example creating innovative products that enable consumers access to insurance solutions that support the transition to a low-carbon economy. We summarise a number of risks and opportunities in the table below relating to our underwriting activities, and highlight key action and assessment taken in 2021 against these.

INBOUND

Impact of climate change on the Group

- The frequency and severity of natural catastrophes and other weather-related events could be affected by climate change and impact insurance liabilities.
- The way we price property underwriting risk due to changes in building codes or standards could be affected.
- Liability loss could arise as people suffer losses from climate change.
- The transition to electric-powered vehicles could have significant strategic and operational impacts, including fundamental changes to the profile of accidents and the nature of risks, supply chain and repair processes.
- Understanding the transition to electric-powered vehicles provides an opportunity to contribute to and benefit from the transition to a greener future. This will ensure optimum risk assessments influence pricing decisions, safeguard efficient repair process in our accident repair centres and help develop new products and propositions for our customers.
- Climate change creates an opportunity to enhance our risk-modelling expertise and help strengthen our pricing decisions.

OUTBOUND

The Group's impact on the environment

- Remaining active participants in developing solutions to influence the debate on weather-related events provides 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.
- Issuing communications on preventative measures customers can take could reduce claims numbers.
- 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 commercial opportunities.
- Integrating electric vehicles into our fleet of courtesy cars to support customer awareness of electric vehicle capability.
- Developing products and propositions that could encourage a reduction in emissions and open up potential commercial opportunities, for example our "Mileage MoneyBack" proposition.
- Monitoring consumer attitudes to green products and develop insurance solutions that best meet our customers' evolving needs and accelerate the transition to a low-carbon future.

Key Group action 2021

In 2021, we continued to explore the potential longer-term climate-related underwriting risk, and how we can support the transition to a low-carbon economy through underwriting activities.

As a participant in the Bank of England's 2021 CBES exercise, we gained extensive insight into the potential impact of modelled climate scenarios on our insurance liabilities over a thirty-year period; this has also expanded our capabilities to enhance in-house scenarios specific to our own risk profile and most material aspects of our business (see pages 79 and 80).

In our Motor business, we announced a new partnership with Motability Operations Ltd which is due to take effect from 2023 (see page 8). The Motability Scheme helps over 640,000 individuals gain access to mobility with lease terms on most vehicles being three years. Over the course of the 10-year partnership we expect the number of electric vehicles we insure to grow significantly, providing valuable underwriting data, insight and capability into the future of vehicle technology and repair, crucial for building long-term strategic resilience against key transition risks.

Demonstrating our commitment to developing insurance products that can support the transition to a low-carbon economy, in Q4 2021 we announced our first 'green' motor insurance solution, launching a fully electric vehicle insurance package to new Direct Line customers (see below).

Making electric easy

Our Direct Line brand is working to make electric easy for our motor insurance customers, offering all new business customers access to a bundle of electric vehicle essentials as well as insurance that covers batteries and charging cables. The bundle includes discounted access to public and community charging, discounted home charger installation, help with grants and discounted parking for electric vehicles*. Our customers also benefit from our repair expertise via our network of body shops.

- * One bundle per Direct Line motor policy, available to new customers only who buy between 28/10/2021 and 31/10/2022. Free bundle provided by Zoom EV for 12 months from activation and validation of Zoom EV account.

Task Force on Climate-related Financial Disclosures continued

Operations

Given the scale of our operations we are all the more determined to ensure action is taken to reduce our impact on the environment. To support this, we are setting clear, transparent and science-based emission reduction targets, improving the way individual business areas operate and exploring the way we leverage our relationship with suppliers. Our operations are also exposed to physical and transition risks, such as possible disruption to direct operations due to the physical impacts of climate change, and we could also see a rise in operating costs through carbon cost increases and regulatory requirements designed to limit GHG emissions. We summarise a number of risks and opportunities in the table below relating to our operations, and highlight key action and assessment taken in 2021 against these.

INBOUND

Impact of climate change on the Group

- Operating costs could rise due to potential carbon cost increases, regulatory requirements designed to limit carbon emissions and as a result of failure to improve operational efficiencies. This would drive the need for more aggressive energy reduction measures across the Group.
- Frequency and severity of natural catastrophes and other weather-related events could impact direct operations leading to business interruption.
- 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.

OUTBOUND

The Group's impact on the environment

- A failure to set long-term emission reduction targets for business operations could see energy consumption increase.
- Investing in energy-efficient features and equipment across our office estate and accident repair centres provides the opportunity to reduce energy consumption, which could otherwise increase.
- Improving operational efficiencies can save on energy consumption particularly in our roadside rescue and recovery business and in our repair centres.
- Encouraging employees to make environmentally conscious decisions can enhance education, increase recycling rates and save on consumption over the long term.
- Once validated, our new Science-Based Targets will ensure we have a clear and transparent route to further reduce and monitor our Scope 1, 2 and 3 emissions.

Key Group action 2021

In 2021, we remained committed to reducing the impact of our operations on the environment and continued to make progress to mitigate the impact physical and transition risk could have on our operations.

At the end of 2020 we announced our commitment to set science-based reduction targets for our Scope 1, 2 and 3 emissions via the SBTi and in 2021 we continued to make progress against this. Working with environmental consultancy Carbon Intelligence, we plan to submit the targets to the SBTi for their independent validation in 2022.

We also joined the Race to Zero in 2021, taking a leadership position as we reduce GHG emissions. It means we will set targets in line with a 1.5°C emissions scenario where we are aiming to achieve net zero emissions by 2050 at the latest. We have also continued to offset the carbon emissions from our operations we can't yet avoid, see pages 71 and 73 for further information.

Throughout 2021, we continued to implement further operational efficiencies and improve long-term operational resilience against climate-related matters. Key action included:

- Launching our **Supply Chain Sustainability Programme**, which outlines our plan for the next ten years to support the reduction of Scope 3 emissions in our supply chain (see below); and
- Embedding new solutions in our Auto Services repair centres by making use of alternative fuels, offering customers the option of choosing 'green' Parts in vehicle repairs and moving away from reliance on gas powered repair processes (see page 74 for more information).

Supply Chain Sustainability Programme

We are using our established relationships and purchasing capabilities through procurement to mitigate our risks by seeking to reduce the emissions in our supply chain. The Group's Ethical Code already sets out our expectations of suppliers that they should support a precautionary approach to environmental challenges, promote greater environmental responsibility and encourage the development of environmentally friendly technologies.

We have launched our Supply Chain Sustainability Programme which outlines our plan for the next ten years. We recognise this will be a gradual process but by acting now we can work with suppliers by signalling our expectations so that we can make the transition to a pathway consistent with a 1.5°C emissions scenario.

Our approach means:

- Engaging with our largest emitting suppliers to encourage them to sign up to SBTi targets or an equivalent.
- Requesting information on what efforts firms have made to measure their carbon footprint across Scopes 1, 2 and 3 and their plans to reduce emissions, including targets.
- Changing our sourcing approach on appropriate contracts by introducing a sustainability rating that will increase over the next ten years, which could exclude prospective suppliers if they have no plans to reduce emissions.

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 will have an impact on our investment portfolio, through their influence on the value of assets. For example, our portfolio is exposed to physical risks through our investment in companies that are exposed to disruption from adverse weather events across their supply chain. It is also exposed to transition risks, where companies that we are invested in are not adapting their strategy to a low-carbon future. However, the transition to a low-carbon economy also creates significant investment opportunities.

We have committed to ensuring our entire investment portfolio is net zero emissions by 2050. In the table below, against the inbound and outbound impacts our investment portfolio brings regarding climate risk, we summarise key climate initiatives started in 2021.

INBOUND

Impact of climate change on the Group

- The impacts of physical and transition risks arising in the wider economy could have an impact on our investment portfolio, through their influence on the value of assets and the potential for certain carbon-intensive assets to become stranded.

OUTBOUND

The Group's impact on the environment

- Working to ensure our climate strategy is aligned with the Race to Zero campaign on climate change, we can reduce the impact of climate risk on our financial assets. The transition to a low-carbon economy will require large scale public and private market investment. This creates opportunities for institutional investors like ourselves to ensure capital is directed to help with the transition.

Key Group action 2021

At the beginning of 2021 we implemented our climate strategy for corporate bond portfolios which represent around two-thirds of assets held. The initiatives are summarised below:

- We have committed that by 2030 the Group will have reduced by 50% the weighted average carbon intensity of corporate bond portfolios (from a 2020 base year).
- Given the need for a phaseout of thermal coal power production (since it's one of the most carbon-intensive forms of energy generation), bond issuers that generate >5% of revenues from thermal coal activity (mining or power production) have been divested unless the company is taking positive climate action.
- We do not invest in companies opening new thermal coal mines or thermal coal power plants.
- Investment within corporate bond portfolios will increasingly be tilted towards companies evidencing they are taking the transition to a low-carbon economy most seriously. These will be companies that have committed to setting Science-Based Targets, or those with a 2°C or better carbon performance alignment from the transition pathway initiative.
- The exclusion of companies with an MSCI Low Carbon Transition Category of "asset stranding".

The actions detailed in the table above form part of the ongoing development of the wider ESG framework underpinning investments. In terms of holding investments in other companies, those with higher reported ESG credentials have more sustainable practices which better align to our investment, environmental and social goals. As such, a requirement of all investment-grade corporate bond portfolios is that each portfolio must maintain a minimum MSCI ESG rating of 'A' or better. Looking through the climate lens, we also have in place the following current initiatives:

- We actively encourage 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 corporate bond mandate guidelines now direct the portfolio manager to purchase a green bond where the risk return characteristics are similar to those of a comparable non-green bond.

- Within our investment property portfolio all assets must have an Energy Performance Certificate of 'D' or better, or a plan and funds in place to achieve that level. The property portfolio also has a tailored set of end 2022 ESG targets covering, inter alia, carbon, energy, water and waste.
- A key objective to enhance further our climate objectives in 2022 is to submit Science-Based Targets for the investment portfolio. The setting and validation of investment targets will form part of our wider application with the SBTi.

Using our influence

We are committed to using our influence to drive wider change. For example, we expect all of our investment managers to be signed up to the UN Principles for Responsible Investment. We also talk regularly to our external asset managers to understand (and where necessary, challenge) how they are using their global presence, size and leverage to engage and encourage corporations to tackle climate change.

Note:

1. Companies taking positive climate action are defined as those that are committed to setting Science-Based Targets or have a 2°C or better carbon performance alignment from the transition pathway initiative.

Task Force on Climate-related Financial Disclosures *continued*

Risk Management

Enterprise Risk Management Strategy and Framework

The Enterprise Risk Management Strategy and Framework sets out the Group's approach to setting risk strategy and for managing risks to the strategic objectives and day-to-day operations of the business. Further information can be found in the Risk management section of the Strategic report on page 89.

Risk taxonomy

The effects of climate change are wide-ranging, affecting many risks across the risk universe. For this reason, the Group reflects the effects of climate change in the drivers of those risks which are defined in the Group Risk Taxonomy rather than adding climate change as a separate risk category. For example, the effects of climate change would be a driver of meteorology risk, which is a subset of underwriting risk.

Risk impact

The impacts of all risks, events and action plans are rated using the Impact Classification Matrix which facilitates a consistent approach to the sizing and categorisation of risk across the Group. This includes those risks relating to climate change, and allows the Group to determine the relative significance of climate-related risks in relation to other risks.

Climate-related risk identification process

Annual risk identification process

Each year, the business is required to review all current and developing risks which could impact on the achievement of strategic objectives. This process includes assessing risk drivers, such as those due to climate change, and their potential impact and likelihood of risk crystallisation on both an inherent and residual basis, in addition to identifying the position which aligns with risk appetite.

Regulatory monitoring

The Group monitors and reviews relevant outputs from the FCA, the PRA, European supervisory authorities (including the European Insurance and Occupational Pensions Authority ("EIOPA")), the European Commission and Her Majesty's Treasury, to consider existing and emerging regulatory requirements.

During 2021, this included reviewing:

- the PRA's launch of the 2021 Climate Biennial Exploratory Scenario on financial risks from climate change;
- the FCA's Policy Statement confirming the introduction of a new comply or explain listing rule requiring companies with a UK premium listing to include a statement in their annual report for accounting periods beginning on or after 1 January 2021 which sets out whether they have made disclosures consistent with the recommendations of the TCFD;
- the HM Treasury roadmap 'A new chapter for financial services', which confirms that the UK Government will implement an integrated Sustainability Disclosures Requirement which will require businesses to disclose their risks and opportunities from, and impact on, the climate and the environment; and
- the minutes of the PRA and FCA's joint Climate Financial Risk Forum.

We continue to monitor future developments and reviews are summarised and distributed to relevant stakeholders, and, where necessary, responses are co-ordinated and overseen by members of Second Line of Defence.

Emerging risk process

In addition to the annual risk review process, the Group has in place an emerging risks process which facilitates the identification, management and monitoring of new or developing risks which are difficult to quantify or are highly uncertain. The Group records emerging risks within an Emerging Risk Register. An update on emerging risk is presented to the Risk Management Committee twice a year, and the Board Risk Committee annually, and is supplemented by deep dives on selected emerging risks.

Climate change is one of the Group's most prominent emerging risks and is owned by the Executive Committee with regular oversight provided by the Climate Executive Steering Group, consisting of First Line of Defence subject matter experts from around the business where the impact of climate change is the highest, in addition to Second Line of Defence subject matter experts who provide oversight and challenge of risk management activity relating to this.

Each emerging risk is owned by an Executive sponsor to help ensure alignment of how it is managed to the strategic objectives and priorities.

Climate risk modelling

The predominant direct physical drivers of risk to the Group's capital position are major UK floods and windstorms. Whilst additional risks such as freeze 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 Management 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. In addition, we purchase risk covers to protect against large individual commercial losses and we make extensive use of Flood Re to cede high flood risk residential properties.

Metrics and targets

We use a variety of indicators across the different lines of our business to assess, monitor and manage our climate-related risks and opportunities.

Underwriting

Weather-related loss impact

The predominant direct physical drivers of catastrophe weather risk from a capital perspective are major UK floods and windstorms. The last peak of windstorm activity was in the late 1980s and early 1990s; the last decade being particularly benign in comparison, by contrast, flood has seen more elevated activity.

Catastrophe reinsurance is purchased annually to protect against event losses greater than £150 million and additional reinsurance cover protects against large individual commercial losses (see page 43). Use of the Flood Re scheme mitigates against the highest individual residential flood risks.

The Group uses sophisticated modelling techniques to determine the expected losses from severe weather events and uses these to set a weather load for budgeting purposes. The following graph shows the impact of severe weather events relative to the weather load; the trend is downwards reflecting recent benign activity, although there is significant variability. The 2018 peak was driven by the 'Beast from the East' freeze event whilst the 2015 peak was a result of a number of weather events in December which caused severe flooding across the UK.

Severe weather losses (actual % of expected loss)

Impact of severe weather on combined operating ratio (pt)

These results can be translated to impacts on the Group's combined operating ratio¹; the relatively benign 2019 year for example improved the Group's combined operating ratio by nearly two percentage points against plan.

The frequency and severity of extreme weather events will be affected by climate change, which in turn will affect our view of risk, how we price severe weather risk, and the type and level of reinsurance we purchase to protect our balance sheet.

Home

Key risk indicators are produced by Underwriting and reviewed quarterly through relevant business forums. The key climate change-related activities are flood, subsidence and weather incidents. For flood and subsidence perils, we monitor the Group's market share for risks deemed to be in the high- or very high-risk segments. We also monitor and review the proportion of policies ceded to Flood Re. Each peril is monitored against set tolerances, with movements in amber or red ratings generating investigation and action as required. We maintain a view of trends and look to take action where a trend is likely to result in a breach of tolerance.

Note:

1. See glossary on page 248 for definition.

Task Force on Climate-related Financial Disclosures *continued*

Subsidence

Subsidence as a peril is a relatively low overall cost, however a subsidence event can be very costly. We monitor this risk via our subsidence market share by geo risk classification. This risk classification aims to give a market view of geographic risk of having a subsidence claim. This enables us to understand the proportion of subsidence risk that we write compared to our estimate of the total in the market.

The classifications take the geographic factors in the subsidence buildings models and not the individual property estimated sums insured.

Flooding

Governments have been working with insurers since 2000 to help make flood risk insurance more affordable. In 2016, a previous solution was replaced with a longer-term plan, called Flood Re. Every insurer that offers home insurance in the UK, the Group included, must pay into the Flood Re scheme. This levy has raised £180 million every year which is used to cover the flood risks in home insurance policies.

To ensure the Group and its customers benefit from the levy and guard against the highest of flood risks, we monitor the volume and proportion of policies we are ceding to Flood Re. Properties are eligible to be ceded to Flood Re when they meet certain criteria. Since early 2019, the cost to cede policies to Flood Re has dropped, driving an increase in ceded volumes.

Motor

The Group's motor market is diversified throughout the UK, and weather-related claims make up a very small part of total motor claims. As such we do not currently consider there to be any valuable climate-related risk indicators that can be tracked for this portfolio.

In order to track the transition towards electric and alternatively fuelled vehicles (such as hybrids), we monitor both the number and proportion of policies we underwrite for these types of vehicles as well as electric vehicle and alternatively fuelled vehicle registration data from The Society of Motor Manufacturers and Traders.

Operational

Our performance to date

We are proud of the progress we have made on reducing emissions and have a record of setting targets to hold the business to account. In 2013 we set two Group-wide environmental targets for our Scope 1 and 2 GHG emissions which we have tracked, reported against and successfully met in 2020. The two targets we set were:

- a 57% reduction in emissions (Scope 1 and 2) on a like-for-like basis by the end of 2020 against a 2013 baseline. In 2021, we saw a 61% reduction in energy-related emissions, which takes into account the impact of Covid-19 where mixed model working measures altered our energy usage; 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 delivered a 45% reduction in energy consumption, which takes into account the continued impact of Covid-19.

Overall, in 2021, we saw an increase in emissions under our direct control compared to 2020, which is explained by an increase in activity in vehicles being repaired in our Auto Services business as a result of Covid-19 restrictions being eased during the year. We have also for the first time this year calculated and included our homeworking emissions under the Scope 3 'Employee Commuting' category in recognition of more colleagues working from home.

Holding ourselves to account in the future: Setting Science-Based Targets across Scopes 1, 2 and 3

We are pleased with the success we have made in reducing our Scope 1 and 2 emissions having met the two targets we set as planned. We now want to go further because we believe transparency can guide the business in making targeted interventions as part of our carbon reduction strategy:

- We continue 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, as well as our supply chain emissions. See page 72 for our 2021 emissions data.
- Throughout 2021, we continued to place an increasing focus on calculating and validating our emissions data across all areas of the business, including our Operations, Supply Chain and our Investments which are embedding plans to reduce carbon footprint.

We are undertaking this activity because we want to enhance our carbon reduction strategy. To go further we are committed to setting Science-Based Targets for Scope 1, 2 and 3 emissions via the SBTi and this year we joined the Race to Zero because we recognise our role in taking a leadership position as we reduce emissions. It means we will set targets in line with a 1.5°C emissions scenario where we are aiming to achieve net zero emissions by 2050 at the latest. We will submit our science-based reduction targets for validation by the SBTi in 2022.

Investments

More than 100 financial institutions have publicly committed to set emissions reduction targets through the SBTi. In 2018, the SBTi launched a project to help financial institutions align their lending and investment portfolios with the ambitions of the Race to Zero campaign. The project audience includes universal banks, pension funds, insurance companies and public financial institutions.

Our long-term goal is for our entire investment portfolio to be net zero emissions by 2050, in line with the aims of the Race to Zero campaign. To support this aim we have an interim target of a 50% reduction in weighted average carbon emissions intensity by 2030 (from a 2020 base year) within our corporate bonds portfolio, the largest asset class within the investment portfolio.

Carbon intensity is the GHG emissions intensity per \$1 million of sales. Normalising by sales allows the investor to compare carbon efficiency of different-sized firms within the same industry and has become a standard metric used in the investment industry.

We will continue to progress towards setting Science-Based Targets for the investment portfolio in line with SBTi's guidance and plan to submit these targets for validation to the initiative in 2022.

Future Group Activity

We want to continue gaining a deeper understanding of how climate change might affect the business, and below we outline the future Group activity to support this.

Governance	We plan to maintain strong Board oversight, ensuring the Planet pillar, as part of our sustainability strategy, continues to take a lead. We will also continue setting the Board's strategic debates in a climate change context, which will be supported by periodic debates on climate-related risks and opportunities. In 2022 we will also incorporate ESG-related metrics into executive management remuneration plans (see page 155).
Strategy	We intend to build further understanding around how we systematically consider climate-related issues from a risk and opportunity perspective across business areas and in our strategic decision making; a key part of how we can achieve this includes driving forward the Strategic Management Actions set in 2021 that business areas are already prioritising (see page 71). Alongside these actions, we also plan to enhance central scenario planning and testing by developing climate-related scenarios specific to our own risk profile. We are also considering how these scenarios could be incorporated into the development of the Group's business plan. We will also be taking part in a second round of the Bank of England's CBES exercise in Q1 2022. This is expected to further explore participants' strategic responses to the climate scenarios published as part of the first round and the associated implications for their business models. During 2022, the Climate Executive Steering Group will maintain its oversight into the Group's business development and strategic processes to make sure climate is given appropriate consideration in long-term strategy and planning. It will also continue to consider the risk management challenges presented by climate change including oversight of the modelling of climate change risk and financial risk related to underwriting and investments.
Risk management	We will continue our robust approach towards the management of physical risk and intend examining in more depth inbound and outbound impacts in order to enhance understanding of transition risks. This includes through the use of central scenario planning as discussed above. 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.
Metrics & Targets	In 2022, we plan to submit our Science-Based Targets to the SBTi for their independent validation. The structured and measurable nature of the emission reduction targets will mean that, once validated, they will formulate the path we must take to ensure we meet our commitment of achieving net zero emissions by 2050 at the latest, which is in line with a 1.5°C emissions scenario.

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	70 and 72
– from buying electricity, heat, steam or cooling by the Group for its own use	70 and 72
Annual global energy consumption in kWh, being the aggregate of:	
– energy consumed from activities for which the Company is responsible	70
– energy consumed resulting from buying electricity, heat, steam or cooling by the Group for its own use	70
The proportion of GHG emissions and energy consumed relating to the UK and offshore area ¹	71 and 72
Methodology used to calculate emissions and energy consumption	72
At least one intensity metric in relation to emissions	73
Description of energy efficiency actions taken	75 and 86 (‘operational’ section)
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.

Environment

	Pages
Journey to net zero	12, 71
Recycling and waste management	70, 82
Science-Based Target initiatives	71
Scope 1, Scope 2 & Scope 3 emissions	72
Sustainable Development Goals	56
Sustainability report	54
TCFD report	76

Anti-bribery and anti-corruption

	Pages
Code of Business Conduct	20, 106
Ethical Code for Suppliers	82, 110
Fraud and money laundering	121, 125
Tax contribution	44, 67
Whistleblowing	125

Employees

	Pages
Diversity and inclusion	12, 61, 115, 128
Employee share incentive scheme	161, 232
Flexible working policy	64, 108
Gender pay gap	63
FTSE Women Leaders Review	63
Health and safety	64, 69
Parker Review	114, 128
Performance, pay and recognition	63, 65, 134
Training and development	59, 114
Workforce engagement	31, 65, 111

Business model

	Pages
Customer complaints	31
Net Promoter Score	31, 58
Pricing Practices Review	27, 28, 94, 108
Prompt payment code	110
Risk management	89
Talent pipeline	18, 114
UK Corporate Governance Code	96, 104
Values, strategy and corporate culture	23, 62, 105

Social and community matters

	Pages
Our Community Fund	68
Social mobility action plan	67
Volunteering	69

Human rights

	Pages
Living wage	65, 135
Mental wellbeing	64, 68
Modern Slavery Statement	65, 110, 131

Risk management

Our aim is to make risk management simple, well understood and embedded. Risk will provide oversight which is pro-active, proportionate 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 risks arising from the strategic plan.

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 rest of 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 has led significant cultural change to drive ownership of risks across the Group. The Group has a strong risk culture, and a mature and embedded Enterprise Risk Management 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 112 for governance structure

Risk appetite

Our risk appetite statements define the opportunities and associated 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 Enterprise Risk Management Framework 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. The risk management framework is designed to manage the Group's risk proactively and to enable dynamic risk-based decision making.

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 pages 84 to 85 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 management *continued*

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 the partial internal model 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.

During the year, Risk has worked collaboratively across the Group to support the embedding of the new ways of working, including working closely with HR, the Agile Centre of Expertise and Group Audit. This activity included ensuring the Enterprise Risk Management Framework remained fit for purpose and efficient, whilst still enabling sufficient Board and Senior Manager oversight.

Risky Road Campaign

Having a good risk culture is critical to the organisation, and we use the Risk Communications Plan to influence a positive risk culture by driving a consistent understanding of risk management and the concept of risk ownership throughout the Group.

Our flagship risk campaign, Risky Road, built on the success of our previous campaigns by exploring risk-based decision making in a novel way, while continuing to remind our colleagues about the important part they play in managing risk.

We created an online computer game that challenged colleagues to guide their Risk Hero through myriad mazes and respond to risk-based questions for a chance to earn points and compete via league tables with people right across the business.

We used a number of communications channels to promote the game and risk management, including a launch video from the Chief Risk Officer, supporting intranet articles, digital advertising and interactive social media posts on Yammer.

The campaign reached a great number of staff across the Group, garnering over 7,000 click throughs and online interactions, and more than 1,500 individual users.

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	
Insurance Risk Relative size of risk Trend over next 12 months – increasing 	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.	Key drivers of the outlook for insurance risk across our strategic plan include reserve, underwriting, distribution, pricing and reinsurance risks. Issues relating to Covid-19, the Pricing Practices Review and claims inflation risk have been a key area of focus for the Group in 2021 and the main driver of the increasing trend in insurance risk. Claims trends have been significantly impacted by Covid-19, leading to uncertainty in claims reserving and pricing. In addition, in 2022 and beyond there is a risk of higher than expected claims inflation driven by customer behaviour, a rebound in global growth and supply chain disruption from the UK's new trading relationships.	Uncertainty following the implementation of the FCA Pricing Practices Regulations will continue to have financial impacts on the market in 2022. We have used scenario testing to understand the potential financial impacts of these risks and continue to monitor these risks closely. Finally, climate change presents a risk of more frequent extreme events and key risk indicators are being continually enhanced to monitor related risks across Home and Motor.
Market Risk Relative size of risk Trend over next 12 months – stable 	The risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.	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. Global geopolitical, economic and other uncertainty 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.	To address this, we have an investment strategy which is approved by the Board and includes limiting exposure to individual asset classes and the amount of illiquid investments we hold. We also use risk reduction techniques such as hedging foreign currency exposures with forward contracts.
Operational Risk Relative size of risk Trend over next 12 months – stable 	The risk of loss due to inadequate or failed internal processes or systems, human error or from external events. The key risks within this category are Cyber, Technology & Infrastructure, Operational Resilience, Change, People, Information Management, Outsourcing, Partnerships and Fraud	Operational risks can arise within all areas of the business and can become manifest as a result of inadequate or failed internal processes or systems, human error or because of external events. Our approach is to proactively manage our operational risks to mitigate potential customer harm, regulatory or legal censure, and financial or reputational impacts. The stable trend in operational risk is driven mainly by the progress demonstrated by the business in delivering key strategic technology improvements that strengthen resilience and have enabled the Group's transition to a more flexible operating model, utilising both virtual and office-based working solutions. We have in place robust operational processes and systems, including prevention and detection measures, that seek to ensure the Group is well placed to absorb and/or adapt to internal or external events that have the potential to impact our customer operations and the wider business more generally.	With large numbers of staff working mainly from home, significant progress has been made to improve the performance and ability of our IT systems, focusing on delivering system stability and optimising capability. Streamlining change implementation and ensuring we drive effective prioritisation in our investment decisions has remained a key area of management focus, to support the Group in achieving its strategic aims, whilst also actively strengthening its controls to further mitigate impacts from potential risk events. Finally, the Cyber threat landscape has continued to remain volatile globally, including the increase in ransomware attacks, and we have introduced new controls, strengthened existing ones, and enhanced our suite of automated monitoring and reporting, to enable us to respond to malicious and unintended threats from both internal and external entities.

Risk management *continued*Principal risks and uncertainties *continued*

Principal risk	Description	Risk commentary	
Regulatory & Compliance Risk Relative size of risk Trend over next 12 months – stable 	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.	We maintain a constructive and open relationship with our regulators and have a strong culture of delivering on our commitments to our customers. Pricing practices within the general insurance market has remained a key area of focus for the FCA and for the Group. We have devoted a lot of attention and resource with the intention of enabling the Group to meet the FCA's Pricing Practices Review requirements within the challenging deadlines prescribed by the FCA, and to be in a position to deliver the intended customer outcomes. Focus has also been given to the ability of the Group to trade effectively post the implementation of the FCA's Pricing Practices Review requirements.	For product lines which sit outside of the FCA's pricing remedies, the Group continues to operate to a set of conduct pricing principles which enable the fair pricing of business across our book and the provision of fair outcomes for our customers. We have maintained regular and open dialogue with both the FCA and PRA on our responses to climate change and the Covid-19 pandemic. We have also engaged with HM Treasury and participated in the PRA's Quantitative Impact Study on the UK review of the Solvency II framework. 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..
Credit Risk Relative size of risk Trend over next 12 months – stable 	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.	To manage credit risk, we set credit limits for each material counterparty and actively monitor credit exposures. In addition, we only purchase reinsurance from reinsurers with at least A- rating and, for liabilities with a relatively long period of time to settlement, this rating is at least A+. Finally, we also have well-defined criteria to determine which customers are offered and granted credit.	
Strategic Risk Relative size of risk Trend over next 12 months – stable 	The risk of direct or indirect adverse effects resulting from strategies not being optimally chosen, implemented or adapted to changing conditions.	Strategic risk is influenced by internal and external developments such as the Covid-19 pandemic, the UK's new trading relationships and FCA's Pricing Practice Review. In addition, the adoption of agile ways of working allows the business to more quickly identify and react to risks to the implementation of the Group's strategic goals. To manage our risks, we have taken the following steps: – we agree, monitor and manage performance against the Board-approved plan and targets;	– 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.

Potential effects of Covid-19 and the UK's new international trading relationships on inflation

The UK's new international trading relationships may have had an impact on claims inflation and may still do so, although the Covid-19 pandemic continues to mask the effects of these relationships. Certain risks related to Brexit could still occur or be exacerbated and we continue to be alert to possible developments.

Emerging risks

Emerging risks are defined by the Group as newly developing or changing threats or opportunities, external to the Group, that are subject to a high degree of uncertainty but have the potential to materially impact 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 emerging risks; and
- mitigate the impact of emerging risks that could impact the delivery of the strategic plan.

The Group records emerging risks within an Emerging Risk Register. An update on emerging risks is presented to the Board Risk Committee annually and is supplemented by deep dives on selected emerging risks.

The most notable emerging risks currently being monitored via the emerging risks process are outlined below:

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 risk can be divided into physical and transition risks. Both of these categories can manifest themselves through a range of existing financial and non-financial risks, including insurance, market, operational, strategic and reputational risks.

In 2021, we participated in the Bank of England's Climate Biennial Exploratory Scenario ('CBES'), which was designed to test the resilience of the financial system to the physical and transition risks from climate change. The CBES covered both quantitative scenario analysis, spanning a 30-year time horizon, and qualitative assessment of management actions and the sustainability of different business models.

We continue to monitor these risks closely and to develop our climate change modelling capability. Further details on our risk management approach to climate change are included on pages 84 to 85, in our TCFD report.

Ethical use of data

The insurance industry is gathering and processing greater volumes of data than ever before. The adoption of artificial intelligence and machine learning introduces the potential to create unfair outcomes if data is not processed responsibly. The use of technology to automate decisions could magnify the impact of problems caused by inaccurate or biased data.

The Group has developed a Data Ethics Framework which introduces a set of principles to drive the ethical use of data and a new governance model to ensure appropriate visibility and escalation of ethical concerns. Furthermore, the Group has an established Data Ethics Steering Group which gathers internal and external views on data ethics, reviews business propositions on data use and helps to drive the embedding of the data ethics framework across the Group.

Global financial instability

Global financial instability can occur through unexpected or unpredictable external events that affect fundamental macroeconomic variables, such as GDP growth, consumption, inflation or unemployment. As markets worldwide continue to recover from the impact of Covid-19, there is a risk that global financial instability could be triggered and/or worsened by numerous external events, including natural disasters, war, terrorism, natural resource or fuel shortages and global technological failures. Should the Russia-Ukraine situation continue to deteriorate, there is a likelihood that the impact on global financial instability will increase.

The principal impacts of global financial instability would likely be felt on the Group's investment portfolio, through changes in credit spreads and sovereign yields. Depending on the cause, there may also be operational and insurance risk impacts to consider.

The Group's investment portfolio is already positioned relatively defensively, reducing the potential exposure to global financial instability. However, if global financial instability were to materialise, further steps could be taken, such as shifting the portfolio further towards 'defensive' sectors, pausing reinvestment or increasing the allocation to cash and sovereign debt.

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 95, 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 91 to 92. Note 3 to the consolidated financial statements starts on page 192 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 ("the **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. By its nature, a strategic plan comprises a series of underlying assumptions which can be uncertain in nature and rely on judgement. Each year, the Group's Risk Function assesses the Plan and provides the ORSA to the Board which supports the Board in concluding on the Group's viability.

When reviewing the 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 Plan. The Board has assessed the principal risks of the Group over the duration of the planning cycle. All of the Group's principal risks, as outlined on pages 91 to 92 were reviewed as part of the preparation of the ORSA and the outlook of those risks over the period covered by the Plan was taken into account (i.e. whether the outlook for each risk was increasing, broadly static or decreasing over the period of the Plan). The Plan did not introduce any new material risks other than those already contained within the Group's Material Risk Register. This review also included reviews of the Group's solvency and liquidity position, up to 31 December 2023 with a further two years of indicative planning from 2024 to 2025. The first year following approval of the 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. As the Plan and the ORSA are used for planning over a timeframe of four years, to 31 December 2025, this has been selected as the most suitable period for the Board to review the Group's viability.

The Group's Risk Function has carried out an assessment of the risks to the Plan and the dependencies for the success of the Plan. The key scenarios considered were in relation to the impact of the FCA's Pricing Practices Review ("PPR") on customer behaviour, the legislative and regulatory environment and the likely time period of continued Covid-19 related effects including the impact on the underwriting cycle, motor claims frequency, travel and supply chain disruption and claims inflation. The key judgements and assumptions applied were as follows:

PPR: the Group's Plan includes a scenario for the impact of PPR from 2022 onwards based on assumptions made on how new business and renewal prices equalise and new business premium inflation in the Motor and Home markets. The Group has made a judgement on the impact of PPR, whilst acknowledging that there are inherent limitations, such as limited historical data on which to base assumptions. Stress testing has been performed on the assumptions, included on the Plan, with a focus on premium inflation being lower than that assumed.

Legislative and regulatory environment: the Plan is consistent with the current Ogden discount rate of minus 0.25%. The table on page 42 in the Finance review quantifies the impact on the Group of a change in the Ogden discount rate of plus or minus 1.0 percentage points. Other scenarios considered included an increase in levies and tax rates.

Covid-19 pandemic: in addition to the scenarios for the implementation of PPR, the Plan has been stress tested for market premium inflation assumptions, following deflation during the Covid-19 pandemic, as well as the impact of a deep UK recession triggered by the end of furlough and a spike in unemployment leading to a reduction in the market for certain insurance products. Although there have been a number of significant developments in 2021, such as the success of the vaccination programme, these scenarios remain relevant in quantifying severe but plausible business impacts. The stress tests have focused on scenarios where premium inflation is lower than the Plan. In addition, there is uncertainty in future claims costs. The risks associated with Covid-19 include frequency of Motor claims, travel disruption, increased demand for building supplies and labour, and reduced supply as a result of increased global competition for products or production shortages. The scenarios applied have focused on claims inflation and claims frequency.

The scenarios have been used to challenge the Group's contingent management actions, which are a series of actions designed to restore the solvency ratio to within our stated risk appetite range after suffering an event which results in a solvency ratio that is lower than our risk appetite range. These actions include short-term actions, such as restriction of dividends or other capital distributions, which can return or preserve capital surplus quickly at certain times of the year, to longer-term actions, such as reducing reinsurance retention levels or reducing marketing or investment spend.

The capital and solvency requirements of the Group have been subject to stress tests over the duration of the Plan using the above inputs. 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 (2021 to 2025).

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 U K Insurance Limited, the Group's principal underwriter, i.e. a reduction of own funds to below the solvency capital requirement. The purpose of this reverse stress test was to assess the coverage and scope of the internal economic capital model and there were no findings that invalidate the internal model.

The results of the key sensitivities that have been applied to the Group's Solvency II balance sheet at 31 December 2021 in respect of the solvency capital ratio are shown on page 40, and applied to profit before tax in respect of claims reserves on page 42 of the Finance review.

Climate change: during the year, the Group undertook a number of stress and scenario tests, designed to reflect the potential impact of short- and long-term climate change risk on the Group's balance sheet and solvency position. The tests are discussed in more detail on pages 79 to 80. The overall conclusion of these tests was that there could be breaches in the Group's risk appetite, however a combination of contingent management actions could be deployed in each scenario to address the risks and allow the business to recover to above risk appetite.

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 2025.

Statement of the Directors in respect of the Strategic report

The Board reviewed and approved the Strategic report on pages 1 to 95 on 7 March 2022.

By order of the Board



Penny James
Chief Executive Officer

7 March 2022

Chair's introduction

Our Governance

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 2021. This report sets out how we have applied the principles of the UK Corporate Governance Code (the "Code") throughout the year. It provides information on changes to your Board of Directors and information about progress we have made in our corporate governance agenda, particularly in the areas of diversity and inclusion, stakeholder engagement and the environment.

Danuta Gray
Chair of the Board

Board changes and effectiveness

As I explained in my statement on page 18, during the year, Tim Harris decided to retire as an Executive Director and Chief Financial Officer ("CFO"). Neil Manser assumed the role of Acting CFO in January 2021, when Tim first took leave of absence, and in May, when Tim stood down from the Board, the Board appointed Neil to the position of CFO on a permanent basis, regarding him to be an excellent candidate for the reasons given in my statement and in the Nomination and Governance Committee Report.

As planned, Jane Hanson stepped down as an independent Non-Executive Director of the Board at our AGM in May 2021, having served a nine-year term. As Jane was Chair of our Board Risk Committee, we took the opportunity to refresh our Committee Chairships. Mark Gregory, independent Non-Executive Director, was appointed Chair of the Board Risk Committee, Richard Ward, Senior Independent Director, took over as Chair of the Remuneration Committee and Fiona McBain, independent Non-Executive Director became Chair of the Investment Committee. I believe these changes support our aim of ensuring fresh perspectives and challenge at our Committee meetings.

In November 2021, we welcomed Tracy Corrigan to the Board as an independent Non-Executive Director. The Board benefits from Tracy's experience in the media industry, spanning financial journalism, digital media and corporate strategy. More information on Tracy's recruitment can be found on page 128.

As reported last year, in January 2021, Adrian Joseph was appointed as an independent Non-Executive Director. Adrian has brought insight and challenge to our Board and Sustainability Committee discussions, as we benefit from his expertise in data analytics and Artificial Intelligence and his passion for promoting diversity and inclusion.

This year, the effectiveness of the Board was assessed through an internal evaluation that I conducted with assistance from our Company Secretary. On page 115 we have set out progress against the actions arising from last year's evaluation and new actions arising from this year's review. Key focus areas for 2022 include the alignment of the Board's rolling agenda with our prioritised Objectives and Key Results, seeking further opportunities for the Board to engage with the wider management team and workforce and the fresh medium- to long-term approach to Board and executive succession planning to be led by the Nomination and Governance Committee.

Stakeholders

Engagement with our stakeholders is one of the key ways we monitor our culture and ensure that their needs and priorities are taken into consideration when making our decisions. I held a number of meetings with some of our institutional shareholders to listen to their priorities and to discuss topical themes, including how we are already benefiting from investment in technology transformation

and the resulting enhanced capability, and how we were preparing to comply with, and trade under, the FCA's new Pricing Practices Review regulations. Details about how the Board has engaged with all stakeholders during 2021 can be found on pages 109 and 110.

“Engagement with our stakeholders is one of the key ways we monitor our culture and ensure that their needs and priorities are taken into consideration when making our decisions.”

Board members attended a number of Employee Representative Board meetings at which colleagues had the opportunity to share their thoughts on how we are doing as a business and what we can do better. I continue to be impressed by the level of insight and vision brought to these sessions by our colleagues, which include discussion on key strategic initiatives and how change programmes are affecting our people. Matters discussed at these sessions are fed back to the wider Board and help inform discussion and decision making. See pages 109 and 111 for more information.

Diversity

As you will have seen in the People section on page 61, diversity and inclusion remains high on our agenda and we have made some positive progress on this during the year, including the publication of our first Black Inclusion report and committing to voluntarily disclose our ethnicity pay gap from 2022. Whilst we are pleased to have met some key industry targets in respect of Board, Executive Committee and senior leadership diversity, particularly in respect of gender, we know we still have a lot to do to achieve similar results in our ethnic diversity ambition. Through our continued succession planning and focus on creating a strong and diverse internal pipeline, we aim to ensure diverse Board and senior management representation both now and in the future. More information on the Board's approach to diversity can be found on page 114.

Remuneration

2021 was the second year of operating under the Remuneration Policy that shareholders approved at our 2020 AGM. As you will see in our Remuneration Report on pages 134 to 159, the outcomes of our Long Term Incentive Plan (“LTIP”) and Annual Incentive Plan (“AIP”) reflect strong profitability and good progress on key strategic metrics in line with our pay for performance principles. Our AIP includes non-financial metrics which measure and reward executives and colleagues for progress in areas that reflect the culture of our business, including customer satisfaction, customer complaints, employee engagement and workforce diversity and inclusion, as well as key strategic objectives relating to growth, competitiveness and technology improvements. For 2022 onward, the Committee approved the introduction of an emissions-related metric for our LTIP, reflecting our commitment to embedding sustainability into our long-term thinking.

Audit

The introduction of accounting standard IFRS 17 represents a significant change to insurance accounting and our Audit Committee has been highly engaged in overseeing the implementation of this standard, receiving both regular updates and deep dive sessions to ensure that they have the necessary information and insight to support this important change. During the year the Audit Committee also oversaw the launch of an external audit tender process that will see us appointing a new auditor for the financial year commencing on 1 January 2024. More information about these activities can be found on page 121.

Sustainability

Sustainability is an integral part of our strategy and underpins much of our activity at Board level. Our Sustainability Committee oversees activity under the five pillars of our sustainability strategy and during the year had the important job of monitoring our progress towards achieving Science-Based Target validation status. Our Investment Committee has been highly focused on monitoring the greenhouse gas emissions intensity of our investment portfolios and considering how we can align investment activity with the transition to a low-carbon economy. Our Board Risk Committee reviewed our submission to the Bank of England's Climate Biennial Exploratory Scenario and our Climate Risk Management report which sets out management actions for managing climate risk. Our Audit Committee reviewed our Task Force on Climate-related Financial Disclosures report and, as I mentioned above, our Remuneration Committee introduced the use of a climate change-related metric for our LTIP. More information on all of these activities can be found in the respective Committee report pages.

Annual General Meeting

Our 2022 AGM will be held on Tuesday, 10 May 2022 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

Board of Directors

Danuta Gray

Chair of the Board

Appointed

Independent Non-Executive Director in February 2017
Chair of the Board since August 2020

Committees



Key Skills and Experience:

- Extensive experience leading and transforming large, consumer-focused businesses.
- Deep understanding of governance and remuneration requirements affecting listed companies gained from previous Chair roles.
- Expertise in sales, marketing, and technology.

Danuta was Chair of Telefónica in Ireland until 2012 having previously been its Chief Executive between 2001 and 2010. During her tenure as Chief Executive she increased the customer base from just under 1 million to 1.7 million. Earlier in her career, Danuta held a variety of senior positions within the BT Group between 1984 and 2001. Additionally, Danuta has been Senior Independent Director of the Aldermore Group, Non-Executive Chair of St Modwen Properties and a Non-Executive member of the Ministry of Defence Board. She was also NED and Chair of the Remuneration Committee at both PageGroup plc and Old Mutual plc until 2018.

External Appointments

- Chair of the Board of North SP Limited.
- Non-Executive Director and Nomination and Remuneration committee member of Burberry Group plc.

Penny James

Chief Executive Officer

Appointed

Executive Director in November 2017
Chief Financial Officer in March 2018
Chief Executive Officer since May 2019

Committees



Key Skills and Experience:

- Deep knowledge of the financial services and insurance sector.
- Strong leadership skills with a focus on cultural and stakeholder alignment.
- Strategic mindset with proven track record in business transformation.

Penny has extensive financial services experience, having been Group Chief Risk Officer and Executive Director at Prudential plc, where she was responsible for leading risk oversight globally. Before this, Penny was Director of Group Finance at Prudential. She had previously been Group CFO at Omega Insurance Holdings Limited and CFO, UK General Insurance, at Zurich Financial Services. Penny was also a NED of Admiral Group plc from January 2015 to September 2017.

Penny is an Associate of the Institute of Chartered Accountants in England and Wales.

External Appointments

- Member of the Association of British Insurers Board.
- Chair of the FCA Practitioner Panel.
- Senior Independent Director and member of the Risk and Nomination Committees of Hargreaves Lansdown plc.

Neil Manser

Chief Financial Officer

Appointed

May 2021

Committees



Key Skills and Experience

- Strong background in financial and strategic leadership roles.
- Extensive corporate finance and capital markets knowledge.
- Deep understanding of the operation of strategy and culture in the insurance industry.

Neil was appointed as CFO in May 2021. Since he joined the Group in 2011, Neil has held several roles in Finance and Strategy from Director of Investor Relations, to Managing Director of NIG and Chief Strategy Officer. Neil was instrumental in the Group's successful IPO in 2012. He brings extensive industry and capital markets experience to the Board having previously worked at Brit Insurance, Merrill Lynch and Fox-Pitt, Kelton. Neil is an Associate of the Institute of Chartered Accountants in England and Wales.

External Appointments

- None.

Key for Committee membership

- Audit Committee
- Board Risk Committee
- Investment Committee
- Nomination and Governance Committee
- Remuneration Committee
- Sustainability Committee
- Chair of the Committee

Tracy Corrigan

Independent Non-Executive Director

Appointed

November 2021

Committees



Key Skills and Experience

- Deep understanding of the development of corporate and digital strategy.
- International experience with broad perspective of business and capital markets.
- Expertise in digital transformation, customer analytics and stakeholder communications.

Tracy's professional background spans financial journalism, digital media and corporate strategy in the media industry. Most recently Tracy was Chief Strategy Officer for Dow Jones where she oversaw the digital transformation of the business and was responsible for global strategy, customer insight and commercial policy. Earlier in her career, Tracy was Editor in Chief of The Wall Street Journal Europe and Digital Editor of The Wall Street Journal. She also held various positions at the Financial Times, including Editor of FT.com and Editor of the Lex Column.

External Appointments

- None.

Mark Gregory

Independent Non-Executive Director

Appointed

March 2018

Committees



Key Skills and Experience

- Extensive experience in both life and general insurance.
- Deep understanding of capital markets.
- Strategically orientated with a detailed understanding of the retail sector.

Mark previously held the role of Group CFO and Executive Director at Legal & General 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 & Wales.

External Appointments

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

Sebastian James

Independent Non-Executive Director

Appointed

August 2014

Committees



Key Skills and Experience

- Extensive experience in retail and consumer practice with large retail groups.
- Strong track record of business transformation and change.
- Detailed understanding of UK consumer markets, products and brands.

Sebastian is Managing Director of Boots UK, a subsidiary of Walgreens Boots Alliance, Inc. Until 2018, he 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, Sebastian was CEO of Synergy Insurance Services Limited, a private equity backed insurance company, and was previously Strategy Director at Mothercare plc. He began his career at The Boston Consulting Group.

External Appointments

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

Board of Directors *continued***Adrian Joseph OBE**

Independent Non-Executive Director

Appointed

January 2021

Committees**Key Skills and Experience**

- Leading expertise in digital, data science and analytics.
- Track record of using data and AI to drive business transformation.
- Recognised Diversity and Inclusion leader and a passionate advocate on this topic.

Adrian is Managing Director, Group Data and Artificial Intelligence at BT Group. Before this he held senior roles at EY and Google and has significant industry and consultancy experience. He was a NED at the Home Office (2016-2020) where he sat on the Data Board advising on data science, digital transformation, and diversity and inclusion. A former Chair of the Race Equality Board, Adrian was appointed to the main Board of Business in the Community in 2014 and continues to act as an adviser to them. In 2019, Adrian was awarded an OBE for services to equality and diversity in business. In 2018, he was announced as the most influential black, Asian and minority ethnic technology leader in the UK by the Financial Times and Inclusive Boards.

External Appointments

- Member of HM Government's AI Council.
- Managing Director, Group Data and Artificial Intelligence at BT Group.

Fiona McBain

Independent Non-Executive Director

Appointed

September 2018

Committees**Key Skills and Experience**

- Extensive global experience in retail financial services.
- Strong background in M&A and developing strategic partnerships.
- Expertise in audit having worked as an auditor and served as Audit Committee Chair of other listed companies.

Fiona's experience in retail financial services, both in the industry and as an auditor, was gained in the UK and the USA. Fiona qualified as an accountant early in her career at Arthur Young (now EY). 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. Fiona is an Associate of the Institute of Chartered Accountants in England & Wales.

External Appointments

- Chair of Audit Committee and Non-Executive Director of Curry's 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

Independent Non-Executive Director

Appointed

March 2018

Committees**Key Skills and Experience**

- Strong audit background having worked as a partner in Ernst & Young's Financial Services practice.
- Extensive experience in the insurance and investment management industry.
- Deep knowledge and understanding of financial services regulation and practice.

Gregor worked at Ernst & Young for 23 years, 10 of which were as partner in the financial services practice. Between 2009 and 2012, he was Finance Director for the insurance division of Lloyd's Banking Group plc which included Scottish Widows. Gregor is a Member of the Institute of Chartered Accountants of Scotland.

External Appointments

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

Key for Committee membership

- Audit Committee
- Board Risk Committee
- Investment Committee
- Nomination and Governance Committee
- Remuneration Committee
- Sustainability Committee
- Chair of the Committee

Board independence

Dr. Richard Ward

Senior Independent Director

Appointed

January 2016

Committees



Key Skills and Experience

- Highly experienced financial services professional with expertise in dealing with complex stakeholder groups.
- Extensive knowledge of the insurance industry with deep insight into prudential regulation.
- Background of delivering business transformation and change in challenging circumstances.

Richard was previously Executive Chair of Ardonagh Specialty and was Chief Executive of Lloyd's of London and the International Petroleum Exchange. He also held the role of Non-Executive Chair at Brit Syndicates Limited and Executive Chair of Cunningham Lindsey. Richard also held NED roles at the Partnership Assurance Group plc and the London Clearing House. Earlier in his career he held a range of senior positions at British Petroleum and was a research scientist for the Science and Engineering Council. Richard has also been a member of the PwC Advisory Board, the PRA Practitioner Panel and of the Geneva Association.

External Appointments

- Non-Executive Chair of CFC Group Limited.
- Non-Executive Chair of Mrald Limited.

Chair and NED tenure

Board gender

Executive Committee

Penny James chairs the Executive Committee. In addition to Penny James and Neil Manser, the Committee comprises the following:

Jessie Burrows

Managing Director, Customer Sales, Service & Claims

Experience and Qualifications

Jessie joined Direct Line Group in 2016. She is responsible for all aspects of personal lines and commercial lines claims; customer sales and service; and the Group's counter-fraud activities. Her focus is very much about creating value for customers by providing them with an exceptional service and value for money, through controlling claims spend.

Prior to joining Direct Line Group, Jessie was at Aviva plc for 13 years, holding a number of senior Finance Director roles at both the Group and in the UK general Insurance business. Jessie joined Aviva from KPMG and is an associate Member of the Institute of Chartered Accountants in England and Wales.

External Appointments

- Non-Executive Director of The Motor Insurers' Bureau.
- Advisory Board member of the CII Society of Claims Professionals.

Mark Evans

Managing Director, Marketing & Digital

Experience and Qualifications

Mark joined Direct Line Group in 2012 and 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.

External Appointments

- Non-Executive Director of Learn Et Al

Jazz Gakhai

Managing Director, Motor

Experience and Qualifications

Jazz joined Direct Line Group in 2005. Before stepping into the Managing Director, Motor role she was Chief Strategy Officer, having previously been Managing Director of Direct Line for Business, leading the growth of the direct Commercial Insurance business.

Prior to this Jazz held roles leading the Pet Insurance portfolio, Head of Direct Line Home and across the Partnerships business. Before joining Direct Line Group, Jazz was a maths teacher.

External Appointments

- Non-Executive Director of Auto Trader Group Plc.

Kate Syred

Managing Director of Household, Partnerships, Data, Pricing and Underwriting

Experience and Qualifications

Kate joined Direct Line Group in 2000. She has over 20 years' experience of the insurance industry and 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

Experience and Qualifications

Humphrey joined the Group in 2011 and 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.

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.

Vicky Wallis

Chief People Officer

Experience and Qualifications

Vicky joined the Group in April 2020. She 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 CIPD qualified and holds a Master's degree in Organisational Leadership.

Jon Greenwood

Managing Director, Commercial

Experience and Qualifications

Jon joined the Group in 2000. He 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.

Jon 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, Jon held roles at HBOS, MBNA and Pinnacle.

Ash Jokhoo

Chief Information Officer

Experience and Qualifications

Ash joined the Group in 2021. He has over 20 years' experience of delivering technological transformation that underpins growth with a focus on the customer journey. He is passionate about technology and diversity.

Ash was previously CIO at Virgin Atlantic where he oversaw technology and data strategy. Prior to this he was UK & Ireland CIO at Centrica, British Gas and Bord Gáis. Additionally, he has 10 years' experience in Telecommunications, holding roles at TalkTalk, Tiscali and British Telecom.

Ash holds a degree in Engineering Product Design. He is a guest speaker and visiting lecturer at London South Bank University.

Aurore Lecanon

Chief Risk Officer

Experience and Qualifications

Aurore joined the Group in 2021. She has over 18 years' experience with global insurers and investment banks and has deep technical, market and commercial knowledge of the insurance and savings industry.

Before joining the Group, she held several Risk roles at M&G / Prudential including Chief Risk and Compliance Officer of Prudential International Assurance, Transformation Risk Director, and Financial Risk Director of the UK insurance business. Aurore was Head of Asset Liability Management at Old Mutual plc and worked in investment banking at Credit Suisse and Société Générale. She holds a Masters in Stochastic Mathematics and Financial Engineering from Princeton University and the University of Paris VI and is a graduate of the Ecole Polytechnique and the Ecole Nationale Supérieure of Economics and Statistics in France.

ExCo Gender breakdown

Senior Management and Direct Reports Gender breakdown¹

Notes:

1. Senior Management is defined as the Executive Committee, Company Secretary and direct reports (excluding administrative and support staff) as at 31 December 2021.

Corporate Governance Report

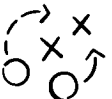
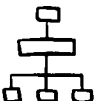
This report explains the Board's role and activities, and how corporate governance operates throughout the Group.

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 2021. 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 160 to 163.

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 and 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 and Accounts.

		Pages
	Board leadership and company purpose	– The role of the Board 105 – Culture and purpose 105 – Board activities and meeting attendance 106-107 – Consideration of S172(1) factors 108 – Stakeholder engagement 109-111
	Division of responsibilities	– Governance framework and structure 112 – Structure of the Board, Board Committees and executive management 113 – Roles and responsibilities of the Board 113
	Composition, succession and evaluation	– Board composition 114 – Induction, training and support 114 – Diversity, inclusion and succession planning 114-115 – Board and Committee effectiveness review 115-116
	Audit, risk and internal control	– Preparation of the Annual Report and Accounts 117 – Assessing emerging and principal risks 117 – Risk management and internal control systems 117-118 – Audit Committee report 119-122 – Board Risk Committee report 123-126
	Remuneration	– Directors' Remuneration report 134-159

Board leadership and company purpose



The Board

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 134.

The role of the Board

Pages 112 and 113 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's responsibility are summarised in the following paragraphs, these are not intended to be an exhaustive list.

Leadership

The Board 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.

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.

Culture and purpose

The Board monitors culture and seeks to ensure that business practices and behaviours are aligned with the Company's culture, purpose and values. Below are examples of reports, metrics and activities which assist the Board in its ongoing monitoring and assessment:

- The Board closely monitors customer metrics including the Company's Net Promoter Score ("NPS") (which is an index that measures the willingness of customers to recommend products or services to others) and customer complaints data. These measures are important indicators of how Company actions affect customers.
- The Board closely monitors the Company's employee engagement survey results and workforce diversity statistics. It monitors the Company's gender pay gap and actions being taken to address this gap. Going forward it will also be monitoring the Company's ethnicity pay gap. These data points provide useful insight into the wellbeing of the workforce and the extent to which objectives around diversity and inclusion are being met.
- Board members regularly attend meetings of the Employee Representative Body ("ERB") in order to hear first-hand from colleagues about how strategic initiatives are working in the business. More information about the work of the ERB can be found on pages 109 and 111.
- The Board Risk Committee reviews issues raised via RightCall, the Group's independent and confidential whistleblowing telephone helpline. In doing so, it considers whether there are any trends in reporting that indicate behavioural or cultural issues in a particular area of the business.
- The Audit Committee receives regular reports from the Internal Audit function which include insights into culture and behaviour in the business.

Corporate Governance Report *continued*

Board meetings and activity in 2021

Scheduled Board meetings focused on four main themes, as detailed below:

Themes	Description
Strategy and execution Strategic alignment ① ② ③ ④ ⑤	- 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 ① ② ④ ⑤	- 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; - reviewing broker reports on the Group, alongside feedback from investor meetings; - considering and approving the Group's share repurchase programme; and - declaring a 2020 final dividend of 14.7 pence and a 2021 interim dividend of 7.6 pence.
Risk management, regulatory and other related governance Strategic alignment ④ ⑥	- Reviewing and agreeing the Group's policies; - setting risk appetite; - 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 ① ⑥	- 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; and - approving the Company's Code of Business Conduct and conducting an annual review of the Group's governance framework.

In addition to its scheduled Board meetings, the Board held a number of ad hoc meetings to deal with urgent or arising matters and in June 2021, the Board held a strategy day to set and monitor progress against the Group's strategy and to discuss the Group's future opportunities.

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 and Committee meeting attendance

The Board and its Committees held a number of scheduled meetings in 2021 at which senior executives, external advisers and independent advisers were invited to attend and present on business developments and governance matters.

Only in exceptional circumstances did Directors not attend such Board and Committee meetings. In such circumstances, papers were circulated to all Directors before the meetings so that those unable to attend could raise issues and give comments to the Chair in advance of the meeting.

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 2021. 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.

Additional Board and Committee meetings were convened during the year to discuss ad hoc business development, governance and regulatory matters.

	Board	Audit Committee	Board Risk Committee	Sustainability Committee	Investment Committee	Nomination and Governance Committee	Remuneration Committee
Chair							
Danuta Gray	9 of 9	–	–	–	–	3 of 3	3 of 3
Senior Independent Director							
Richard Ward	9 of 9	–	5 of 5	–	–	3 of 3	3 of 3
Non-Executive Directors							
Tracy Corrigan ¹	2 of 2	–	–	1 of 1	–	–	–
Mark Gregory ²	9 of 9	7 of 7	3 of 3	–	4 of 4	–	3 of 3
Jane Hanson ³	4 of 4	4 of 4	2 of 2	1 of 1	2 of 2	–	–
Sebastian James	9 of 9	–	–	4 of 4	–	3 of 3	3 of 3
Adrian Joseph OBE ⁴	8 of 9	–	–	3 of 4	–	–	–
Fiona McBain ⁵	6 of 9	5 of 7	3 of 5	–	2 of 4	–	–
Gregor Stewart ⁶	8 of 9	7 of 7	3 of 5	–	–	–	–
Executive Directors							
Penny James	9 of 9	–	–	4 of 4	–	–	–
Tim Harris ⁷	–	–	–	–	–	–	–
Neil Manser ⁸	5 of 5	–	–	–	2 of 2	–	–

Notes:

1. Tracy Corrigan joined the Board on 1 November 2021 and the Sustainability Committee on 4 November 2021.
2. Mark Gregory joined the Board Risk Committee on 13 May 2021.
3. Jane Hanson stepped down from the Board on 13 May 2021.
4. Adrian Joseph was unable to attend certain meetings due to illness.
5. Fiona McBain was unable to attend certain meetings due to a bereavement and illness.
6. Gregor Stewart was unable to attend certain meetings due to illness.
7. On 11 January 2021, Tim Harris took a leave of absence to support a family member who was undergoing medical treatment. On 13 May 2021, Tim retired as CFO.
8. Neil Manser joined the Board and the Investment Committee on 13 May 2021. He also attended Board and Investment Committee meetings during his time as Acting CFO.

Corporate Governance Report *continued*

Consideration of section 172(1) factors by the Board

The Group's section 172(1) statement can be found in the Strategic report on page 20.

The table below sets out how factors under section 172(1) of the Companies Act 2006 and engagement with stakeholders have fed into Board discussion and decision making on key topics. More information about Board engagement with stakeholders can be found in the table on pages 109 to 110.

Section 172(1)	
<i>The Board has a duty to act in the way it considers, in good faith, would be most likely to promote the long-term success of the Company for the benefit of its members as a whole, whilst having regard to (amongst other matters):</i>	
(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

Topic	Section 172(1) considerations
The future of Direct Line's workplace and culture Following the fundamental change in our ways of working during the pandemic, the Board considered what this meant for the future of the DLG workplace and culture. They considered what office space would be required in the future, what this should be used for and how best to foster a culture of collaboration and flexibility whilst maintaining productivity. These considerations resulted in a decision to reduce the square footage of Group's office space, invest in repurposing remaining office space and move to a mixed model of home and office working.	(b) Consultation with workforce on flexible working via surveys which showed a clear desire from colleagues to retain the flexibility to work from home where possible once social distancing had eased. (a) Financial analysis and projections showing long-term cost benefits of reducing the property portfolio and undertaking work to repurpose existing office space. (e) Security arrangements and policies to ensure the Company can continue to protect our customers, data and reputation in the home working environment. (d) Predicted lower carbon emissions achieved through reduced travel and a smaller office footprint. (b) The promotion of social mobility through access to a recruitment pool that is less geographically restricted and the promotion of gender equality through flexible working practices.
Return of capital to shareholders During the year the Board approved a distribution of surplus capital of up to £100 million by way of a share buyback programme. The Board also approved a final dividend of 14.7p per share in respect of 2020 and an interim dividend of 7.6p per share in respect of the first half of 2021.	(f) Shareholder expectations set through the Group's published dividend policy and feedback received from shareholders as part of the Group's investor relations programme which expressed a preference for a return of capital via a share buyback over a special dividend. (a) The strength of the Group's capital position, taking into consideration regulatory and policy holder requirements and the long-term investment needs of the business. (f) The Company's initiatives to support staff, customers and local communities in times of hardship and the absence of reliance on Government support schemes during the pandemic supported the position that a return of capital to shareholders was not inequitable to the Company's other stakeholders. (b) The promotion of social mobility through access to a recruitment pool that is less geographically restricted and the promotion of gender equality through flexible working practices. (c) How changes could drive positive outcomes for customers.
Implementation of Pricing Practices Review rules During the year, the Board oversaw work being undertaken to ensure the business was ready to comply with new rules brought in for the pricing of home and motor insurance as a result of the FCA's Pricing Practices Review.	(a) Monitoring the preparation of new pricing models, the objective of which is to seek to thrive under the new Pricing Practices Review rules in the long term. (e) The need to ensure full compliance with new rules to maintain a reputation for high standards of business conduct. (b) How additional work required to implement necessary changes within a short timescale was affecting colleagues and the Group's business priorities. (c) How changes could drive positive outcomes for customers.
Delivery of the sustainability strategy The Sustainability Committee oversaw work to deliver against and develop the Company's sustainability strategy and embed sustainability at every level of the business.	(d) Repositioning the Company's Community Fund to help 'left-behind' groups access financial services careers in support of the 'Society' pillar of the sustainability strategy. (d) Reports of the Climate Executive Steering Group, which aims to align thinking across areas of the business which could be affected by climate change, under the 'Planet' pillar of the sustainability strategy. (b) How the Company's first Black Inclusion Report could further the Company's diversity and inclusion strategy under the 'People' pillar of the sustainability strategy. (c) How involvement in the 'Plain Numbers' social enterprise initiative supports fair outcomes for customers under the 'Customer' pillar of the sustainability strategy.

How the Board engages with stakeholders

The table below sets out how the Board has engaged with various stakeholders or received information about engagement with stakeholders throughout the year.

Stakeholder	Board engagement and oversight	
Our Shareholders	The Investor Relations team runs a comprehensive programme of engagement with a broad range of the Company's shareholders, which includes meetings with the Chair and Executive Directors, presentations and conference calls to discuss performance and strategy. The Chair of the Remuneration Committee also meets with shareholders when appropriate to discuss remuneration-related issues. During the year, the Executive Directors hosted investor insight webinars on the Group's claims strategy and the commercial business. During the year the Board also received presentations by its brokers on shareholder sentiment regarding the Group's strategy and performance. The AGM provides both institutional and retail shareholders with the opportunity to ask the Board questions either live or by submitting questions in advance. Due to restrictions in place as a result of Covid-19, in 2021 the Company held a hybrid/virtual AGM, which allowed shareholders to participate remotely and included the facility to ask questions via phone or webchat.	Feedback received from shareholders regarding a return of capital via a share buyback was considered in Board decision making on this matter (see page 108). In response to feedback from investors expressing a desire for more information about the Company's environmental activities, a dedicated sustainability hub on our corporate website was created during the year with the aim of making it easier to find key environmental content.
Our People	Non-Executive Directors periodically attend meetings of the Group's formal workforce advisory panel, the Employee Representative Body ("ERB"). These meetings are also attended by Executive Directors. Attendance and information on matters discussed at ERB meetings during the year and action taken in response to issues raised can be found on page 111. Executive Directors host interactive sessions with colleagues to understand their views and answer questions. These sessions have been adapted to accommodate the Group's new ways of working and held in various formats in order to encourage maximum participation in the virtual environment e.g. video conference town halls which include live Q&As and 'virtual cuppas' enabling colleagues to have a more informal discussion with senior managers.	The Board receives regular updates on people matters from the Chief People Officer and reviews the results and key outcomes of the Group's colleague engagement survey 'DiaLoGue'. More information about the outcomes of these surveys can be found on page 65. During the year, the CEO visited the Group's operations in Doncaster to discuss new ways of working with colleagues and to get a better understanding of how colleagues from different areas of the business were feeling. The CEO also undertook a number of virtual site visits where visiting in person was not possible due to Covid restrictions.

Corporate Governance Report *continued***How the Board engages with stakeholders (continued)**

Stakeholder	Board engagement and oversight	
Our Customers	The Board closely monitors customer conduct and satisfaction. It considers a Customer Conduct Report at each of its scheduled meetings, which includes data in respect of a number of customer experience metrics including Net Promoter Scores and customer complaints data relating to sales, service and claims. It also reviews data in respect of digital service interactions. During the year, the Board received detailed updates on the impact of various key strategic matters on customers including the implementation of the FCA's Pricing Practices Review regulations and the rollout of the Best For Customer technology platform.	As part of the CEO's ongoing programme of meeting and engaging with different areas of the business during the year, she visited the Company's contact centre in Doncaster. She spoke with customer-facing colleagues about customer engagement to learn about the challenges of supporting customers in the hybrid working environment. The Board are customers of the business themselves and therefore regularly experience the key touch points in the customer journey first hand.
Our Suppliers	The Board reviews and approves the Group's Ethical Code for Suppliers and Modern Slavery statement on an annual basis. The Code states that the Company encourages and welcomes feedback from suppliers on the Group as a customer and on how policies and procedures can be improved. This feedback can be given as part of regular review meetings with management. The Board receives regular updates on key issues with strategic suppliers. During the year, the Board received updates on the Group's Supply Chain Sustainability Programme which encourages suppliers to sign up to the Science-Based Targets initiative ("SBTi") and involved communication with suppliers about the Group's planned sourcing approach over the next 10 years.	The Group is a long-standing signatory of the Prompt Payment Code. Key performance indicators in respect of prompt payment are reported internally and there are mechanisms in place for any significant issues regarding prompt payment to be escalated to the Board.
Our Planet and Our Society	The Sustainability Committee is a key vehicle through which the Board receives updates on engagement with key community and environmental stakeholders. More information on the work of the Sustainability Committee can be found on pages 130 to 131.	The CEO was a member of the Build Back Better Business Council and represented the Company at various climate-related events during the year (including COP26) and fed back the outcomes of this engagement to the Board. Among the initiatives discussed by the Build Back Better Council was the Electric Vehicle Fleet Accelerator ("EVFA"), which brings together the CEOs of seven companies, including DLG, that own and operate some of the largest van fleets in the UK and companies involved with infrastructure, EV charging, retail and insurance and repair. EVFA companies have pledged to convert, and to support the conversion of, their van fleets to EVs by 2030.

Employee Representative Body

DLG has an established Employee Representative Body ("ERB"), meetings of which are attended by elected representatives from the different areas of the business, the CEO, the Chief People Officer and members of the senior leadership team. Non-Executive Directors also attend some meetings on a rotational basis. Output from the meetings attended by Directors is reported to the full Board so they can consider relevant colleague views in their decision making.

The Board considers that this arrangement fulfils the recommendation under Provision 5 of the Code to provide a mechanism for engaging with the workforce, being an enhanced version of the "formal workforce advisory panel" method referred to in Provision 5. The Board considers this arrangement to be highly effective as it provides a formal framework through which a wide variety of views can be represented and provides colleagues the opportunity to express these views directly to both Executive and Non-Executive Directors. It also means Director attendance can be tailored so that colleagues can engage with the most appropriate Board member on a particular topic. For example, during the year, the Chair of the Remuneration Committee attended the meeting at which workforce pay was discussed. The Board will continue to keep the effectiveness of this arrangement under review and seek the views of the ERB on this in the coming year.

Information about Board representation at ERB meetings, topics discussed and outcomes of this engagement is summarised below:

Meeting	Board Representation	Key Topics	Outcomes in response to feedback received
March	Penny James (CEO)	– CEO update on business and strategic projects. – DiaLoGue survey results. – The future of Direct Line's workplace and culture including mixed model home and office working.	– Post-Covid Repair Centre shift arrangements reviewed, to ensure safe working arrangements are balanced with individual wellbeing.
June	Penny James (CEO)	– CEO update on business and strategic projects. – Implementation of the Pricing Practices Review. – DiaLoGue survey results. – DLG's People strategy focusing on: skills needed for the future; culture; wellbeing; diversity and inclusion.	– New employee communication channels piloted to ensure effective information flow under new ways of working.
September	Penny James (CEO) Danuta Gray (Chair of the Board) Mark Gregory (Non-Executive Director)	– CEO update on business and strategic projects. – Role of the Non-Executive Director. – Discussion with NEDs on: change programmes; Pricing Practices Review; and the impact of the pandemic. – How mixed model working is bedding in. – Strategy for growing and developing People.	– Focus given to providing greater transparency for promotion opportunities. – Prioritisation exercise to ease pressure on certain areas of the organisation. – DiaLoGue survey moved from monthly to quarterly in response to concerns about survey fatigue affecting response rates.
December	Penny James (CEO) Richard Ward (Remuneration Committee Chair)	– CEO update on business and strategic projects. – CEO presentation on strategic direction of DLG for 2022 and beyond. – Implementation of Pricing Practices Review. – DiaLoGue survey results. – Executive Remuneration. – All-employee pay review.	– Approach to all-employee pay review revisited. – Additional wellbeing support targeted to certain areas of the business.

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 89.

The Group's governance framework is detailed in the Group's High-Level Control and System of Governance Framework document. This document also 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 89;
- Enterprise Risk Management Strategy and Framework, which is described on page 89;
- Group policies, which address specific risk areas, are aligned to the Group's risk appetite, and inform the business on 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.

Matters Reserved for the Board and Board Committees' terms of reference

High-Level Control and System of Governance Framework document

Overarching risk appetite statements

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).

Enterprise Risk Management Strategy and Framework

Group policies

Policy risk appetite statements

Policy owner approves

Minimum standards, subject to non-objection from the Risk Management Committee.

Minimum standards

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 2021, 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 and Accounts. The terms of reference for each Committee can be found on the corporate website at: www.directlinegroup.co.uk/en/who-we-are/leadership/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 98 to 101.

Board Committees

Full details of membership, responsibilities and activity of each Committee throughout the year can be found on pages 119 to 136.

Audit Committee	Board Risk Committee
Investment Committee	Nomination and Governance Committee
Remuneration Committee	Sustainability Committee

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 102 to 103.

Chair

- Guides, develops and leads the Board
- Plans and manages the Board's business
- Oversees the governance framework

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

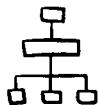
Executive Directors

- 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 areas and functions

Company Secretary

- Ensures the Directors receive accurate, timely and clear information
- Alongside the Chair, oversees the governance framework

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.

Biographical details of the Directors of the Company as at the date of this report are set out on pages 98 to 101. Full details of dates Directors who have served throughout the year can be found on page 160.

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 127 to 129.

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 of 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 included competition law, 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, including:

- Claims strategy;
- DLG Auto Services;
- Technology transformation;
- Expense management;
- DLG Vision;
- Electric vehicles;
- Data ethics and governance;
- Megatrends;
- Price Comparison Websites; and
- Pricing strategy.

Non-Executive Director ("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 2022 AGM. You can find out more about the activities of the Nomination and Governance Committee's work during the year on pages 127 to 129.

Information and support

The Board accesses assistance and advice from the Company Secretary. The Board, and each member of the Board, may seek external independent professional advice at the Company's expense, if required, to discharge its duties.

Board's approach to diversity and inclusion

The UK Corporate Governance Code promotes, and the Board supports, diversity of gender, social and ethnic backgrounds, cognitive and personal strengths in Board and senior management appointments.

During the year the Company made progress in improving the gender and ethnic diversity of its Board, Executive Committee and workforce as a whole. More information on this and statistics in respect of diversity can be found on page 64 of the Strategic report and pages 101 and 103 of the Corporate Governance report.

The Company has met or exceeded key external targets including the Hampton-Alexander Review's target to have 33% representation of women on FTSE 350 Boards, Executive Committees and their direct reports by 2020; and the Parker Review's target to have at least one director from an ethnic minority background by 2024. The Group, having achieved its Women in Finance Charter target to have 30% of women in senior finance positions by 2019, has increased this target to 35% by the end of 2022.

Senior management succession planning

The Board recognises that in order to maintain and improve on diversity levels, it must ensure that senior management succession planning is focused on promoting diverse leadership and that workforce diversity is achieved at all levels in order to secure a diverse pipeline of talent. During the year, the Board has overseen succession planning that has driven deeper into the organisation to identify talent.

In order to put further focus on diversity in succession planning, the Company's Annual Incentive Plan includes targets for Executive Directors, the Executive Committee and senior management in respect of improving gender and ethnic diversity of the workforce in the context of leadership succession planning (more information on this can be found on page 143 of the Remuneration report).

External directorships

During the year, Penny James, CEO, joined the Board of Hargreaves Lansdown plc as Senior Independent Director and a member of its Nomination and Risk Committees. Before Penny accepted the appointment, the Board reviewed the time commitment likely to be required for the role. The Board was satisfied that the time commitment would not affect Penny's ability to carry out her role as CEO and that she and the Board would be likely to benefit from the additional external perspective to be gained. The Board therefore approved the appointment.

The Board also reviewed and approved, in advance, Mark Gregory's appointment as a Non-Executive Director of Entain plc, Danuta Gray's appointment as Non-Executive Director of Burberry Group plc and North SP Limited, and Richard Ward's appointment as Non-Executive Director of CFC Group Limited. Again, the Board was satisfied that, in taking on the new positions, Mark, Danuta and Richard would continue to have sufficient time to dedicate to their roles with the Group.

Board appointments

The Board has in place a Board Diversity Policy which is reviewed annually and can be found on the Group's website. The policy sets out the key principles to be followed in respect of the Board appointment process. When using executive search firms, the Board will only engage those who are signatories to the Voluntary Code of Conduct for Executive Search Firms, which aims to promote diversity in the executive search process. More information on the Board appointment process can be found in the Nomination and Governance Committee report on pages 127 to 129.

Workforce diversity and inclusion

The Board continues to support Group-wide diversity and inclusion activities and initiatives, many of which are outlined on pages 61 to 64. This includes the work of Company's Diversity Network Alliance ('DNA1') which champions diversity and inclusion in the Group through its 'DNA strands': REACH; Belief; LGBT+; Life (working families and carers); Neurodiversity and Disability; Social Mobility; and Thrive (gender). More information about the work of the DNA during the year can be found on page 62.

Board skills, experience and knowledge

The Nomination and Governance Committee has an active and dynamic process of assessing and monitoring the skill set, experience and knowledge of Board members. The principles of the UK Corporate Governance 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.

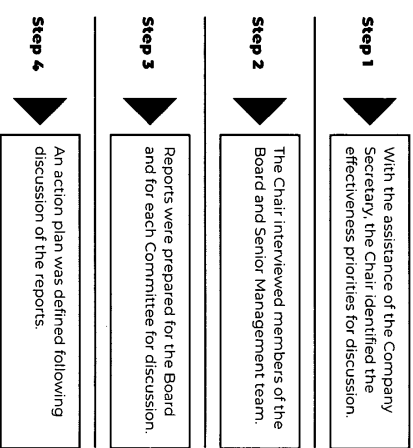
Board and Committee effectiveness review: three-year Board evaluation cycle

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 2021 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 2021 evaluation focused on both the preservation of the strengths identified in the 2020 and earlier evaluations, and on themes for sustaining effectiveness suggested in 2019 by Professor Robert Coffee, who was the external facilitator for the evaluation that year, 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.

Evaluation process



Corporate Governance Report *continued*

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) and provided constructive feedback to the Chair. No Director was involved in the review of their own individual 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 2020 review, as summarised in the table below. Suggestions for utilising the Independent Non-Executive Directors' experience, strengthening the Board's agenda and information flow, and engaging with external experts, were addressed during the year.

Focus areas from the 2020 review

Action taken during 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.



Due to continuing pandemic-related restrictions and the Group's adoption of a hybrid (remote and site-based) working model, a number of virtual deep-dive sessions were held during the year, in the context of which the Board was able to interact with the wider management team.

The Board's agenda and information flow

The sequence of strategic topics on the Board's agenda should be aligned with the executive programme, to allow for deeper and more regular strategic discussion.



The Board's agenda was more effectively aligned with the executive programme, which enhanced the quality of the Board's strategic discussion and its ability to provide timely insight and support.

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.



During the year, the Board received regular updates from brokers and, at the Board's annual strategy day in June 2021, external speakers from a range of backgrounds presented on key topics including: megatrends, technology platforms and electric vehicles.

Focus areas from the 2021 review

Proposed action for 2022

Strategic topics



The Board proposes to align its agenda during 2022 with the Group's prioritised Objectives and Key Results and to include thematic debates including: people, culture and the talent pipeline; growth and innovation; sustainability; and delivering the benefits of investment in technology.

Engaging more effectively with the wider executive team



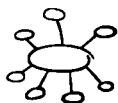
Opportunities will continue to be sought for the Board to engage with the wider management team and workforce, both in and around Board and Committee meetings and, as sites reopen, locally and in the context of divisional town hall sessions.

Preserving and refreshing skills and experience in future Board composition



The Nomination and Governance Committee will take a medium- to long-term view of pipeline development and succession planning, seeking to define the combination of Non-Executive Directors' experience, expertise, diversity and functional role fulfilment required to address future challenges and opportunities faced by the business.

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 and 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 94 and page 162;
- the Board's 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 Audit Committee report which starts on page 119.

Responsibility for preparing the Annual Report and Accounts

The Board's objective is to give shareholders a fair, balanced and understandable assessment of the Group's position, performance, 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 163. The Group's External Auditor explains its responsibilities on page 173.

The Directors confirm that they consider that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information that shareholders need to assess the Group's position, 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 and 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 and Accounts;
- the Company's Disclosure Committee reviewed an advanced draft of the Annual Report and Accounts; and
- the Audit Committee reviewed the substantially final draft of the Annual Report and 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 91 to 92.

This determination 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 greater based on a 1-in-200 year likelihood period. The quantifications are produced through stress and scenario analysis, and our 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, with the assistance of the Board Risk Committee and the Audit Committee, and support from the Risk and Group Audit functions 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 Risk function annually produces an Internal Risk and Control Assessment Statement to support the Board in monitoring the effectiveness of the Group's risk management and internal control systems. Each function completes a self-assessment of its risks and key controls and an Executive Sponsor, responsible for the function, attests to the status of the effectiveness of the risk management and internal control systems. The Risk function reviews and challenges these findings and the Group Audit function provides an independent assessment of the overall effectiveness of the governance and risk and control framework of the Group. The overall findings are combined into a Group-level assessment.

The 2021 Internal Risk and Control Assessment process did not identify any material control weaknesses; however, it did identify areas where further enhancements could be made to the Group's risk and control environment. Actions being taken in these areas of enhancement include: ongoing activities related to the Group's technology, information and system security, change and resilience controls; and the significant programme of activity of designing and embedding controls in relation to the delivery of the FCA's Pricing Practices remedies.

Corporate Governance Report *continued*

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. Group Audit's 2021 annual assessment of the risk management, governance and control environment did not identify any matters that conflict with the 2021 Internal Risk and Control Assessment Statement.

On behalf of the Board, the Board Risk Committee reviewed the 2021 Internal Risk and Control Assessment Statement and was satisfied with the conclusion that the Group's risk management systems were fit for purpose for managing all material risks and that its internal control systems were effective for managing all key controls, including financial, operational and compliance controls. The Board Risk Committee also 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.

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 confirms that there is an ongoing process for assessing the Company's risk management and internal control systems and identifying, evaluating and managing the significant risks faced by the Group, which has been in place throughout the period and up to the date of this report. The Board takes the view that, on the basis of the assessment carried out in and in respect of 2021, it would be reasonable to conclude that the Group's risk management and internal control systems are effective. 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.

Remuneration



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.

In his report on pages 134 to 159, 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 139.

Audit Committee Report

Areas of focus in the reporting period

- Financial reporting: reviewing and challenging the key accounting and actuarial estimates and judgements made by management to support the financial statements.
- Insurance reserves: reviewing the Group's insurance reserves to obtain assurance that they remain appropriate for discharging expected liabilities.
- IFRS 17 implementation under the Actuarial and Finance Transformation programme.
- Reviewed and challenged the Group's second Task Force on Climate-related Financial Disclosures Report.
- Overseeing the beginning of the external audit tender process.

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.

The Committee Chair, Gregor Stewart, is a member of the Institute of Chartered Accountants of Scotland. Fiona McBain and Mark Gregory are members of the Institute of Chartered Accountants in England and Wales.

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 various matters including IFRS 17 and the Actuarial Financial Transformation programme.

Main activities during the year

At each of its scheduled meetings, the Committee received reports on financial and non-financial reporting, insurance reserves, internal controls and Group Audit.

Financial reporting

The Committee followed a review process before recommending the Annual Report and 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 120. In the context of the Covid-19 pandemic, the Committee reviewed in detail the impact on the Group's financial performance, in particular on the level of Motor claims frequency, the development of prior-year reserves and specific areas of critical accounting estimates and judgements including on investment asset valuations.

In addition, the Committee considered the Group's use of alternative performance measures in explaining its financial performance.

Gregor Stewart
Chair of the Audit Committee

Committee membership¹

- **Gregor Stewart**
Chair
- **Mark Gregory**
Independent Non-Executive Director
- **Fiona McBain**
Independent Non-Executive Director

Committee meeting attendance can be found on page 107.

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 climate-related financial disclosures

Note:

1. Jane Hanson was a member of this Committee until she retired from the Board on 13 May 2021.

Audit Committee Report *continued*

The Committee reviewed papers prepared by management on the use of alternative performance measures in the financial statements and was satisfied that an explanation of both the alternative performance measure and why it was used was clearly communicated to users of the financial statements. Furthermore, the Committee also considered the estimates and judgements used to prepare the Group's capital position under Solvency II, including focusing on the level of technical provisions held. Specific matters considered included judgements made in respect of events not in data, and the risk margin. The Committee reviewed the Group's Solvency and Financial Condition Report and Regular Supervisory Reports and the quantitative reporting templates on behalf of the Board before submission to the PRA, and concluded that the processes to produce and review the Group's regulatory reports had operated satisfactorily.

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. During the year, inflation risks were discussed in detail, taking account of the end of the Brexit transition period, the continuing impact of Covid-19, supply chain constraints, as well as care cost, parts and

general labour inflation affecting different lines of business. The Actuarial Director presented scenario analyses for various inflationary drivers, supporting the booking of the claims reserves. The impact on investments and pricing were also considered with comprehensive asset liability matching. 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 Committee by PricewaterhouseCoopers LLP ("PwC").

IFRS 17 implementation under the Actuarial and Finance Transformation programme

During the year, the Committee was highly engaged in overseeing the Group's Actuarial and Financial Transformation programme. The programme is charged with the design and implementation of the changes required to be made to accounting and reserving processes and systems to ensure compliance with the new reporting standard IFRS 17. The Committee: reviewed and approved key design decisions underpinning the proposed solution; monitored the build of systems against key milestones; reviewed assurance updates in respect of the progress of the programme from Group Audit; and approved and monitored resourcing and budgetary requirements. The Committee held deep-dive training sessions on: the requirements of IFRS 17; accounting policy choices under IFRS 17; and changes to the reserving process as a result of the programme.

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 41 to 42.	In 2021, the Committee reviewed and challenged the approach, methodology and key assumptions used by management in setting the level of insurance reserves, and monitored developing trends that could have a material impact on them. On an ongoing basis it received updates from the Actuarial Director on how actual claims experience compared to expectations. Particular points of discussion in 2021 were the changes in frequency and severity trends due to Covid-19, care cost and damage claims inflation, as well as the impact of the Whiplash reform. The Committee also obtained insight and reviewed results from an independent actuarial review of the reserves. The Committee was satisfied that management had exercised appropriate control and judgement in estimating insurance liabilities. *
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. 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 2021, 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. The Committee concluded that the carrying values in the accounts were reasonably stated.

TCFD Report

The Committee reviewed the TCFD Report on behalf of the Board as part of its review of the Annual Report and Accounts. The TCFD Report can be found on page 76.

Going concern, viability and fair, balanced and understandable

The Committee considered the going concern assumptions and viability statement in the 2021 Annual Report and 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 and Accounts taken as a whole were fair, balanced and understandable and provided sufficient information to enable the reader to assess the Group's position, performance, business model and strategy.

When considering the 2021 Annual Report and Accounts, the Committee considered the significant judgements and issues which could be material to the financial statements. These included the matters set out in the table on page 120. 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 94.

Internal control

During the year, the Committee reviewed the adequacy and effectiveness of the controls that underpin the Group's financial reporting control framework which 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 2021, the Committee received regular reports on any control deficiencies, compensating controls and the mitigating actions taken by management. There were no material control issues reported to the Committee in the year. The Committee also considered management's processes and controls for identifying and responding to the risk of fraud. The Committee noted that there were no fraud-related events or actions to suggest that fraud might have a material impact on the financial statements. The Committee also monitored management's responses to the control insights and observations raised by the External Auditor in its annual management letter during the year, and were satisfied that management was taking appropriate and timely action to resolve the issues raised.

Group Audit

The Committee is responsible for overseeing the work of Group Audit and for ensuring industry best practice is adopted appropriately. 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.

During the year the Committee oversaw key developments in the Group Audit function, including the adoption of a new structure to provide clearer stakeholder alignment and enable more dynamic audit delivery which has led to improved productivity. Group Audit also established a Centre of Expertise to enable and drive the delivery of Group Audit's continuous improvement activities in conjunction with their external performance

partner, PwC. PwC continued to provide independent quality assurance activity and reported to the Committee on a regular basis.

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. Group Audit performed continuous oversight of the change portfolio and completed a number of reviews of major programmes during the year. The Committee approved Group Audit's plan on a rolling quarterly basis and confirmed the audit plan coverage on an annual basis. The Committee received quarterly reports detailing internal audit activity, key findings, management responses, and proposed action plans. There were no significant failings or weaknesses reported to the Committee in the year.

Following assessment by the Committee during the year, it was concluded that the Group Audit function was effective. The Committee approved the Group Audit Charter, which is reviewed annually.

Additional information

The Committee has unrestricted access to management and external advisers to help discharge its duties. It is satisfied that in 2021 it received sufficient, reliable and timely information to perform its responsibilities effectively.

During the reporting period the External Auditor and Group Head of Audit met privately with the Audit Committee, in the absence of management. The Chair of the Committee reported on matters dealt with at each Committee meeting to the subsequent Board meeting.

During the year, the FRC carried out a review of the Group's report and accounts for the year ended 31 December 2020. No substantive questions or queries were raised as a result of the review. It is noted that the FRC's review was limited to considering compliance with reporting requirements and it is not the FRC's role to verify the information provided.

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 work of the External Auditor and agreeing the audit fee, as well as approving the scope of the External Auditor's annual plan.

To ensure the continuing independence of Deloitte as External Auditor, and in compliance with the Group's minimum standard on independence of the External Auditor, this year Adam Addis, ACA, took over as lead partner for the 2021 audit.

External Auditor tenure

The Committee is responsible for conducting the external audit tender process. During 2021, it discussed the options for tendering the external audit contract. Under the reforms of the audit market by the Competition and Markets Authority, Deloitte could 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 relevant legislation, the firm may not re-engage for the audit after 17 June 2023.

Audit Committee Report *continued*

When considering the timing of the external audit tender and what would be in the best interests of shareholders, the Committee took into account relevant regulation, the Group's change programmes, the implementation of IFRS 17 and the objective of securing the participation of a broad range of firms in the tender. The Committee concluded that the most appropriate timing would be to undertake an initial request for information from audit firms in the fourth quarter of 2021, before moving to a formal competitive tender process in the second quarter of 2022, with a view to appointing the successful firm for the audit of the financial year commencing 1 January 2024. The Committee has initiated the request for information to potential audit firms, ensuring that firms outside the 'Big 4' audit firms were included in the invitation to participate, based on their general insurance industry capability and experience. It will continue to lead the process with the intention of making a recommendation to the Board later in 2022.

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 services by the External Auditor. The minimum standard is compliant with the Financial Reporting Council's review of its Ethical Standard for Auditors which was published in December 2019.

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 £0.3 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 2021.

	Fees £m	Proportion %
Audit fees	2.1	83
Audit-related assurance services	0.2	7
Non-audit services	0.3	10
Total fees for audit and other services	2.6	100

Audit-related assurance services were in respect of the Group's Solvency II reporting and the review of the Half Year Report 2021 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 ended during the year. To guard against any independence issues, appropriate safeguards were discussed and agreed by the Committee and Deloitte. 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 2021, the Committee conducted its annual review of the External Auditor's effectiveness. 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 2022 AGM.

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, provides the right degree of challenge, and interacts well with other Committees and the Board. Further information on the Board effectiveness review can be found on pages 115 to 116.

In addition, the Committee's terms of reference were reviewed against the activity of the Committee during the year. The terms of reference were found to be suitable, comprehensive and of appropriate scope.

The Committee's terms of reference can be found on the corporate website:

www.directlinegroup.co.uk/en/who-we-are/leadership/board-committees

The Board reviewed and approved this report on 7 March 2022.



Gregor Stewart
Chair of the Audit Committee

Board Risk Committee Report

Areas of focus in the reporting period

- Reviewed and challenged compliance with the FCA's new Pricing Practice Review rules.
- Challenged and supported the Group's approach to fair pricing and outcomes for all of our customers, including those that are vulnerable.
- Oversaw change risk arising from the Group's multi-year transformation programmes.
- Examined and monitored the embedding of climate-related financial risk management.
- Monitored progress on our operational resilience programme.

Further detail on these areas can be found in the body of the Committee report.

Customer and conduct

Customer and conduct risks are a principal focus of the Committee. The Committee devotes significant time to challenging and supporting management on its approach to managing these risks and seeking assurance that fair pricing and outcomes are being achieved for customers across all Direct Line Group products. In addition, the Group has a management-level Customer Conduct Committee which reviews, challenges and oversees customer and conduct matters across the business. The Customer Conduct Committee's findings and any

recommendations for improvement are regularly reported both to the Board and the Committee.

The Committee received reports on the actions taken during the year to support vulnerable customers. The Committee challenged management on the Group's vulnerable customer strategy to ensure that: regulatory expectations were being met; the work that had been undertaken to define, identify and understand vulnerable customers was sufficient; and appropriate and timely vulnerable customer training was being provided to our customer facing and support staff.

In respect of the Pricing Practices Review, the Committee received assurance reports from management at each of its meetings throughout the year to ensure that customer and conduct risks were being carefully managed and mitigated and that the Group was in a position to deliver the intended customer outcomes. Focus was also given to the ability of the Group to trade effectively following the implementation of Pricing Practices Review requirements.

In addition, the Committee reviewed the Group's annual pricing report, pricing strategy and pricing governance and control framework. The Committee also received updates and challenged management on the data ethics framework which had been deployed for the Group, and on the activities undertaken to complete and embed the framework into governance and business processes.

Mark Gregory

Chair of the Board Risk Committee

Committee membership¹

- **Mark Gregory** – appointed as Chair on 13 May 2021
Committee 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 107.

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
- 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

Note:

1. Jane Hanson was Chair of this Committee until she retired from the Board on 13 May 2021.

Board Risk Committee Report *continued*

Compliance and regulatory risk

During the year, the Committee regularly received reports on the Group's interpretation of and compliance with the new Pricing Practices Review rules. The Committee sought assurance that management was on track and had adequate resource to meet the challenging regulatory deadlines; had developed robust and reasonable rule interpretations; and had managed regulatory risks appropriately.

During the year, the Committee considered the Group's compliance with other regulatory requirements including those relating to conduct and financial crime. The Committee approved the annual Compliance Plan which sets out compliance activities to be undertaken in the coming year, with a view to ensuring compliance with regulation, 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 2021. 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.

Operational risk

During the year, through receipt of regular operational resilience programme 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, systems and processes for identifying important business services. Committee members also attended a deep-dive session on the Group's operational resilience self-assessment, important business services and impact tolerances.

The Committee supported the significant progress that management has made in completing the majority of the Group's transformation agenda to deliver greater technology and data capability across the business and further embed sustainable outcomes. The Committee reviewed and challenged summaries from management on the transitioning and embedding of new systems into business operations and the development of the Group's remaining technological transformation releases. The Risk function also provided updates to the Committee on its assurance activity, which included reviewing and challenging programme plans and processes to ensure the safe delivery of new systems and the mitigation of customer impacts. In addition, third-party assurance was provided to the Committee by Deloitte, who had been engaged to conduct a deep-dive review on technical readiness for business volume increases and programme closedown. KPMG also carried out a readiness assessment which was presented to the Board and Committee.

Through receipt of a cyber risk update, the Committee challenged management on the lessons learned from a real-world highly sophisticated supply chain attack on another organisation during the year and sought assurance that Direct Line Group had appropriate technical expertise and mitigating controls and actions in place to respond and recover in the event of a ransomware incident. The Committee also probed to ensure that management was satisfied with its approach to managing cyber risk in relation to home working arrangements.

Financial risk

During the year, through a technical briefing and regular climate-related updates, the Committee examined and monitored management on its progress to embed climate-related financial risk management in the business. The Committee reviewed and challenged updates on key deliverables such as the completion of the Bank of England Climate Biennial Exploratory Scenarios ("CBES") and the full implementation of the PRA's supervisory statement requirements relating to climate change. The Committee reviewed the Climate Risk Management Report, which included the Group's climate change strategy and the CBES model results, and approaches to evolving the strategy through management actions. Further details on the risks due to climate change faced by the Group can be found on pages 84 to 85 and 93.

At each meeting, the Committee monitored the Group's performance against its capital risk appetite through the CRO's report. Committee members also reviewed and challenged the 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, the prioritisation of change resource and activities to deliver the strategic plan, pricing and underwriting risk, internal model validation activity and the appropriateness of contingent management actions.

The Committee monitored and challenged the stress and scenario testing plan with a particular focus on areas of uncertainty such as further lockdown periods leading to continued global disruption and customer behaviour changes, the potential economic implications resulting from the end of the furlough scheme and adverse Brexit consequences. In addition, the Committee reviewed the potential contingent management actions which management could consider taking in times of stress to restore the Group's capital strength to within an acceptable risk appetite range. Further details on the risks due to climate change faced by the Group can be found on pages 84 to 85 and 93.

The Committee regularly reviewed and challenged reports on our internal model for determining regulatory capital requirements in the year, including model changes and future management actions assumed by our internal model such as continuing to buy reinsurance, selling downgraded bonds and hedging of currency risks. The Committee also reviewed the independent validation results which outlined the scope of our internal capital model, key outputs, risk drivers, significant parameters, expert judgements and key assumptions. In addition, the Committee reviewed the internal model owners' report with a particular focus on the model insights relating to sources of profit.

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 summarised the outputs of regular risk monitoring and details of specific risk matters. Areas that the Committee focused on in particular included Covid-19 impacts and risks, financial impacts and risks of the FCA's Pricing Practices Review, motor market trading challenges, Brexit uncertainties, climate change, strategic plan key assumption and dependencies, cyber risk, lessons learned from the technology transformation, key ongoing regulatory developments and interactions and the Group's current and forward-looking solvency position.

The Committee received regular reports regarding our 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 Group's 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. Further detail on the outcome of these assessments can be found on page 117.

Principal and emerging risks

The Committee assessed the principal risks facing the Group, which are listed on pages 91 and 92, 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 Committee meeting.

The Committee assessed the Group's emerging risks. It challenged management on the identification of all possible significant emerging risks during the year and on the Risk function's role in ensuring that such emerging risks were being monitored and managed appropriately. The most notable emerging risks identified included those relating to climate change, ethical use of data and global financial instability.

Further details regarding such risks can be found on pages 91 to 93.

Whistleblowing

As delegated by the Board, the Committee routinely reviews 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. As Committee Chair, I am responsible for oversight of the independence, autonomy and effectiveness of the Group's policies and procedures on whistleblowing including the procedures for protection of staff who raise concerns from detrimental treatment. During the period, the Committee 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.

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 to ensure that employees act responsibly and ethically at all times when conducting business.

The Committee considered the Group's actions to prevent financial crime through its review of the annual financial crime report and recognised the additional monitoring controls that had been implemented to manage remote working fraud risk. 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. 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.

Board Risk Committee Report *continued*

Appointment of new CRO

Following Jose Vazquez's decision to retire as CRO, a search was launched by management, who appointed Rice Search Partners to assist in the search for his successor. Members of the Committee were invited to interview shortlisted candidates and supported management's choice to appoint Aurore Lecanon as CRO to succeed Jose. Aurore was previously Chief Risk and Compliance Officer of Prudential International Assurance and her DLG appointment was effective from 2 December 2021.

Risk governance

During the reporting period, the Committee received assurance from management on the process for policy review and reviewed material changes to 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 as appropriate. The Committee considered, challenged and approved the annual Risk Operational Plan which set out the Risk function's priorities aligned to the strategic plan.

The Committee has unrestricted access to management and external advisers to help discharge its duties. It is satisfied that in 2021 it received sufficient, reliable and timely information to perform its responsibilities effectively. In addition to one-to-one meetings with the Chair, the Chief Risk Officer also met privately with the Committee without the Executive Directors. The Chair also reported on matters dealt with at each Committee meeting to the subsequent Board meeting.

Committee effectiveness review

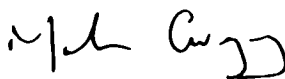
During the year, an internal evaluation of the effectiveness of the Committee was conducted by the Chair of the Board as part of the wider review of the Board and the Board Committees. The review found that the Committee's agenda was well-aligned with the Group's strategic priorities and that the Committee Chair transition had been managed seamlessly. Further information on the Board effectiveness review can be found on pages 115 to 116.

In addition, the Committee's terms of reference were reviewed against the activity of the Committee during the year. The terms of reference were found to be suitable, comprehensive and of appropriate scope.

The Committee's terms of reference can be found on the corporate website:

www.directlinegroup.co.uk/en/who-we-are/leadership/board-committees

The Board reviewed and approved this report on 7 March 2022.



Mark Gregory

Chair of the Board Risk Committee

Nomination and Governance Committee Report

Areas of focus in the reporting period

- Oversaw the appointment of the new CFO.
- Reviewed the skills and experience needed by the Board and its Committees to oversee the Group's strategy and led the search for a new Non-Executive Director.
- Monitored progress on executive succession planning, both for members of the Executive Committee and for the Senior Management talent pipeline below Executive Committee level.

Main activities during the year

Board changes

One of the key matters that the Committee considered during the year was the appointment of the new CFO following Tim Harris's decision to retire as CFO for personal reasons. In reaching its CFO succession recommendation, the Committee reviewed the benchmarking that had been carried out during the previous CFO search and considered Neil Manser's strong contribution and performance while he acted as CFO both immediately before Tim's appointment and in Tim's absence.

The Committee took into account Neil's deep strategic understanding of the Group, his strong background in the insurance sector and capital markets, and his excellent working relationship with Penny James, CEO. The Committee concluded, for those reasons, that the strength of Neil's candidacy was such that a formal executive search was unnecessary and, regulatory approval having been obtained, recommended to the Board that Neil be appointed as CFO on a permanent basis. Neil's appointment as CFO was announced on 13 May 2021. More information about Neil's experience can be found on page 98.

In May 2021, Jane Hanson, Non-Executive Director, stepped down from the Board as planned, having served a full nine-year term. The Committee took the opportunity to review and refresh the Chairship of its Committees which resulted in a recommendation that Mark Gregory be appointed as Chair of the Board Risk Committee and relinquish the Chairship of the Remuneration and Investment Committees, that Richard Ward be appointed Chair of the Remuneration Committee, and that Fiona McBain be appointed as Chair of the Investment Committee.

Danuta Gray
Chair of the Nomination
and Governance Committee

Committee membership

- **Danuta Gray**
Chair
- **Sebastian James**
Independent Non-Executive Director
- **Dr Richard Ward**
Independent Non-Executive Director

Committee meeting attendance can be found on page 107.

Key responsibilities

- Review composition of the Board and its Committees
- 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
- Set diversity objectives and strategies
- Oversee and monitor the corporate governance framework of the Group
- Monitor developments in governance and investor ESG expectations

Nomination and Governance Committee Report *continued*

Following Jane Hanson's departure, the Committee reviewed the composition and balance of the Board and identified a requirement for an additional independent Non-Executive Director. 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 individual Director, was engaged to assist in a search for a candidate with experience of digital transformation, cultural change and customer-focused innovation. Shortlisted candidates were interviewed by members of the Committee and the preferred candidate met other members of the Board before the Committee made its final recommendation. This process resulted in the Committee's recommendation to the Board that Tracy Corrigan be appointed as an independent Non-Executive Director with effect from 1 November 2021. In early November 2021, the Committee also recommended, and the Board agreed, to appoint Tracy as a member of the Sustainability Committee. More details on Tracy's experience and skills can be found on page 99.

Board and Senior Management succession planning

The Committee keeps the composition of the Board and its Committees under continual review 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 Committees' responsibilities effectively. For example, in appointing Tracy Corrigan as an additional member of the Sustainability Committee, we have recognised the expanded remit of that Committee, including its oversight of the establishment of Science-Based Targets, the Group's approach to supporting vulnerable customers and our community support and social mobility initiatives.

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.

Electing and re-electing Directors

Before recommending the proposed election or re-election of Directors at the 2021 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 UK Corporate Governance Code. The Chair of the Board was independent on appointment.

The Committee also carefully considered Directors' external responsibilities and concluded that all Directors had sufficient time to dedicate to their respective roles.

The Committee recommended to the Board and shareholders that all serving Directors, except Jane Hanson, who would be stepping down from the Board, be submitted for election or re-election at the Company's 2021 AGM. Tim Harris made his decision to step down as CFO for personal reasons following the circulation of the Notice of the 2021 AGM and the AGM resolution to re-elect him was withdrawn accordingly.

All current Directors will submit themselves for election or re-election at the Company's 2022 AGM.

Diversity and inclusion

The Committee believes that an effective Board with a broad strategic perspective embraces a diversity of gender, ethnicity, skills, experience and cognitive diversity, as well as diversity of regional, socio-economic, educational and professional backgrounds.

The Board's Diversity Policy is available to view on the Company's website at www.directlinegroup.co.uk/en/sustainability/reports-policies-and-statements. This policy, which is monitored and reviewed annually by the Committee, is made available 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's Diversity Policy and initiatives can be found in the Corporate Governance report on page 114 which includes progress against Hampton-Alexander and Parker review targets.

The Committee is also engaged in promoting diversity at a Senior Management and Group-wide level. 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, which includes the objectives both of encouraging diversity in succession planning and of fostering a culture of growing inclusivity. Further information on the Group's diversity policy and initiatives can be found in the People section of the Strategic report on page 61.

Corporate governance

The Committee monitors emerging governance matters, compliance with the UK Corporate Governance Code, observance of ESG standards and subsidiary governance. It will continue to monitor consultations, developments and reforms which affect the Group's adherence to corporate governance best practice.

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, involves the wider Board in search processes as necessary and strikes an appropriate balance between Committee and Board discussions about the executive talent pipeline and succession planning. Further information on the Board effectiveness review can be found on pages 115 to 116.

In addition, the Committee's terms of reference were reviewed against the activity of the Committee during the year. The terms of reference were found to be suitable, comprehensive and of appropriate scope.

The Committee's terms of reference can be found on the corporate website:

www.directlinegroup.co.uk/en/who-we-are/leadership/board-committees

The Board reviewed and approved this report on 7 March 2022.



Danuta Gray

Chair of the Nomination and Governance Committee

Sustainability Committee Report

Sustainability Committee Report

Areas of focus in the reporting period

- Monitored the Group's activity under the five pillars of the Group's sustainability strategy.
- Oversaw the Group's involvement in environmental initiatives, including progress towards achieving Science-Based Target initiative ("SBTi") validation status.
- Considered decision making on ethical matters, including the Group's Modern Slavery Statement.
- Reviewed performance and approach on ethical matters, including customer and supply chain issues.
- Reviewed the Group's people plans, including any impact of a move to a hybrid working model.

Main activities during the year

Customer

During the year, the Committee oversaw the team's work to drive positive customer outcomes and to align business practices with the Group's purpose: "to help people carry on with their lives, giving them peace of mind now and in the future." The Committee reviewed work being undertaken to implement changes required by the FCA's Pricing Practices Review and considered how this could be used as an opportunity to achieve even better outcomes for customers, as well as ensuring regulatory compliance.

Additional opportunities to deliver further improvements in outcomes for customers were reviewed. This included an action plan laying out how the Group ensured fair treatment of vulnerable customers. In addition, the Group's involvement in the Plain Numbers trial was recognised as an important way to further enhance clarity for customers. The Committee welcomed the Group's engagement in the initiative and supported commitment to use lessons learned in future customer communications and to allocate dedicated resource to this area.

People

Over the course of 2021, the Committee oversaw work to encourage a culture that helps people thrive through celebrating difference. The Committee additionally considered the use of engagement tools to understand how colleagues' wellbeing had been affected by the Covid-19 pandemic. It examined, in depth, the Group's transition to a mixed working model and reviewed the Group's strategy to create meaningful engagement in a context of remote working. The Committee reviewed the Group's approach to future skills development, which supported the Group's work to ensure a sustainable business for the future.

Sebastian James
Chair of the Sustainability
Committee

Committee membership¹

- **Sebastian James**
Chair
- **Tracy Corrigan** – appointed on 4 November 2021
Independent Non-Executive Director
- **Penny James**
Chief Executive Officer
- **Adrian Joseph**
Independent Non-Executive Director

Committee meeting attendance can be found on page 107.

Key responsibilities

- Provide oversight of and advice to the Group on conducting its business in a responsible and sustainable manner
- Monitor the progress of the Group against its five sustainability pillars

Note:

1. Jane Hanson and Tim Harris were members of this Committee until they retired from the Board on 13 May 2021.

The Committee reviewed steps taken to address feelings of isolation reported by some colleagues as a result of lockdown measures and advocated for the alignment of the Group's vision and strategy at every level of the business.

Since the inclusivity survey conducted in 2020, a number of minority groups reported that they felt less marginalised. This was welcomed by the Committee, with the publication of the Group's first Black Inclusion report identified as an important step as part of the Group's wider aim to facilitate social mobility.

Planet

Throughout 2021, the Committee oversaw work to protect the business from the impact of climate change and to achieve the goal of "giving more back to the planet than the Group takes out." The Committee oversaw the Group's involvement in external engagement initiatives, including the Group's commitment to setting Science-Based Targets ("SBTs") by August 2022. To this end, the Committee received insights into challenges facing the three most carbon-intensive areas of the business, namely, Auto Services, procurement and investments. For further details on alignment of our investment portfolio with initiatives which will support the transition to a low-carbon economy, see the Investment Committee report for 2021 on pages 132 to 133.

During the year, a Climate Executive Steering Group was set up to actively monitor progress towards sustainability across the business. The Committee received its first report from the Steering Group in September 2021 and will continue to engage with the Steering Group moving into 2022.

The Committee received updates on additional activities undertaken by the Group as part of its commitment to the environment, most notably:

- participation in the Electric Vehicle Fleet Accelerator ("EVFA"), a pledge to convert the Company's van fleets to electric vehicles by 2030;
- co-sponsorship of one of the workstreams in HRH the Prince of Wales' Sustainable Markets Initiative Insurance Taskforce; and
- a commitment to the Get Nature Positive campaign to restore nature and biodiversity.

Updates on the Group's involvement in the Bank of England's Climate Biennial Exploratory Scenario ("CBES") were received and noted by the Committee. Further detail regarding the Group's CBES submission can be found in the Board Risk Committee report on pages 123 to 126.

Society

Over the course of the year, the Committee reviewed the allocation of the Group's £1.5 million Community Fund (the "Fund"), which had been launched as part of the Group's response to the Covid-19 pandemic in 2020. In 2021, funding priority was given to addressing problems arising from: marginalised groups; loneliness; food poverty; and mental health and wellbeing. Resource has been allocated to continue the Fund into 2022 and the Committee reviewed a refreshed purpose for the Fund: to help build a more inclusive and equitable Britain by improving social mobility and accelerating inclusion.

In the latter part of the year, the Committee reviewed management's shortlist of potential strategic partners to deliver the new vision for the Fund and monitored progress made under the Fund Steering Group.

Governance

The Committee is committed to its role in supporting ethical and sustainable business practice across the Group and challenging management's approach to delivering outcomes in line with the Group's vision and purpose.

In December 2021, the Committee reviewed the Group's policy on compliance with the Modern Slavery Act 2015 (the "MSA") and how third-party suppliers complied with the Act's requirements.

The Committee reviewed the Procurement function's activity in relation to the MSA and concluded that processes and policies in connection with the MSA were robust, effectively embedded in supply chain processes, and reflected the Procurement function's updated sustainability processes.

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's scope had evolved effectively during the year and allowed a range of sustainability issues to be addressed strategically and in suitable depth. Further information on the Board effectiveness review can be found on pages 115 to 116.

In addition, the Committee's terms of reference were reviewed against the activity of the Committee during the year. The terms of reference were found to be suitable, comprehensive and of appropriate scope.

The Committee's terms of reference can be found on the corporate website:

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The Board reviewed and approved this report on 7 March 2022.



Sebastian James

Chair of the Sustainability Committee

Investment Committee Report

Investment Committee Report

Main areas of focus in the reporting period

- Monitored the financial consequences for the Group's investment assets as global economies started to recover during 2021 from the economic downturn driven by the Covid-19 global pandemic.
- Ensured investment activities continued to provide sufficient access to liquidity to meet a stress insurance or market event and remain within risk tolerances and other agreed parameters.
- Considered future possible developments to asset strategy as the Group continued to align its investment activity with the transition to a low-carbon economy and possible future investment into areas such as carbon sequestration.
- Considered how the investment portfolio is responding proactively to the global challenge to reduce greenhouse gas emissions.
- Received updates on the Group's progress to finalise identified actions to be ready for the discontinuation of the London Inter-Bank Offered Rate ("LIBOR") in 2022.

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 and key data points in the UK, the US and the Eurozone as economies exited lockdowns; 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 market consensus views and guidance on the development of interest rate policies set by the Bank of England, the US Federal Reserve, and the European Central Bank.

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 holdings. During the year, the Committee agreed amendments to the existing strategic benchmark which entailed exiting a dedicated euro fixed income benchmark allocation with corresponding increases in allocations to specialist subordinated financial debt and global fixed income benchmarks.

Fiona McBain

Chair of the Investment Committee

Committee membership¹

- **Fiona McBain** – appointed as Chair on 13 May 2021
Committee Chair
- **Mark Gregory**
Independent Non-Executive Director
- **Neil Manser** – appointed on 13 May 2021
Chief Financial Officer

Committee meeting attendance can be found on page 107.

Key responsibilities

- Provide oversight of the Group's investment strategy
- Oversee the management and performance of the Group's investment portfolio

Note:

1. Tim Harris was a member of this Committee until he retired from the Board on 13 May 2021. Mark Gregory was Chair of this Committee until 13 May 2021.

The Committee considered the Group's strategy and use of Money Market Funds ("MMFs") for cash investments. It looked at the requirements set for using such funds, the diversification within such funds and across the MMFs invested into, and what could potentially limit DLG's access to liquidity (from MMFs) in a period of market stress.

Responsible investing – climate change

Following Committee approval in 2020 to set a target to reduce greenhouse gas ("GHG") emissions intensity¹ across corporate bond portfolios by 50% before the end of 2030 (benchmarked against the end of 2020 position), the Committee received confirmation and analysis of the end 2020 GHG emissions intensity calculations. The analysis studied the top contributors to the Group's 2020 year-end emissions by sector, currency, and single name, and detailed the findings from the Audit function's independent assessment of management's emissions calculation. At each subsequent meeting, the Committee received updated GHG emissions intensity calculations.

The Committee received updates from the CRO and Director of Financial Risk on progress and results from the Bank of England's Climate Biennial Exploratory Scenario ("CBES").

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; the alignment of the investment portfolio with an agreed climate framework; and compliance with an agreed framework of risk and liquidity limits. During the year, the Committee invited the team managing the internal pound sterling fixed income portfolios and two external managers responsible for managing other investment-grade fixed income portfolios to present updates on their respective portfolios and their assessments of conditions and the outlook for fixed income markets.

Committee effectiveness review

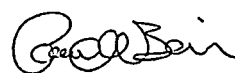
During the year, an internal evaluation of the effectiveness of the Committee was conducted as part of the wider review of the Board and the Board Committees by the Chair of the Board. The review found that the Committee functions effectively and that issues are dealt with in a thoughtful and rigorous manner. Further information on the Board effectiveness review can be found on pages 115 to 116.

In addition, the Committee's terms of reference were reviewed against the activity of the Committee during the year. The terms of reference were found to be suitable, comprehensive and of appropriate scope.

The Committee's terms of reference can be found on the corporate website:

www.directlinegroup.co.uk/en/who-we-are/leadership/board-committees

The Board reviewed and approved this report on 7 March 2022.



Fiona McBain

Chair of the Investment Committee

Note:

1. Greenhouse gas emissions intensity = metric tonnes CO₂e (CO₂ equivalent) GHG emissions/million \$ sales.

Directors' Remuneration Report

Directors' Remuneration Report

Dear Shareholders,

I am pleased to introduce my first Directors' Remuneration Report (the "**Report**") as Chair of the Remuneration Committee (the "**Committee**"), for the 2021 financial year. I would like to thank Mark Gregory for his interim stewardship of the Committee since October 2020.

The remuneration of our Executive and Non-Executive Directors for 2021 is based on the Directors' Remuneration Policy which was approved with 97.55% shareholder support at the AGM in May 2020. Consistent with the regulations, the Directors' Remuneration Policy is next due to be submitted to the Company's 2023 AGM for approval.

The Group delivered significant strategic progress, at the same time as delivering strong financial performance during 2021 whilst navigating the complexities and uncertainties of a challenging market impacted by the pandemic. It completed the majority of its planned technology transformation and built data capability across the business. The increase in underwriting profit from growing own brand policy count and a strong investment return results in a strong profit before tax.

This has been a busy year for the Group with the progression of our transformation. In the context of remuneration, the Committee considered the following items:

- Neil Manser's appointment to CFO on 13 May 2021. The Committee considered the appropriate remuneration that would motivate him in the context of market practice and wider workforce remuneration.
- The arrangements for the retirement of Tim Harris and appointments of new Executive Committee members. More information is in the Annual Report on Remuneration in relation to the departing CFO.
- Refining the indicators used within the Annual Incentive Plan ("**AIP**") and Long Term Incentive Plan ("**LTIP**") to optimise the links to our strategic agenda to deliver long-term sustainable growth with a customer-obsessed mindset as well as emphasising our net zero commitment.

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.

Richard Ward
Chair of the Remuneration
Committee

Committee membership

- **Dr Richard Ward**
Chair – appointed 13 May 2021
- **Danuta Gray**
Chair of the Board
- **Sebastian James**
Independent Non-Executive Director
- **Mark Gregory**
Independent Non-Executive Director

Key responsibilities

- Determine the policy for rewarding Directors and senior leadership for results that are generated within the risk appetite set by the Board and oversee how the Group implements its Remuneration Policy
- Oversee the level and structure of remuneration arrangements for senior executives, approve share incentive plans, and recommend them to the Board and shareholders
- Review workforce remuneration and related policies and the alignment of incentives and rewards with culture

Note:

Mark Gregory was Chair of the Committee until Richard Ward's appointment on 13 May 2021.

The Report is set out in the following sections:

Section	Page
Chair's statement	134 to 136
Remuneration at a glance – summarising the remuneration arrangements for Executive Directors	137
Annual Report on Remuneration – detailing pay outcomes for 2021 and covering how the Group will implement remuneration in 2022	138 to 155
Summary of the Policy approved at the 2020 AGM	156 to 159

“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.”

Wider workforce engagement and pay considerations for 2021

As part of the wider Committee oversight on all-employee pay matters, the Committee (following a detailed review) is delighted to confirm that the Group will apply an increase to our minimum salary of £1,300 (6.7%) bringing the Group-wide minimum salary from £19,500 to £20,800 for full-time colleagues on 37.5hrs from 1 April 2022, subject to satisfactory performance. This is 7.8% above the Living Wage Foundation's National Real Living Wage (November 2021) and 12.3% higher than the Government's statutory National Living Wage (April 2022 figure for those aged 23 or over). In addition, a £400 special payment will be awarded in April 2022 to everyone who is not usually eligible for a bonus as part of their contract, to recognise their contribution to the business during 2021.

The Committee regularly and carefully considers wider employee pay as context for the decisions it makes. For the ways in which this is achieved, including further information relating to the matters discussed at the Group's Employee Representative Body (“ERB”) relating to executive pay and how internal relativities have been monitored, see page 138 for further information.

Performance and incentive outcomes for 2021

During 2021, we continued to balance the needs of our stakeholders, supporting our people through the pandemic, looking after our customers, protecting the business for the long term, and supporting our local communities. 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. The Group embraced a mixed working model during 2021, ensuring a safe, supportive and caring environment for each other every step of the way.

The management team has made good progress this year, completing much of our technology transformation and delivered good results despite the complexities and uncertainties of a challenging market. The Group has achieved a strong capital position supported by our successful customer-focused strategy and our investment in sustainable future capabilities. This performance is reflected in the incentive outcomes for our Executive Directors.

AIP

We have achieved a strong set of results in 2021, having grown our own brand policy count, increased operating profit with higher prior year reserving releases and a strong investment return result, alongside incredible efforts whilst supporting our customers, people and local communities which has helped us to achieve strong results in 2021. This has led to a profit before tax of £547.5 million (before restructuring and one-off costs), significantly above the maximum performance level set at the start of the financial year.

Performance across the Customer measures (including Net Promoter Score, complaints, and customer experience) was also strong, and the Committee awarded an 80% of maximum outturn for this element. The People measures were assessed as being between target and maximum, at 70% of maximum because of strong improvements in inclusion, but moderated engagement scores. Although management has made significant progress by completing much of its transformation agenda to deliver greater technology and data capability across the business, there has been lower in-force policies growth and the Committee therefore awarded an outturn of 50% of maximum for this element.

There have been no adjustments to the performance targets set at the beginning of the year. The Committee determined that the formulaic outturn of the 2021 AIP was appropriate based on the Group's strong performance in the year, noting that the employee bonus pool is based on the same performance measures as the Executive Directors to ensure consistency of performance outcomes. The Committee therefore agreed that no discretionary adjustments were required.

The overall AIP outcome for the Executive Directors for 2021 was therefore 84% of maximum which resulted in a payout of £1,200,990 for the CEO and £479,465 for the CFO (relating to the period as an Executive Director), which the Committee believes is appropriate in the context of the Group's performance in 2021. 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 141 to 144.

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. The March 2018 and August 2018 LTIP awards (which vested during 2021) were granted before the appointment of Tim Harris; however, the outcomes of these awards are relevant to Penny James, Neil Manser, and certain former Directors.

In accordance with the remuneration reporting regulations, the reported figures in the single figure table for 2021 include:

The RoTE element of the 2019 LTIP awards (performance period ending 31 December 2021):

- average RoTE performance of 21.4% over 2019, 2020 and 2021, is above the maximum performance level of 20.5% and therefore this element will vest at the maximum level (subject to the above underpins).

Directors' Remuneration Report *continued*

The relative TSR element of the 2018 LTIP (performance period from grant to vesting date):

- relative TSR performance was above the threshold performance level for both the March and August 2018 LTIP awards (based on performance over the three-year period from the date of grant of each award).

The overall outcome of the March and August 2018 LTIP awards (including the RoTE outcomes disclosed last year) were 74.8% and 68.0% of maximum respectively.

The relative TSR elements of the 2019 LTIP awards will be disclosed in next year's report once the performance period is complete.

No discretion was exercised in respect of LTIP awards vesting during the year, which reflects the Group's exceptional RoTE performance and TSR outcomes in a challenging market over the last three years.

Remuneration Policy

In accordance with the regular shareholder voting cycle, we intend to review the Directors' Remuneration Policy during 2022 and we will put forward a new Directors' Remuneration Policy for shareholder approval at the 2023 AGM.

Executive Director changes

On 11 January 2021, Tim Harris commenced a leave of absence for personal reasons. However, for the reasons explained in the RNS announcement published on 13 May 2021, Tim retired as CFO and stepped down from the Board with immediate effect. Tim's employment with DLG will cease at the end of his 12-month notice period on 12 May 2022. During this period, he continues to receive his contractual entitlement to salary, pension, and benefits. In accordance with the Directors' Remuneration Policy, our incentive plan rules and our standard treatment for retirees, the Remuneration Committee determined that Tim would be treated as a "good leaver". As such, Tim's unvested share awards will continue to vest on their usual vesting dates (with time pro-rating applied to his LTIP awards). To reflect the period worked as an Executive Director to 10 January 2021, Tim is also eligible to receive a 2021 AIP award (with 40% deferred in shares for three years). Further details are set out on pages 151-152.

Neil Manser was appointed to the Board as CFO and a member of the Investment Committee with effect from the conclusion of the 2021 AGM. In setting Neil's remuneration, the Committee considered market data in respect of FTSE 51-150 companies and other FTSE 350 Insurers, the previous CFO's remuneration package, our Directors' Remuneration Policy and the pay and conditions of the wider workforce. Neil's salary was set at £515,000, slightly below that of the previous CFO (£535,000). Neil's maximum opportunity under the AIP and LTIP is 175% and 200% of salary respectively, consistent with the CEO and previous CFO. In line with the wider workforce, Neil's pension contribution is 9% of salary. Details of Neil's remuneration, which took effect from 13 May 2021, are set out on page 152.

Approach to pay in 2022

Salary increases will be awarded for the wider workforce population distributed from a budget of 2.5% of current salary. Neither the CEO nor CFO will be awarded a salary increase. No change is proposed to the overall weightings of the financial and strategic elements under the AIP, however the underlying categories and sub-weightings within the

strategic element have been reviewed. The Committee carefully considered how best to align remuneration to delivering profitable growth, realising cost savings, alongside supporting customers and great people and has amended the categories and weightings appropriately to reflect these strategic priorities. The performance measures within the new categories are aligned with the Group's Objectives and Key Results, reflecting a series of stretching, long-term objectives, with one-year targets set on an annual basis, at the start of the year to ensure continued progress towards each long-term goal. Further details are set out on page 154.

We are introducing an emissions measure (10% weighting) based on greenhouse gas reduction targets, certified by the Science Based Target Initiative ("SBTi"). The Group is currently in the process of seeking certification of its long-term emissions targets with the SBTi and expects this to be completed later in 2022. The emissions targets for the LTIP will be set by the Committee based on the certified SBTi targets and disclosed in next year's Directors' Remuneration Report. The target RoTE scale of 17.5% to 20.5% will remain at the same level as in 2021 and reflects an appropriate performance range in the context of the Group's planned underlying RoTE performance. The RoTE weighting will reduce from 60% to 50%. The Relative TSR weighting will remain at 40% and continue to be measured against the FTSE 350 (excluding investment trusts) peer group. Vesting for median TSR performance (threshold) remains at 20% and for upper quintile TSR performance (maximum) is 100% with straight-line vesting in between these points. Further details are set out on page 155.

Committee performance

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. Further information on the Board effectiveness review can be found on pages 115-116.

In addition, the Committee's terms of reference were reviewed against the activity of the Committee during the year. The terms of reference were found to be suitable, comprehensive and of appropriate scope, subject to some minor clarifications, which were incorporated.

The Committee's terms of reference can be found on the corporate website: www.directlinegroup.co.uk/en/who-we-are/leadership/board-committees

Your AGM vote

The Committee welcomes investor feedback on an ongoing basis and this Report seeks to describe and explain our remuneration decisions clearly. I hope that having read the information in this report, and considering the performance of the Group during 2021, you will vote in support of the 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,



Dr Richard Ward

Chair of the Remuneration Committee

Remuneration at a glance

Remuneration outcomes for 2021

> Find out more on page 140

AIP achievement

This chart illustrates the actual amounts earned from the AIP reflecting performance in 2021. 60% of the amount is payable in March 2022 and 40% will be deferred into shares for three years.

> Find out more on pages 141-144

LTIP

Release of value under the LTIP

This chart illustrates the total value of the 2018 LTIP awards that vested in 2021.

Shareholding at 31 December 2021

This chart illustrates the number of shares held at the end of 2021 by the Executive Directors against the share ownership guidelines of 250% of salary for the CEO and 200% of salary for the CFO.

> Find out more on pages 148

> Find out more on pages 145-146

Directors' Remuneration Report *continued*

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 UK 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 2021. You can find information about each member's attendance at meetings on page 107. You can find their biographies on pages 98-101.

Committee Chair

Dr Richard Ward¹

Non-Executive Directors

Danuta Gray

Mark Gregory²

Sebastian James

Notes:

1. Dr Richard Ward joined the Committee with effect from 1 January 2021 and was appointed as Chair of the Committee with effect from the conclusion of the AGM on 13 May 2021.
2. Mark Gregory stepped down as Chair of the Committee with effect from the conclusion of the AGM on 13 May 2021.

Advisers to the Committee

The Committee consults with the Chief Executive Officer, Chief Financial 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, Chief Financial 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 2021. 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.

During the year, PwC advised on market practice, corporate governance and regulations, incentive plan design and target-setting, recruitment, 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 2021. PwC is a member of the Remuneration Consultants Group and a signatory to its Code of Conduct and the Committee is therefore satisfied that the advice PwC provided was objective and independent.

PwC's total fees for remuneration-related advice in 2021 were £90,900 excluding VAT. PwC charged its fees on a time and expenses basis.

Wider workforce engagement and pay considerations for 2021

The Committee carefully and regularly considers wider employee pay as context for the decisions it makes.

The Group's ERB is a valued forum for having a two-way dialogue on many important matters, and since 2018, at appropriate times during the year the Committee Chair has attended meetings. The Committee Chair attended the ERB in December 2021 where there was a Q&A session around executive pay, covering topics such as alignment of incentives to strategic objectives, an explanation of how pay is set for Executive Directors and a debate over the purpose of elements within the executive package.

The outcome of our DiaLoQue People Survey is an important factor for the Committee to reflect on and it has been kept abreast of matters by the Chief People Officer and Chief Executive Officer throughout the year. Our existing workforce engagement is strengthened through "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. This standing agenda item provides valuable insight and context for framing executive pay and policies.

The Committee considers it important to monitor and assess internal pay relativities, including the CEO pay ratio disclosure, and takes these into account when determining Executive Director remuneration. During 2021, neither the CEO nor CFO was awarded a salary increase, consistent with the approach we took across our senior leadership population given the challenging economic climate. Salary increases were awarded to the wider workforce population, in recognition of their hard work. They received increases of between 1.5% to 2%.

Through continued focus on building an inclusive organisation, the Group have maintained female representation in senior jobs in line with the Women in Finance Charter target of 30.0% since 2019, and as of 31 December 2021, 32.8% representation of women in our senior leadership has been achieved. We will continue with the programmes underway to further reduce the gender pay gap. We are also pleased that we will voluntarily disclose the Group's Ethnicity Pay Gap for the first time. Both reports can be found at www.directlinegroup.co.uk

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.

Clarity Remuneration arrangements should be transparent and promote effective engagement with shareholders and the workforce.	– 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. The Chair of the Remuneration Committee attended an ERB meeting in December 2021. Further details are set out on pages 111 and 138. – During 2021 in conversations with investors, a few shareholders asked clarification questions about the executive remuneration arrangements, and some enquired about how we align our executive remuneration with ESG priorities, explaining the importance to them. When the Committee further considered our approach to ESG metrics, taking into account our business strategy priorities, shareholder feedback and market practice, it concluded that it would be appropriate to include the emissions-based target in our LTIP from 2022 onwards.
Simplicity Remuneration structures should avoid complexity and their rationale and operation should be easy to understand.	– 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. For example, when deciding to introduce the emissions targets to the 2022 LTIP, the Committee determined that these should be linked to the SBTi-certified targets to ensure simplicity and consistency with the Group's broader emissions targets.
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.	– The ability to mitigate potential risks is within the Policy. Examples include: – 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. No such adjustments were made in 2021.
Predictability The range of possible values of rewards to individual directors should be identified and explained at the time of approving the Policy.	– At the time of approving the Policy full information on the potential values of the AIP and LTIP are provided, with strict maximum opportunities and minimum and target and maximum performance scenarios. An indication of the potential impact of a 50% share price appreciation on the value of LTIP awards is also included. – The 2021 AIP and LTIP award opportunities were in line with the maximum opportunity in the Policy.
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.	– Payments under variable incentive schemes require robust performance against challenging conditions over the short and longer term. For example, 55% of the AIP is based on Profit Before Tax and from 2022, 50% of the LTIP awards granted during the year are based on RoTE – both measures are key Performance indicators for the Group. – 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.
Alignment to culture Incentive schemes should drive behaviours consistent with Company Purpose, values and strategy.	– 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 them in the following ways: – 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. For example, the Committee felt introducing an emissions target to the 2022 LTIP furthers this ambition. – Work together – the Strategic element of the AIP requires our Executive Directors and senior leadership to work together to deliver key results to our stakeholders. For example, the Committee has amended the underlying categories and sub-weightings of the strategic elements under the AIP to better align with delivering profitable growth, realising cost savings alongside supporting customers and great people. – Take ownership – financial targets under the AIP are the same for all eligible 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.

Directors' Remuneration Report *continued*

Implementing policy and pay outcomes relating to 2021 performance

Single figure table (Audited)

		Salary ¹	Benefits ²	Annual bonus ³	Long-term Incentives ^{4,5}	All-employee share plans ⁶	Pension contributions and cash allowance in lieu of pension	Fixed pay and benefits sub-total	Variable remuneration sub-total	Total
£'000										
Penny James	2021	817	36	1,201	1,107	–	74	927	2,308	3,235
	2020	813	26	1,166	1,208	–	73	912	2,374	3,286
Neil Manser ⁷	2021	326	1	479	187	1	29	357	666	1,023
	2020	–	–	–	–	–	–	–	–	–
Tim Harris ⁸	2021	134	5	19	–	0	18	157	19	176
	2020	535	14	768	–	–	48	597	768	1,365

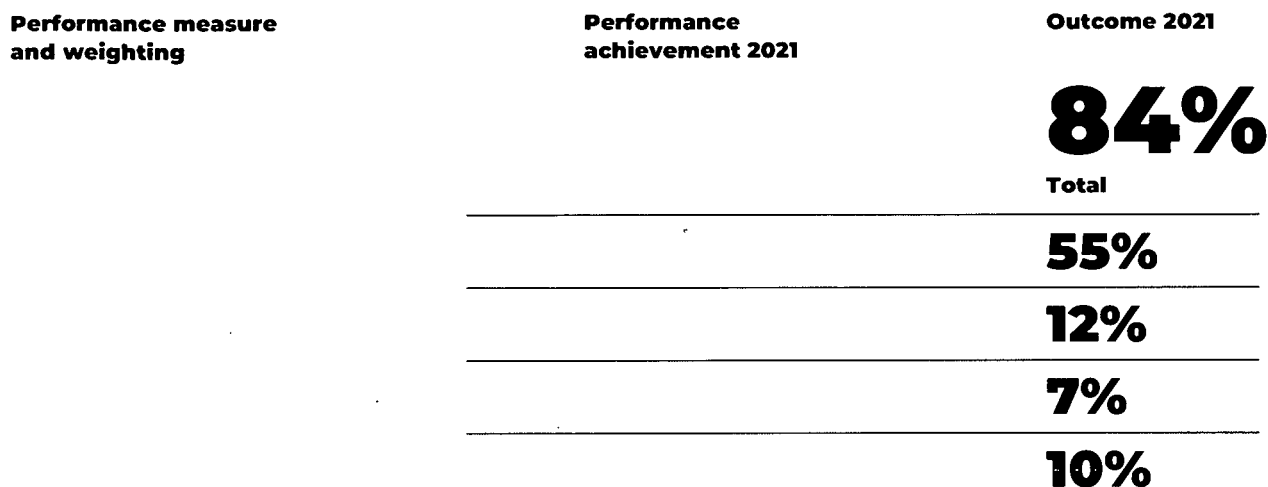
Notes:

- Salary – the Company operates a flexible benefits policy, and salary is reported before any personal elections are made.
- 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.
- Annual bonus – includes amounts earned for performance during the year but deferred for three years under the DAIP. For more information, see page 148. These deferred awards are normally subject to continuous employment. However, awards remain subject to malus and clawback.
- The expected vesting outcome figures for the RoTE portion of the awards granted under the LTIP in 2018 and reported in 2020 have been updated. These updates are based on the actual vesting of the RoTE portion of the awards and a share price of £3.20 and £3.09 on 26 March 2021 and 31 August 2021 respectively, compared to the three-month average share price of £2.91 used in reporting this figure in the 2020 report. The revised figures include the actual number of dividends accrued on this portion of the award at vesting. This results in an adjusted reportable increase of approximately £97,794 for Penny James, with a corresponding increase of the single figure in 2020 reflected in the table above. Further information on LTIP awards can be found on pages 145-146.
- The 2021 LTIP figure for Penny James reflects the relative TSR element of her 2018 LTIP awards and the RoTE element of her 2019 awards. The value is calculated based on the share price at the date of vesting for the 2018 LTIP awards, of £3.20 and £3.09, and a three-month average share price to 31 December 2021 of £2.78 for the 2019 awards. The same approach is used for Neil Manser, but the value of the relative TSR element of his March 2018 LTIP award is not included as the performance period was completed prior to his appointment to the Board. Further information on LTIP awards can be found on pages 145-146.
- The value of matching shares under the SIP for Tim Harris is a de minimis amount of £198.
- Neil Manser was appointed to the Board on 13 May 2021. His salary, bonus, benefits, and pension for 2021 have been pro rated accordingly.
- Tim Harris stepped down from the Board on 13 May 2021, following a period of paid compassionate leave from 11 January 2021 to 31 March 2021, and unpaid leave 1 April 2021 to 12 May 2021. His remuneration for the purposes of this table has been pro-rated. Details of Tim's salary, pension and benefits paid following his cessation as an Executive Director on 13 May 2021 until 31 December 2021 can be found on pages 151-152.

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 2021 (Audited)

The chart illustrates the final assessment of the level of achievement under the AIP and total outcome approved by the Committee.



Executive Director	Achievement under the 2021 AIP	2021 AIP payment ¹
Penny James	84% of maximum	£1,200,990
Neil Manser ¹	84% of maximum	£479,465
Tim Harris ²	84% of maximum	£18,725

Notes:

1. The AIP for Neil Manser is pro-rated to reflect the period from 13 May 2021, being the date he was appointed as an Executive Director.
2. Tim Harris' AIP is pro-rated to reflect the period of 1 January 2021 to 10 January 2021, before his period of paid compassionate leave.
3. 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 for 2021 is profit before tax (excluding restructuring costs of £101.5 million).

The Committee established threshold and maximum performance levels at the start of the year considering internal budgets and analysts' consensus forecasts and did not adjust the targets during the year.

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.

The table below sets out the threshold and maximum performance targets for the year, and the actual performance achieved.

Measure	Threshold 10%	Maximum 100%	2021 Actual	2021 Achievement
Profit before tax	£392.4m	£479.6m	£547.5m	100%

Directors' Remuneration Report *continued*

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 Remuneration Committee sets challenging target and stretch performance levels with reference to customer-centric KPIs. These are intended to ensure that remuneration is aligned with and supports continuous improvement.

A detailed assessment of the Customer measures is set out below.

Measure	Assessment
Net promoter score ("NPS") Improvement of customer advocacy across the Group	- Our NPS scores measure the likelihood of our customers recommending one of our brands. We set on-target and stretch performance levels for each NPS score. - Strong brand NPS scores on Direct Line and Churchill continued with motor claims and renewals journeys showing particularly positive performance, with two NPS scores above on-target and one score above stretch. - Rescue claims NPS performance ended the year below on-target levels for 2021, in part due to pressure on our recovery network due to high volumes of UK-based 'staycation' holidays during the summer. - 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	- The volume of complaints further reduced during 2021 to lowest-ever levels. - Focus on continual improvement and taking learnings from dissatisfied customers helped ensure that our customer outcomes continued to be positive. - There was a small increase in complaints in the summer holidays for Rescue due to significant increase in road traffic against a stretched network, but overall, the complaints measure was above stretch performance.
MyCustomer Transaction customer experience performance measuring our people/calls	- MyCustomer performance in Customer Operations and Claims Operations achieved strong levels during 2021 and was above stretch and above on-target respectively, despite the challenges we faced, including handling digital transformation and headcount levels. - Over 1 million responses from customers across the Group have provided feedback on the experience delivered by our people; 89.3% of customers rated our people as 9 or 10 out of 10.

Good performance has been delivered against Customer metrics during 2021 whilst continuing to provide support in a continued challenging time with a relentless focus on customer needs, efficiency, and innovation.

Having considered performance against targets and an assessment of the quality of performance achieved, the Committee judged the performance against the Customer element to be above target, giving a total of 12% out of 15% attributable to this element.

Measure	2021 Achievement
Customer	80%

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. The Committee judged the performance against the People element to be above on-target, giving a total of 7% out of 10% attributable to this element. A detailed assessment of the People measures is set out below.

Measure	Assessment
Leadership effectiveness and 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	- Our 2021 Leadership index final position is below on-target level landing at 74%. In 2020, we set up a leadership index to measure progress in leadership effectiveness. It indicates the extent to which colleagues feel positive about our leaders and decisions they make. - In part, we were unable to meet these ambitions because of operating in a high-change landscape with minimal opportunity for in-person interactions, and because of the significant changes to some of our biggest leadership roles. - To prepare future successors, we made several internal talent moves in 2021 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 extremely strong, continuing to improve in 2021. - 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 14 graduates and 40 apprentices in 2021.
Diversity Ensure the Group is a diverse and inclusive place to work where differences are respected, valued, and celebrated	- Since signing the Women in Finance Charter five years ago, we have recruited, developed and promoted more women into senior roles. Women now account for 32.8% of our senior leadership, above our on-target level and up from 22.2% in 2016. We are working towards our next milestone of 35% by the end of 2022. - We have grown our senior diversity profile across ethnic minority and Black professionals in leadership, to 11.7% and 0.9% respectively, which is above and at our on-target levels, making good progress towards our milestones of 13% and 1.5% by the end of 2022. - We are pleased that our inclusivity score for our most marginalised communities (Black, Non-Binary/Gender Fluid and Sikh) have increased ahead of our on-target threshold. - We have grown empathy and understanding across our senior leaders through our reverse mentoring programme and a comprehensive campaign led by our employee networks to educate colleagues on issues affecting our most marginalised communities. Storytelling has been hugely effective to allow colleagues to share their experiences on sensitive topics such as racism, gender identity, what religion means to them, 'coming out' and living with a disability. - During 2021, we introduced an even stronger focus on inclusive recruitment for senior roles, including anonymised CVs, diverse shortlists, and panel-based assessment to help protect against bias. - As a result of our focus, we were delighted to be placed 13th on the Inclusive Companies Top 50 UK Employers List which recognises leading companies that promote inclusion within their organisations.
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 roles	- To bolster our listening capabilities further, we transitioned to a new engagement platform during 2021 with better functionality. The surveys gather a mix of quantitative and qualitative data across a range of topics including overall sentiment, wellbeing, leadership, empowerment, and inclusion. - We have settled into a quarterly survey cadence. 78% of our employees took the time to share their views in November, our highest response rate in over two years. This was a 20% uplift on the prior survey and reversed the previous trend of declining responses. - At the end of 2021, as uncertainty over a further wave of lockdowns hit, increased external pressures and increased workload alongside ambitious technology change resulted in a fall in our engagement score to 66%, which was below the required on-target level. Our biggest declines related to Pride and Advocacy. Although we are ahead of the Financial Services external benchmark (61%), we are behind the upper quartile (high performing) and are therefore below our threshold target. - Alongside engagement surveys, we continued to run All Colleague Calls, Town Hall events, Q&As and Coffee and Chat sessions with ExCo leadership, which all provided a great opportunity to sense the mood of the business and allow tailored responses, such as measures to emphasise work and personal boundaries, and colleague vouchers to encourage teams or individuals to meet up because of feedback that they were feeling disconnected. - We also continued to re-invent many of our Group-wide high-profile engagement activities, such as our coveted Chief Executive Awards programme, to be delivered in an even more engaging format.
Measure	2021 Achievement
People	70%

Directors' Remuneration Report *continued*

Shared element (20% weighting)

For the Shared element of the AIP, the Board set a range of strategic measures specifically around growth, business transformation and cost savings, with the aim of ensuring the Group has the capabilities and cost base to ensure its sustained success. Although the Group's multi-brand, multi-channel strategy places the Group in a strong position to deliver sustainable growth under the pricing rules, the specific stretching Group objectives were met in part. Therefore, the Committee agreed an outturn of 50% for the Shared measures, giving a total of 10% out of 20% attributable to this element. A detailed assessment is set out below.

Measure	Assessment
Best at Direct Grow Direct Line materially, sustainably, and profitably	– Direct own brands in-force policies grew 1.0% with growth across Commercial direct (7.5%), Green Flag Rescue (5.8%) and Home (2.3%) offsetting declines in Motor. Motor direct own brands in-force policies were stable in H2 2021 with a reduction of 1.9% over the year. The lower in-force policies growth was partly attributable to underwriting discipline in a deflating Motor market. This was lower than the on-target level. – Overall Group Loss Ratio was 58.1% in 2021 (2020: 57.9%), which exceeded the on-target level. This was partly attributable to benign weather but also to good underwriting performance across Motor and Rescue in particular.
Best at Direct / Win on Price Comparison Websites / Extend our reach Turn renewal and new business price equalisation into an advantage for us and value for our customers	– The Group implemented the FCA's Pricing Practices Review requirements within the challenging deadlines prescribed by the FCA. – The business's preparations involved a large-scale programme of activity and the deployment of considerable resources to meet the requirements of the new regulations within an ambitious timeframe during 2021 which exceeded the on-target level. – In our Motor business, we announced a new partnership with Motability Operations Ltd which is due to take effect from 2023 (see page 8). It will provide valuable underwriting data, insight, and capability into the future of vehicle technology and repair, crucial for building long-term strategic resilience against key transition risks. The partnership is anticipated to increase Motor gross written premium by around £500 million each year from H2 2023.
Technical Edge Become market leaders in pricing and underwriting and continue to deliver in-year claims cost savings	– During the year, our strategic technology transformation delivered material improvements to the way we interact with our customers. – We've achieved step changes in our use of pricing and data, which are already beginning to improve our competitiveness in Motor, and we will continue to refine and enhance our pricing models and capabilities. – Commercial continued the rollout of its new pricing and underwriting system across Commercial combined and Fleet, alongside the launch of machine learning pricing models, dramatically improving pricing accuracy. – Motor's current-year attritional loss ratio rose 6.3 percentage points to 72.9% (2020: 66.6%) driven predominantly by a reduction in the severity of lockdowns in 2021 compared to 2020. Whilst the Motor current-year loss ratio in H1 2021 was modestly higher than for H1 2020, it increased in H2 as lockdown restrictions were eased and claims frequency increased closer to expected levels. In addition, claims severity inflation was slightly above our medium-term 3% to 5% per year inflation expectations during 2021, due to high levels of inflation in second-hand vehicles and additional Covid-19 related cleaning costs.
Nimble and cost efficient Deliver a step change in our competitiveness by reducing our Cost per in-force policy	– We continued to make progress on our cost agenda, with operating expenses reducing £18 million to £706.3 million (2020: £724.4 million) and the expense ratio falling 0.6 percentage points to 23.9%. Whilst we saw levies increase by 11% during 2021, alongside heightened inflation in wage costs, these impacts were more than offset by lower technology costs, savings from our property strategy and 9% reduction in headcount. We also incurred lower Covid-19 related costs.

Moderate performance has been delivered against Shared metrics during 2021. Having considered performance against targets and an assessment of the quality of performance achieved, the Committee judged the performance against the Shared element to be around target, giving a total of 10% out of 20% attributable to this element.

Measure	2021 Achievement
Shared	50%

LTIP outcomes for 2021 (Audited)

2018 LTIP awards (vesting in 2021)

Awards under the LTIP granted in March and August 2018 vested during 2021. They were subject to relative TSR performance over the three-year period from the date of grant, and RoTE performance in 2018, 2019 and 2020.

Consistent with the Regulations, the expected RoTE vesting outcomes for the year ended 31 December 2020 (together with the TSR elements from the 2017 awards) are included in the 2020 LTIP column of the single figure table. The performance outcomes of these elements are included in the table below.

The 2021 single remuneration figure includes the value of the 2018 TSR elements and the awards vested shortly after. Details of the targets and performance achieved are set out in the table below.

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 2018	RoTE (2020 single figure)	60%	15.0%	18.0%	20.7%	100.0%	60.0%
	Relative TSR (2021 single figure)	40%	Median	Upper quintile	Between median and upper quintile	36.9%	14.8%
August 2018	RoTE (2020 single figure)	60%	15.0%	18.0%	20.7%	100.0%	60.0%
	Relative TSR (2021 single figure)	40%	Median	Upper quintile	Between median and upper quintile	20.7%	8.0%

2019 LTIP awards (vesting in 2022)

Awards under the LTIP granted in March and August 2019 (for Penny James and Neil Manser) and October 2019 (for Tim Harris, granted on joining DLG) will vest, subject to Remco approval, during 2022. They are subject to relative TSR performance over the three-year vesting period, and RoTE performance in 2019, 2020 and 2021. The RoTE performance period for these awards ended on 31 December 2021 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 2022, August 2022, and October 2022 respectively and will be disclosed in the 2022 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 2019 LTIP awards (together with the TSR elements from the 2018 awards) are included in the 2021 single remuneration figures for Penny James and Neil Manser based on the three-month average share price to 31 December 2021. You can find details of this on page 140. The RoTE element of the October 2019 award for Tim Harris is not included in the single figure table because the performance period was completed after he stepped down from the Board.

Award	Performance measure	Weighting	Threshold (20% of maximum)	Maximum (100% of maximum)	Actual performance	Achievement	Outcome
March 2019	RoTE (2021 single figure)	60%	17.5%	20.5%	21.4%	100%	60%
	Relative TSR (2022 single figure)	40%	Median	Upper quintile	Performance period not yet complete		
August 2019	RoTE (2021 single figure)	60%	17.5%	20.5%	21.4%	100%	60%
	Relative TSR (2022 single figure)	40%	Median	Upper quintile	Performance period not yet complete		
October 2019	RoTE (2021 single figure)	60%	17.5%	20.5%	21.4%	100%	60%
	Relative TSR (2022 single figure)	40%	Median	Upper quintile	Performance period not yet complete		

Directors' Remuneration Report *continued*

Summary of the 2021 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 2019 LTIP – RoTE ¹	Penny James	144,178	100%	144,178	401
	Neil Manser	28,835	100%	28,835	80
August 2019 LTIP – RoTE ¹	Penny James	191,976	100%	191,976	534
	Neil Manser	33,610	100%	33,610	93
March 2018 LTIP – TSR ^{2,3}	Penny James	91,296	36.9%	33,688	108
August 2018 LTIP – TSR ²	Penny James	101,448	20.7%	21,000	65
	Neil Manser	20,289	20.7%	4,200	13
Total single figure LTIP ⁴	Penny James				1,107
	Neil Manser				187

Notes:

- 2019 RoTE elements are based on the three-month average share price to 31 December 2021 of £2.78.
- 2018 TSR element is based on share price on the date of vesting on 26 March 2021 and 31 August 2021 of £3.20 and £3.09 respectively.
- The value of the relative TSR element of his March 2018 LTIP award is not included in the single figure disclosure for Neil Manser as the performance period was completed prior to his appointment to the Board. It is however displayed above for completeness.
- The vesting outcome for the RoTE and TSR elements of Tim Harris' October 2019 LTIP will be disclosed as a payment to past directors in the 2022 Directors' Remuneration Report, in line with the requirements of the remuneration reporting regulations.

Directors' share interests (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 2021 to the date of this report.

	At 31 December 2021			Share plan interests exercised during the year to 31 December 2021		
	Share plan awards subject to performance conditions ^{1,2,3}	Share plan awards subject to continued service ¹	Share plan interests vested but unexercised ¹	Shares held outright ⁴	Number of options exercised ¹	Share price on date of exercise ^{5,6}
Penny James	1,573,519	392,706	778,619	783,169	137,156	3.11
					58,870	3.11
					100,178	3.07
Neil Manser	466,548	188,468	–	177,728	34,487	3.10
Tim Harris ⁷	741,647	185,478	–	5,912	–	–

Notes:

- These awards take the form of nil-cost options over the Company's shares. Such awards accrue dividend entitlement from the grant date to the date on which an award vests, or the end of the applicable holding period. Dividends added post-vesting are shown to 31 December 2021 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.
- These awards include beneficial share interests acquired under the SIP. At 7 March 2022, the number of shares beneficially held by Neil Manser had increased to 177,828.
- Penny James exercised options on 29 March 2021.
- Neil Manser exercised options on 29 March 2021, 6 August 2021, and 1 September 2021.
- The above share plan interests for Tim Harris are at 13 May 2021, being the date he stepped down from the Board.

The table below shows the Non-Executive Directors' beneficial interests in the Company's shares¹.

Director	Shares held at 31/12/2021	Shares held at 31/12/2020
Danuta Gray	26,500	10,000
Tracy Corrigan ²	–	–
Mark Gregory	–	–
Jane Hanson ³	11,083	11,083
Sebastian James	5,000	5,000
Fiona McBain	–	–
Gregor Stewart	2,925	2,925
Richard Ward	–	–
Adrian Joseph ⁴	–	–

Notes:

1. This information includes holdings of any connected persons, as defined in section 253 of the Companies Act 2006.
2. Tracy Corrigan joined the Board on 1 November 2021.
3. Jane Hanson stepped down from the Board on 13 May 2021 and her beneficial interests are as at this date.
4. Adrian Joseph joined the Board on 1 January 2021.

LTIP awards granted during 2021 (Audited)

The table below shows awards granted under the LTIP to Executive Directors in 2021 in the form of nil-cost options.

Director	Position	Awards granted in 2021 under the LTIP ¹		
		Award as % of salary	Number of shares granted	Face value of awards (£)
Penny James	Chief Executive Officer	100%	259,365	817,000
		100%	262,700	817,000
Neil Manser ²	Chief Finance Officer	62.5%	65,476	206,250
		100%	165,594	515,000

Notes:

1. The number of shares awarded was based on the average share price in the three-day period prior to grant, which was £3.15 in March 2021 and £3.11 in August 2021.
2. The LTIP award made to Neil Manser in March was made before he was an Executive Director.

The performance conditions that apply to the LTIP awards granted in 2021 are set out below:

Performance Measure	Performance conditions for awards granted in 2021 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 2021, 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 26 March 2021 will end on 31 December 2023 for the RoTE element and 25 March 2024 for the TSR element. The performance period for the awards granted on 31 August 2021 will also end on 31 December 2023 for the RoTE element and 30 August 2024 for the TSR element.

Direct Line Group 2012 Share Incentive Plan ("SIP") (Audited)

During 2021, all employees, including Executive Directors, were eligible to invest from £10 to £150 a month from their pre-tax pay into the scheme, and receive one matching share for every two shares they purchased. This table details the number of shares held by Neil Manser and Tim Harris under the SIP. Penny James does not participate in the plan.

	Matching shares granted during the year	Matching shares cancelled during the year	Value of matching shares granted (£) ¹	Balance of matching shares at 31 December 2021 ²
Neil Manser	304	–	901	895
Tim Harris	63	–	198	63

Notes:

1. The accumulated market value of matching shares at the time of each award. Purchase of the matching shares takes place within 30 days of the contributions being deducted from salary.
2. Matching shares which are subject to forfeiture.

Directors' Remuneration Report *continued*

DAIP awards granted during 2021 (Audited)

The table below shows the deferred share awards granted under the DAIP to Executive Directors on 26 March 2021 in respect of the 2020 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 2021 under the DAIP	
		Value of deferred bonus (£)	Number of shares granted ¹
Penny James	Chief Executive Officer	466,519	148,101
Neil Manser ²	Chief Financial Officer	135,300	42,952
Tim Harris	Chief Financial Officer (former)	307,090	97,488

Notes:

- The number of shares awarded was based on the average share price in the three-day period prior to grant, which was £3.15. 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.
- The DAIP award made to Neil Manser was made before he became an Executive Director.

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 2021 ^{2,3} (% of salary)
Penny James	Chief Executive Officer	250%	490%
Neil Manser	Chief Financial Officer	200%	159%
Tim Harris ⁴	Chief Financial Officer (former)	200%	62%

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 unvested DAIP awards, all vested but unexercised awards, or awards unvested but after the performance period and in the holding period. Holdings of Ordinary Shares are 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 2021 share price of £2.79.
- Shareholding for Tim Harris is calculated based on the 13 May 2021 share price of £2.93, being the date he stepped down from the Board.

Non-Executive Directors (Audited)

Fees were the only remuneration paid to Non-Executive Directors in 2020 and 2021. 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	
	2021 £'000	2020 £'000	2021 £'000	2020 £'000	2021 £'000	2020 £'000
Tracy Corrigan ³	13	–	–	–	13	–
Danuta Gray	350	209	–	–	350	209
Mark Gregory	125	109	–	–	125	109
Jane Hanson ⁴	44	120	–	3	44	123
Sebastian James	100	96	–	–	100	96
Fiona McBain	101	95	–	3	101	98
Gregor Stewart	115	115	–	2	115	117
Richard Ward ⁵	143	120	0	0	143	120
Adrian Joseph ⁶	80	–	–	–	80	–

Notes:

- 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.
- 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).
- Tracy Corrigan joined the Board on 1 November 2021.
- Jane Hanson stepped down from the Board on 13 May 2021.
- The value of benefits for Richard Ward in 2021 totals £222, compared to £76 in 2020, these values are rounded to 0 for consistency within the table above.
- Adrian Joseph joined the Board on 1 January 2021.

CEO pay ratio

The table below compares the single total figure of remuneration for the CEO since 2019 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.

Year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2021	Option A	126:1	98:1	67:1
2020 ¹	Option A	132:1	108:1	73:1
2019 ²	Option A	123:1	101:1	67:1

Notes:

1. The 2020 figures have been updated for Penny James' updated 2020 single figure value (see page 140 note 4).
2. 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 James' service as CFO excluded.

The UK employees included are those employed on 31 December 2021 and remuneration figures are determined with reference to the financial year ending on 31 December 2021 (consistent with the approach taken in previous years).

Option A, as set out under the reporting regulations, was used to calculate remuneration for 2021 as we continue to believe that that 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. No other adjustments were made.

	25th percentile (P25)	Median (P50)	75th percentile (P75)
Salary	£19,720	£29,326	£32,987
Total pay and benefits	£25,691	£32,900	£48,302

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 28:1 (2020: 31:1). 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.

The 2021 ratios are slightly lower than last year. This is partly attributable to the CEO's single figure of remuneration being lower for 2021 due to a lower value of the LTIP vesting outcome, partially offset by a higher AIP outcome. Employees have similarly experienced higher bonus outcomes (consistent with the CEO's AIP result), and this combined with broader salary increases has led to an increase in the total pay and benefits for 2021 compared to last year. The median ratio has remained reasonably consistent since 2019, moving broadly in line with the CEO's single figure of remuneration, as explained above.

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 a 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 remuneration of Executive Directors and the wider workforce are set out on page 138. The Committee is satisfied that these policies drive the right behaviours and reinforce the Group's values which in turn drives the correct culture, and, for the reasons given above, believes that the ratios are consistent with the Group's reward policies.

Directors' Remuneration Report *continued*

Percentage change in Executive Directors' and Non-Executive Directors' pay for 2020 to 2021

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	
	2020	2021	2020	2021	2020	2021
Executive Directors						
Chief Executive Officer	7.6%	0.5%	(24.6%)	37.3%	16.1%	3.0%
Chief Finance Officer	n/a	n/a	n/a	n/a	n/a	n/a
Chief Finance Officer (former) ⁴	0.0%	0.0%	0.5%	(0.3%)	7.9%	2.4%
Non-Executive Directors^{5,6}						
Tracy Corrigan	n/a	n/a	n/a	n/a	n/a	n/a
Danuta Gray	90.1%	67.4%	(100.0%)	0.0%	n/a	n/a
Mark Gregory	7.2%	15.0%	(100.0%)	0.0%	n/a	n/a
Jane Hanson	0.0%	0.0%	(69.3%)	(100.0%)	n/a	n/a
Sebastian James	1.0%	4.2%	0.0	0.0%	n/a	n/a
Fiona McBain	14.6%	6.7%	(79.9%)	(100.0%)	n/a	n/a
Adrian Joseph	n/a	n/a	n/a	n/a	n/a	n/a
Gregor Stewart	0.0%	0.0%	(87.2%)	(100.0%)	n/a	n/a
Richard Ward	0.0%	18.9%	(5.7%)	193.3%	n/a	n/a
All employees (average)	3.5%	2.7%	(1.4%)	(18.6%)	3.9%	8.8%

Notes:

- Based on the change in average pay for employees employed in the year ended 31 December 2021 and the year ended 31 December 2020. The increase to the CEO salary in 2019 reflected her being CFO for part of the year before promotion to CEO. 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. Non-Executive Director fee levels were unchanged between 2020 and 2021, any changes above relate to individual changes in committee membership through the year.
- For the CEO, the decreased value of benefits from 2019 to 2020 relate to the car service used by the CEO, for which usage was reduced due to the Covid-19 pandemic. The increase in 2021 reflects increased usage of the car service, of which the Group also pays for any associated tax liability that arises on this benefit. For all employees, there were no changes in benefits provision between 2020 and 2021. 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 2021 figure for Tim Harris is based on an annualised amount as he stepped down as an Executive Director on 13 May 2021.
- The decreased value of benefits in 2020 related to a decrease in travel expenses due to the Covid-19 pandemic. Jane Hanson stepped down from the Board on 13 May 2021, the 2021 figure in the table is based on an annualised amount to compare to the prior year.
- Adrian Joseph, Neil Manser and Tracy Corrigan have no figures shown in the table above as they joined the Board during 2021.

Chief Executive Officer's pay between 2012 and 2021 and historical performance of TSR

The table below shows historical levels of the CEO's pay between 2012 and 2021. 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 (%)

	2012 ¹	2013 ¹	2014 ¹	2015	2016 ²	2017	2018	2019 ³	2019 ³	2020 ⁴	2021 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	3,286	3,235
Annual bonus payment (% of maximum)	65%	63%	75%	83%	43%	88%	68%	76%	76%	82%	84%
LTIP vesting (% of maximum) ¹	30%	55%	88%	96%	86%	99%	71%	0%	100%	80%	74%

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 2020 single figure has been revised to reflect the actual vesting of the 2018 awards under the LTIP.
5. The 2021 single figure reflects the estimated vesting of the RoTE portion of the LTIP granted in March and August 2019. Any shares under the LTIP granted in 2019 will not be delivered until the end of the applicable vesting periods in March and August 2022. However, they have been included in the single figure, as the performance period in respect of the RoTE portion has now been completed.

Payment for loss of office (Audited)

Tim Harris

Tim Harris retired as Chief Financial Officer and stepped down from the Board on 13 May 2021 for reasons explained in the RNS announcement published on 13 May 2021. During 2021 Tim worked as an Executive Director to 10 January 2021 only and took paid compassionate leave from 11 January to 31 March 2021 during which he continued to receive salary, pension, and benefits. This was followed by a period of unpaid leave from 1 April 2021 to 12 May 2021, during which time he continued to be eligible for benefits only (in line with the Group's employee policies). Following his cessation as a Director of the Company with effect from the conclusion of the 2021 AGM on 13 May 2021, Tim's contractual salary, pension and benefits will be paid in monthly instalments until the end of his 12-month notice period on 12 May 2022.

The Remuneration Committee determined that Tim will be treated as a good leaver in relation to outstanding awards under the Company's Share Schemes and the AIP by reason of his retirement, in accordance with the plan rules and the Directors' Remuneration Policy.

Salary (£'000)	Benefits (£'000)	Pension (£'000)	Total (£'000)
340	9	31	380

Directors' Remuneration Report *continued*

AIP

The 2021 AIP was subject to the satisfaction of the gateway criteria and relevant performance criteria. The award was also pro-rated to reflect the period worked until he commenced compassionate leave (10 January 2021). 40% of the award will be deferred into shares. Further detail is set out on pages 141-144.

DAIP

The 2019, 2020 and 2021 DAIP awards will continue to vest on their third anniversaries of award and remain subject to all scheme rules, including malus and clawback provisions. Awards will be exercisable for 12 months after they vest.

LTIP

Awards made under the Restricted Share Plan pursuant to Listing Rule 9.4.2 ("RSP"), to compensate Tim for remuneration arrangements forfeited on leaving his former employer, will continue to vest on the normal vesting dates and will be time pro-rated to reflect the period from their date of grant to the end of employment and remain subject to all scheme rules, including malus and clawback provisions.

The October 2019, March 2020 and August 2020 LTIP awards will be time pro-rated to reflect the period from their date of grant to the end of his employment. The awards will vest on the third anniversary of their grant, subject to their original performance conditions and to all scheme rules, including malus and clawback provisions. Furthermore, if Tim secures a new role which the Committee considers is comparable with his role with the Group, and which it considers should reasonably compensate him for the loss of any unvested awards, then such unvested awards will be forfeited.

Both Tim's LTIP and RSP awards will continue to be subject to a further two-year holding period after vesting (and then there will be a 12-month exercise period).

Furthermore, any LTIP or RSP awards which are unvested or still in the holding period will be forfeited if Tim takes up employment with another organisation which compensates him, and or which the Committee considers should reasonably compensate him for the loss of any unvested awards.

No LTIP awards have been made to Tim since August 2020.

SIP

In accordance with the Rules of the Share Incentive Plan ("SIP"), as a good leaver, all Tim's Plan shares will be released to him, which follows legislation and HMRC guidance for tax advantaged plans in the UK.

Share Ownership Guideline

Tim is to comply with the Company's post-cessation shareholding requirements; maintaining his current shareholding for a period of two years after he has left the Company. Tim's current shareholding includes shares owned outright, as well as his unvested DAIP and RSP awards (on a net of tax basis). Tim will be permitted to sell sufficient shares to cover any tax liability on exercise of these awards.

Payments to Past Directors (Audited)

March and August 2018 LTIP

The table below sets out the awards which vested during the year to Paul Geddes (former CEO) and Mike Holliday-Williams (former MD, Personal Lines), who exited the Group on 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 ¹	Total value of share options (including dividends) vested (£)
March 2018 ²	Paul Geddes	260,887	35.4%	92,289	295,602
	Mike Holliday-Williams	179,580	39.0%	70,103	224,540
August 2018 ³	Mike Holliday-Williams	188,657	24.9%	46,960	145,106

Notes:

1. 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.
2. Based on closing share price of £3.20 on the vesting date (26 March 2021).
3. Based on closing share price of £3.09 on the vesting date (31 August 2021).

The March 2018 LTIP award vested overall at 74.8%, with the RoTE element (60% weighting) achieving 100%, and relative TSR (40% weighting) at 36.9%. The August 2018 LTIP award vested at 68.0%, with the RoTE element (60% weighting) achieving 100% and relative TSR (40% weighting) at 20.7%. 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.

New Executive Director

On 13 May 2021, following the conclusion of the AGM Neil Manser, the then current Chief Strategy Officer, joined the Board as an Executive Director and was appointed CFO. Neil's annual salary is £515,000. This salary is in line with the FTSE 51-150 CFO benchmark and below the previous CFO's salary level. Neil's pension allowance will continue to be 9% of salary, in line with that of the wider workforce. He also participates in the Group's Annual Incentive Plan up to a maximum of 175% of salary and the Long-Term Incentive Plan of up to 200% of salary.

Distribution statement

This chart shows the overall pay expenditure across all Group employees compared with the total dividend value paid to shareholders in 2020 and 2021.

Dividend (£m)

Overall expenditure on pay (£m)

Note:

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 2020 Directors' Remuneration Report which was put to shareholders at the 2021 AGM.

The resolution approving the Directors' Remuneration Report was passed by 97.69% of the votes cast in favour of the resolutions.

	For		Against		Number of votes withheld (abstentions)
	Number	Percentage	Number	Percentage	
Approval of Directors' Remuneration Policy (2020 AGM)	1,051,904,620	97.55%	26,440,027	2.45%	60,251
Approval of Directors' Remuneration Report (2021 AGM)	1,038,647,888	97.69%	24,537,644	2.31%	117,721

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.

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.
Neil Manser	13-May-21	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.

Directors' Remuneration Report *continued*

Implementing the Policy in 2022

Key feature	Implementation in 2022
Base salary	
– 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	– The CEO's salary remains appropriate at £817,000 – The CFO's salary remains appropriate at £515,000
Pensions	
– 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	– CEO and CFO pension contribution remains at 9% (in line with the workforce)
Annual Incentive Plan	
– Maximum opportunity of 175% of salary for the CEO and the CFO – At least 50% of the AIP is based on financial measures. The Committee considers various non-financial performance measures such as strategic measures – 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	– No change to the maximum opportunity – No change from the weightings used for 2021 – There will be a straight-line vesting between AIP threshold and maximum performance – Financial measures (55%): Profit before tax – Non-financial measures (45%): The assessment will be against a set of Group Objectives and Key Results relating to delivering profitable growth and great customer experience (20%), realising cost savings (15%), alongside supporting great people (10%) – The performance targets will be set following the usual process, considering internal and consensus forecasts and the key strategic priorities for the Group in 2022 – The performance targets are considered commercially sensitive and will therefore be disclosed in next year's Report
Deferred Annual Incentive Plan	
– 40% of the AIP is deferred into shares – Typically vesting after three years, normally subject to continued employment – Malus and clawback provisions apply	– No further performance conditions apply

Key feature	Implementation in 2022
Long Term Incentive Plan	
– 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	– No change to the maximum annual award levels – Nil-cost options will continue to be used for the grants – A new emissions metric will be applied for 2022 onwards; 50% will be based on RoTE; 40% on TSR and 10% on emissions – A RoTE target range of 17.5% (threshold) to 20.5% (maximum) is required for the 2022 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 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 – The Group is currently in the process of seeking certification for our long-term emissions targets from the SBTi. The emissions targets for the 2022 LTIP awards will be set based on the SBTi certified targets once this process is completed later in the year. The emissions performance targets will be disclosed in next year's Directors' Remuneration Report.

Non-Executive Directors' fees

The fees for the Chair and Non-Executive Directors for 2022 are set out below.

Position	Fees for 2022 £'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	15
Member of Board Committee (Audit, Board Risk or Remuneration)	10
Member of Board Committee (Sustainability, Investment or Nomination)	5

The Board determined that a small increase to the fee for the Chair of Sustainability and Investment Committees, as well as introducing a fee for member of the Investment Committee would apply following a review of market practice and to reflect the additional duties that the Committee is undertaking.

Directors' Remuneration Report *continued*

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 2022 on pages 154-155.

Policy table

Element and purpose in supporting the Group's strategic objective	Operation
Base salary – 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	– 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: – 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
Pension – To remain competitive within the marketplace – To encourage retirement planning and retain flexibility for individuals	– 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
Benefits – A comprehensive and flexible benefits package is offered, emphasising individuals being able to choose the combination of cash and benefits that suits them	– 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

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- 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 what 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

Directors' Remuneration Report *continued*

Element and purpose in supporting the Group's strategic objective	Operation
AIP – To motivate executives and incentivise delivery of performance over a one-year operating cycle	– 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
DAIP – To enable a stronger focus and alignment with the short to medium-term elements of our strategic aims	– 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
LTIP – 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	– 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
Share ownership guidelines – To align the interests of Executive Directors with those of shareholders	– 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
– 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	– 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
– 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	– 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
– 250% of salary for the CEO and 200% for the CFO. – The Committee reserves the discretion to amend these levels in future years	– Not applicable

Directors' Report

Directors' Report

The Board of Directors present their report for the financial year ended 31 December 2021 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 256.

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 95 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	37, 43, 44
Important events since the financial year end	18 to 27
Likely future developments in the business	27
Employee engagement	31, 65, 108, 109, 111, 143
Engagement with suppliers, customers and other business relationships	58 to 59, 110
Research and development	2, 6, 19, 26
Greenhouse gas emissions, energy consumption and energy-efficient action	70 to 75
Branches outside the UK	242

Disclosure of information required by Disclosure Guidance and Transparency Rule 7.2

The FCA's Disclosure Guidance and Transparency Rule 7.2 requires 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 into the Directors' report by reference.

Disclosure of information under Listing Rule 9.8.4C

In accordance with Listing Rule 9.8.4C, the table below sets out the location of the information required to be disclosed under LR 9.8.4R, where applicable.

Subject	Page
Interest capitalised by the Group	Not applicable
Unaudited financial information	Note 3.5
Details of long-term incentive schemes	145 to 147
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)	Not applicable
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	161
Controlling shareholder agreements	Not applicable

Dividends

The Board recommends a final dividend of 15.1 pence per share to shareholders. Subject to shareholder approval at the Company's 2022 AGM, this will become payable on 17 May 2022 to all holders of Ordinary Shares on the Register of members at close of business on 8 April 2022.

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 2022.

The Board also recommends a new share buyback programme of up to £100 million split into two tranches of £50 million in H1 2022 and H2 2022.

You can find information on dividend and capital management, including the share buyback programme, in the Finance review, on pages 32 to 45.

Directors

The names of all current Directors and their biographies are set out on pages 98 to 101. All Directors will retire and those wishing to continue to serve will be submitted for election or re-election at the 2022 AGM. 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 98 to 101 were the Directors of the Company throughout the year under review, except:

- Adrian Joseph was appointed as an independent Non-Executive Director with effect from 1 January 2021.
- Tim Harris retired from the Board with effect from 13 May 2021.
- Neil Manser was appointed as CFO with effect from 13 May 2021.
- Jane Hanson stepped down from the Board with effect from 13 May 2021.
- Tracy Corrigan was appointed as an independent Non-Executive Director with effect from 1 November 2021.

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 134 to 159.

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 and can be contacted at the Company's Registered Office, details of which are on page 257.

Share capital

The Company has a premium listing on the London Stock Exchange. As at 31 December 2021, the Company's share capital comprised 1,330,713,012 fully paid Ordinary Shares of 10 ¹/₄ pence each.

At the Company's 2021 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 £49,536,818, and to allot further shares up to an aggregate nominal amount of £49,536,818 for the purpose of a rights issue;
- allot shares having a nominal amount not exceeding in aggregate £7,430,523 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 £7,430,523 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 136,226,250 shares in the Company, representing 10% of the Company's issued share capital at the time (this authority, which expires at the conclusion of the AGM being held on 10 May 2022, was used to purchase 22,515,414 shares (the Company used the similar authority granted at the Company's 2020 AGM to purchase 11,323,179 shares between 9 March 2021 and 13 May 2021). Further information can be found below); 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 ("RTI") Instruments.

To date, the Directors have not used these authorities granted in 2021, with the exception of the authority to make market purchases of shares, as described below. At the 2022 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 2021 in notes 31 and 37 of the consolidated financial statements.

On 9 March 2021, the Company announced the launch of a share buyback programme of up to £100 million, which was undertaken during 2021 in two tranches of up to £50 million (a previous share buyback programme, launched on 3 March 2020, was terminated on 19 March 2020 as a result of the volatile conditions arising from the Covid-19 pandemic). In line with the Group's capital management approach of growing the regular dividend in line with business growth and distributing surplus capital, the share buyback programme was 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. During 2021, a total number of 33,838,593 ordinary shares of 10 ¹/₄ pence each were repurchased under the share buyback programme representing 3% of the called up share capital of the Company as at 31 December 2021. The aggregate consideration paid across the two tranches was £99,910,742.39. The effect of the share buyback has been to: reduce the weighted average number of Ordinary Shares in issue during 2021, which is used to calculate earnings per share, from 1,356.5 million in 2020 to 1,335.8 million in 2021 (see note 15 to the consolidated financial statements for more details); and reduce the closing number of Ordinary Shares at 31 December 2021 to 1,317.3 million from 1,351.8 million at 31 December 2020 (see note 16 to the consolidated financial statements for more details).

Further information on the Company's share buyback programme can be found in the Finance Review on pages 32 to 45.

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 which 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 37 on page 232. The Company is not aware of any other dividend waivers or voting restrictions in place.

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.

Directors' Report *continued*

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 (which may exclude non-working days) 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.

Use of financial instruments

Information regarding the Company's use of financial instruments, financial risk management objectives and policies can be found in the Risk Management section of the Strategic Report on page 89 and note 3 of the Consolidated Financial Statements.

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 holdings of the major shareholders in the Company's ordinary issued share capital, as at 31 December 2021 and as at 7 March 2022, 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 2021	7 March 2022
BlackRock, Inc.	9.92%	9.92%
Artemis Investment Management LLP	5.07%	5.07%
Majedie Asset Management Limited	4.99%	4.99%
T.Rowe Price Associates, Inc	4.94%	4.94%
Norges Bank	4.91%	4.91%
abrdn plc	4.57%	4.57%
APG Asset Management N.V	2.99%	2.99%

Political donations

The Group made no political donations during the year (2021: nil).

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 61 to 65.

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 describes the Group's capital management strategy, including the capital actions taken in the last twelve months 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 starts on page 192 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 exposure to these risks.

The Directors have assessed the principal risks of the Group over the duration of the planning cycle. The assessment included the impact of the Covid-19 pandemic on the underwriting cycle, including motor claims frequency, travel disruption and supply chain disruption, and the possible impacts of the FCA's Pricing Practices Review ("PPR"). The key judgements and assumptions applied were in relation to the likely time period of continued Covid-19 related effects and the impact on the general insurance market, the economic recovery and the impact of the PPR on customer behaviour. The 2021 Strategic Plan (the "**Plan**") indicates that the Group will continue to maintain levels of solvency in line with its risk appetite across the planning cycle (to 31 December 2025).

In addition, the Group's Risk function has carried out an assessment of the risks to the Strategic Plan and the dependencies for the success of the 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 our partial internal economic capital model. In both scenarios, it was concluded that the Group's solvency capital requirement would not be breached following the implementation of management actions.

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 U K Insurance Limited, the Group's principal underwriter, i.e. a reduction of own funds to below the solvency capital requirement. The purpose of this reverse stress test was to assess the coverage and scope of the internal economic capital model and there were no findings that invalidate the internal model.

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 7 March 2022 (the date of approval of the consolidated 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 and 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 pages 121 to 122.

Conflicts of interest

Each Director has a duty to avoid conflicts of interest and must declare any conflict of interest that could interfere with their ability to act in the Group's best interests. In accordance with the Companies Act 2006, 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. As a matter of course, the Board authorises certain potential conflicts of interest in this way including Directors' external directorships and their interests in securities of other financial service institutions. The Company Secretary maintains a register of potential conflicts which the Board reviews at each scheduled Board meeting.

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.

Each of the Directors, whose names and functions are listed on pages 98 to 101, 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 95) and Directors' report (on pages 160 to 163) include a fair review of: (i) the business's development and performance; and (ii) the position of the Company 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, performance, business model and strategy.

This report was approved by the Board on 7 March 2022 and signed on its behalf by:



Roger C. Clifton
Company Secretary

Registered address: Churchill Court, Westmoreland Road, Bromley, BR1 1DP

Registered number: 02280426

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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 (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 2021 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards and International Financial Reporting Standards ("**IFRSs**") as issued by the International Accounting Standards Board ("**IASB**");
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom ("**UK**") 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 45 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 that are marked as unaudited.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law, and UK adopted international accounting standards and IFRSs 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. The non-audit services provided to the Group for the year are disclosed in note 10 to the consolidated financial statements. We confirm that we have not provided any non-audit services prohibited by the FRC's Ethical Standard 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.

Independent Auditor's Report to the shareholders of Direct Line Insurance Group plc *continued*

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: - valuation of insurance liabilities: 1) The frequency and severity assumptions for large bodily injury claims; 2) The inflation and discount rate assumptions for periodic payment orders ("PPOs"); and 3) The judgement applied in setting the margin above the actuarial best estimate. - valuation of illiquid investments: 1) Commercial real estate loans, infrastructure debt and private placement bonds; and 2) Investment property; Within this report, key audit matters are identified as follows: ⚠ Newly identified; ⬆ Increased level of risk; ↔ Similar level of risk; and ⬇ Decreased level of risk.
Materiality	The materiality that we used for the Group financial statements was £28 million, which approximates to 5.9% of the three-year average profit before tax, excluding the impact of the Ogden discount rate change to minus 0.25% in the 2019 results which we elected to exclude due to the non-recurring nature of this event.
Scoping	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 97% of the Group's net assets, 100% of the Group's gross earned premium and 92% 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.
Significant changes in our approach	During the year we have made the following changes to our audit approach: a. We took into account the further implementation of the Group's new underwriting, claims and data technologies; b. We addressed the risk arising from a new actuarial calculation model and associated processes; and c. We addressed the risks arising from the Group's change to an agile finance operating model and continued implementation process of IFRS 17.

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:

- We obtained an understanding of the internal controls relating to management's going concern assessment process;
- We assessed management's Strategic Plan and challenged management's underlying business plans and forecasts to support key forward-looking assumptions such as the Group's growth rate and discount rate given our understanding of the Group and its industry;
- We evaluated the historical accuracy of forecasts prepared by management; and
- We evaluated management's reverse stress testing and assessed the likelihood of various scenarios that could adversely impact upon the Group's liquidity and solvency headroom.

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's 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 19 (Audit Committee Report), page 183 (Accounting policies), page 191 (Notes to the consolidated financial statements - note 2.3) and page 228 (Financial statements).

The Group's gross insurance liabilities total £3.7 billion (2020: £3.6 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.

There is additional inherent uncertainty underlying the estimation of the ultimate number of non-large bodily injury claims for the 2020 and 2021 accident claims cohort. This arises from the consequences of the Covid-19 pandemic and associated travel and lockdown restrictions, which affect traffic volumes and subsequently claim numbers.

Furthermore, the current UK inflationary environment results in inherent uncertainty regarding the severity of bodily injury claims.

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 cost per claim 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

We have concluded that the assumptions used in the calculation of the bodily injury claims reserves are reasonable.

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 £757.8 million (2020: £814.8 million) on a discounted gross basis as detailed in note 3.5.

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. The PPOs are sensitive to economic assumptions selected and as at 31 December 2021, the Group valued PPOs using an inflation rate of 3.5% (2020: 3.5%) and a discount rate of 3.5% (2020: 3.5%). 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.

Independent Auditor's Report to the shareholders of Direct Line Insurance Group plc *continued*

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, namely the challenge and approval of these assumptions by the reserving 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 valuation.

We have worked with our actuarial specialists to challenge:

- The PPO inflation assumption through inquiries with the Actuarial Director, assessing 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 nominal 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 reasonable.

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 and the ongoing uncertainty with regard to the rates of inflation in the UK economy, 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 existed at each respective reporting date.

Key observations

We have determined that the margin remains appropriate. In combination with the conclusions drawn in relation to bodily injury claims and PPO assumptions above, we have observed that the booked reserves are in line with the Group's prudent accounting policy.

5.2 Valuation of illiquid investments

Refer to page 119 (Audit Committee Report), pages 185 and 186 (Accounting policies) and pages 219 and 224 (Financial statements).

In the current year, we continue to identify the valuation of illiquid investments, specifically the commercial real estate loans, infrastructure debt, private placement bonds and investment property investments as a key audit matter as described below.

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 £542.8 million (2020: £575.1 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 the Covid-19 pandemic.

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 banks 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 management's conclusion was 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, retail warehouse, supermarkets and foodstores, industrial, hotel and alternative properties. As noted in disclosure note 20, the total value as at 31 December 2021 is £317.0 million (2020: £292.1 million). Given the impact of the Covid-19 pandemic 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, hotel and alternative sector properties held, where tenants have experienced an increased exposure to the persistent impacts of the Covid-19 pandemic; these may accelerate the long term downwards trend of property valuation in these sectors. These properties total £103.2 million (2020: £101.6 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 the Covid-19 pandemic and long-term trends in the use of various types of property. Valuation methodologies for investment properties are subjective in nature and involve various key assumptions. The use of different valuation methodologies and assumptions could produce significantly different estimates of fair value. With the persistent impact of the Covid-19 pandemic, 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 of and tested the relevant control related to the annual meeting with management's external valuation expert; this is where management review and challenge the assumptions and methodologies used in determining the fair value. This 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 misstatements within the investment property portfolio fair value.

Independent Auditor's Report to the shareholders of Direct Line Insurance Group plc *continued*

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 (2020: £28.0 million)	£25.2 million (2020: £25.2 million)
Basis for determining materiality	The materiality approximates to 5.9% (2020: 5.6%) of the three year average profit before tax, excluding the impact of the Ogden discount rate change to minus 0.25% in the 2019 results.	Materiality equates to less than 1% (2020: 1%) of shareholders' equity and is capped at 90% (2020: 90%) of Group materiality.
Rationale for the benchmark applied	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 was 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 minus 0.25% in the 2019 results due to the non-recurring nature of this event. We also considered this measure suitable having compared to other benchmarks: our materiality equates to 6.3% (2020: 6.2%) of statutory profit before tax, 0.9% (2020: 0.9%) of gross earned premium and 1.1% (2020: 0.9%) of total equity.	We determined that the critical benchmark for the Parent Company was shareholders' equity. This is because the Parent Company is not a trading entity but rather received dividend income from its subsidiaries. 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.

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 components 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 75% of Group statutory profit before tax, is scoped to a component materiality of £25.2 million (2020: £25.2 million). Component materiality for other entities within the scope of our Group audit ranged from £0.9 million to £8.5 million (2020: £0.8 million to £8.8 million).

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	70% (2020: 67.5%) of Group materiality	70% (2020: 67.5%) of Parent Company materiality
Basis and rationale for determining performance materiality	In 2020, we adjusted down performance materiality after assessing the potential impact of the Covid-19 pandemic. In 2021, when determining performance materiality, we considered the following factors: - 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, and our assessment that these were not likely to recur in the current period; and - We did not identify any significant changes in the Group's control environment due to the Covid-19 pandemic.	For consistency within the Group, the same percentage of 70% 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 (2020: £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 97% (2020: 99%) of the Group's net assets, 100% (2020: 100%) of the Group's gross earned premium and 92% (2020: 95%) 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.

Independent Auditor's Report to the shareholders of Direct Line Insurance Group plc *continued*

7. An overview of the scope of our audit continued

7.1. Identification and scoping of components continued

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 2021 audit, we identified 19 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 19 systems identified.

Business processes and financial reporting controls

In planning our 2021 audit, we identified 22 business processes that were material to the Group's financial reporting processes. These processes spanned the Group's material transactions and account balances including the premiums, claims, reinsurance, expenses, payroll, investments and intangibles processes and part of the reserving process relating to reconciliation of data, and we intended to rely on the business controls associated with all of these processes. Having completed our testing over the operating effectiveness of business controls associated with these processes, through a combination of current period testing and reliance on prior period testing, we concluded that we are able to rely upon the business controls associated with all 22 processes.

7.3 Our consideration of climate-related risks

We have gained an understanding of management's processes to address climate-related risks, including management's implementation of the Sustainability Committee and Group Sustainability Framework. We have assessed whether these initiatives undertaken by management are aligned with the Climate Change Roadmap developed by the Association of British Insurers. We have performed a risk assessment of the financial impact of climate risks on the financial statements and concluded the risks of material misstatement due to climate risk factors are remote. In doing so we considered the estimates and judgements applied to the financial statements and how climate risks impact their valuation. We challenged management's disclosure relating to climate risks in the Planet section of the Annual Report and note 3 of the financial statements. We have considered whether information included in the climate related disclosures in the Annual Report were consistent with our understanding of the business and the financial statements.

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.

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 reviewed by the Audit Committee on 1 November 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 relevant internal specialists, including actuarial, tax, real estate, valuations, pensions, IT, forensic 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 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, FCA and environmental regulations.

11.2 Audit response to risks identified

As a result of performing the above, we identified the valuation of insurance liabilities a key audit matter 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 that key audit matter.

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 the 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 indications of fraud or non-compliance with laws and regulations throughout the audit.

Independent Auditor's Report to the shareholders of Direct Line Insurance Group plc *continued*

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 163;
- 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 94;
- the Directors' statement on fair, balanced and understandable set out on page 117;
- the Board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 118;
- 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 192; and
- the section describing the work of the Audit Committee set out on page 119.

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 Insurance Group plc, 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. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 22 years, covering the years ending 31 December 2000 to 31 December 2021. Under the Companies Act 2006, the last financial year of our maximum engagement period is the year ending 31 December 2023.

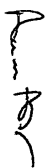
15.2 Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

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.

As required by the Financial Conduct Authority ('FCA') Disclosure Guidance and Transparency Rule ('DTR') 4.1.14R, these financial statements form part of the European Single Electronic Format ('ESEF') prepared Annual Financial Report filed on the National Storage Mechanism of the UK FCA in accordance with the ESEF Regulatory Technical Standard ('ESER-RTS'). This auditor's report provides no assurance over whether the annual financial report has been prepared using the single electronic format specified in the ESEF RTS.



ADAM ADDIS, ACA

SENIOR STATUTORY AUDITOR

FOR AND ON BEHALF OF DELOITTE LLP

LONDON, UNITED KINGDOM

7 March 2022

Consolidated Income Statement

For the year ended 31 December 2021

	Notes	2021 £m	2020 £m
Gross earned premium		3,168.0	3,189.3
Reinsurance premium		(210.6)	(228.8)
Net earned premium	5	2,957.4	2,960.5
Investment return	6	146.3	95.1
Instalment income		97.3	109.3
Other operating income	7	46.7	49.9
Total income		3,247.7	3,214.8
Insurance claims	8	(1,915.3)	(1,730.4)
Insurance claims recoverable from reinsurers	8	196.6	16.8
Net insurance claims	8	(1,718.7)	(1,713.6)
Commission expenses	9	(240.9)	(254.7)
Operating expenses (including restructuring and one-off costs)	10	(807.8)	(763.8)
Total expenses		(1,048.7)	(1,018.5)
Finance costs	11	(34.3)	(31.3)
Profit before tax		446.0	451.4
Tax charge	12	(102.3)	(84.2)
Profit for the year attributable to the owners of the Company		343.7	367.2
Earnings per share:			
Basic (pence)	15	24.5	25.8
Diluted (pence)	15	24.1	25.5

The attached notes on pages 181 to 238 form an integral part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2021

	Notes	2021 £m	2020 £m
Profit for the year attributable to the owners of the Company		343.7	367.2
Other comprehensive (loss)/income			
Items that will not be reclassified subsequently to the income statement:			
Remeasurement gain/(loss) on defined benefit pension scheme	27	3.8	(0.4)
Tax relating to items that will not be reclassified	13	(0.8)	0.3
		3.0	(0.1)
Items that may be reclassified subsequently to the income statement:			
Cash flow hedges		(0.3)	(0.1)
Fair value (loss)/gain on AFS investments	32	(84.1)	47.4
Less: net gains on AFS investments transferred to income statement on disposals	32	(7.9)	(1.1)
Tax relating to items that may be reclassified	32	17.1	(9.9)
		(75.2)	36.3
Other comprehensive (loss)/income for the year net of tax		(72.2)	36.2
Total comprehensive income for the year attributable to the owners of the Company		271.5	403.4

The attached notes on pages 181 to 238 form an integral part of these consolidated financial statements.

Consolidated Balance Sheet

Company number: 02280426

As at 31 December 2021

	Notes	2021 £m	2020 £m
Assets			
Goodwill and other intangible assets	17	822.5	786.8
Property, plant and equipment	18	113.8	146.1
Right-of-use assets	19	76.1	137.8
Investment property	20	317.0	292.1
Reinsurance assets	22	1,211.8	1,129.2
Current tax assets		14.4	—
Deferred acquisition costs	23	186.6	172.2
Insurance and other receivables	24	762.8	848.2
Prepayments, accrued income and other assets	25	125.1	126.0
Derivative financial instruments	26	35.9	73.4
Retirement benefit asset	27	12.1	9.0
Financial investments	28	4,633.6	4,681.4
Cash and cash equivalents	29	955.7	1,220.1
Assets held for sale	30	41.2	—
Total assets		9,308.6	9,622.3
Equity			
Shareholders' equity		2,550.2	2,699.7
Tier 1 notes	33	346.5	346.5
Total equity		2,896.7	3,046.2
Liabilities			
Subordinated liabilities	34	513.6	516.6
Insurance liabilities	35	3,680.5	3,617.0
Unearned premium reserve	36	1,500.7	1,497.1
Borrowings	29	59.2	51.9
Derivative financial instruments	26	19.5	57.2
Provisions	38	96.4	114.8
Trade and other payables, including insurance payables	39	457.3	549.9
Lease liabilities	40	84.2	152.4
Deferred tax liabilities	13	0.5	8.7
Current tax liabilities		—	10.5
Total liabilities		6,411.9	6,576.1
Total equity and liabilities		9,308.6	9,622.3

The attached notes on pages 181 to 238 form an integral part of these consolidated financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 7 March 2022.

They were signed on its behalf by:



NEIL MANSER

CHIEF FINANCIAL OFFICER

Consolidated Statement of Changes in Equity

For the year ended 31 December 2021

	Share capital (note 31) £m	Employee trust shares £m	Capital reserves (note 32) £m	AFS revaluation reserve (note 32) £m	Foreign exchange translation reserve £m	Retained earnings £m	Shareholders' equity £m	Tier 1 notes (note 33) £m	Total equity £m
Balance at 1 January 2020	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/(loss)	—	—	—	36.4	(0.1)	(0.1)	36.2	—	36.2
Total comprehensive income for the year	—	—	—	36.4	(0.1)	367.1	403.4	—	403.4
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 31)	(1.1)	—	1.1	—	—	(30.0)	(30.0)	—	(30.0)
Credit to equity for equity-settled share-based payments (note 37)	—	—	—	—	—	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
Total transactions with equity holders	(1.1)	(10.1)	1.1	—	—	(337.2)	(347.3)	—	(347.3)
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
Profit for the year	—	—	—	—	—	343.7	343.7	—	343.7
Other comprehensive (loss)/income	—	—	—	(74.9)	(0.3)	3.0	(72.2)	—	(72.2)
Total comprehensive income for the year	—	—	—	(74.9)	(0.3)	346.7	271.5	—	271.5
Dividends and appropriations paid (note 14)	—	—	—	—	—	(317.4)	(317.4)	—	(317.4)
Shares acquired by employee trusts	—	(20.3)	—	—	—	—	(20.3)	—	(20.3)
Shares cancelled following buyback (note 31)	(3.7)	—	3.7	—	—	(101.0)	(101.0)	—	(101.0)
Credit to equity for equity-settled share-based payments	—	—	—	—	—	17.0	17.0	—	17.0
Shares distributed by employee trusts	—	19.2	—	—	—	(19.2)	—	—	—
Tax on share-based payments	—	—	—	—	—	0.7	0.7	—	0.7
Total transactions with equity holders	(3.7)	(1.1)	3.7	—	—	(419.9)	(421.0)	—	(421.0)
Balance at 31 December 2021	145.2	(41.4)	1,454.8	9.0	(0.3)	982.9	2,550.2	346.5	2,896.7

The attached notes on pages 181 to 238 form an integral part of these consolidated financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December 2021

	Notes	2021 £m	2020 £m
Net cash generated from operating activities before investment of insurance assets	40	271.8	268.8
Cash generated from investment of insurance assets	40	167.2	315.9
Net cash generated from operating activities		439.0	584.7
Cash flows used in investing activities			
Purchases of goodwill and other intangible assets	17	(109.4)	(140.7)
Purchases of property, plant and equipment	18	(29.3)	(20.1)
Net cash flows from acquisition of subsidiaries		—	(0.2)
Net cash used in investing activities		(138.7)	(161.0)
Cash flows used in financing activities			
Dividends paid	14	(300.8)	(295.9)
Appropriations paid	14	(16.6)	(16.6)
Finance costs (including lease interest)		(31.4)	(30.2)
Principal element of lease payments		(101.9)	(12.5)
Purchase of employee trust shares		(20.3)	(23.8)
Proceeds on issue of subordinated Tier 2 notes	40	—	257.2
Shares purchased in buyback	31	(101.0)	(30.0)
Net cash used in financing activities		(572.0)	(151.8)
Net (decrease)/increase in cash and cash equivalents		(271.7)	271.9
Cash and cash equivalents at the beginning of the year	29	1,168.2	896.3
Cash and cash equivalents at the end of the year	29	896.5	1,168.2

The attached notes on pages 181 to 238 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, the Group's consolidated financial statements are prepared in accordance with IFRSs issued by the IASB as adopted by the UK. 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 4.5) and assets held for sale which are measured at the lower of carrying amount and fair value less costs to sell.

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 2021 and 31 December 2020 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 describes the Group's capital management strategy, including the capital actions taken in the last 12 months 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. The financial disclosures relating to the Group's principal risks are set out in note 5. This covers insurance, market and credit risk, and the Group's approach to monitoring, managing and mitigating exposures to these risks.

The Directors have assessed the principal risks of the Group over the duration of the planning cycle. The assessment included the impact of the Covid-19 pandemic on the underwriting cycle, including motor claims frequency, travel disruption and supply chain disruption, and the possible impacts of the FCA's Pricing Practices Review ('PPR'). The key judgements and assumptions applied were in relation to the likely time period of continued Covid-19 related effects and the impact on the general insurance market, the economic recovery and the impact of the PPR on customer behaviour.

The 2021 Strategic Plan ('the Plan') indicates that the Group will continue to maintain levels of solvency in line with its risk appetite across the planning cycle (to 31 December 2025).

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 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 scenarios, it was concluded that the Group's SCR would not be breached following the implementation of management actions.

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 U K Insurance Limited, the Group's principal underwriter, i.e. a reduction of own funds to below the SCR. The purpose of this reverse stress test was to assess the coverage and scope of the internal economic capital model and there were no findings that invalidate the internal model.

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 7 March 2022 (the date of approval of the consolidated financial statements). Accordingly, the Directors have adopted the going concern basis in preparing the consolidated 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 2021.

In August 2020, the IASB issued 'Interest Rate Benchmark Reform Phase 2' (amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) which was effective from 1 January 2021 and was adopted by the UK in January 2021. The key considerations are as follows:

The Phase 2 amendments provide practical relief from certain requirements in IFRS standards. These reliefs relate to modifications of financial instruments and lease contracts or hedging relationships triggered by a replacement of a benchmark interest rate in a contract with a new alternative benchmark rate. If the basis for determining the contractual cash flows of a financial asset or financial liability measured at amortised cost changed as a result of interest rate benchmark reform, then the Group updated the effective interest rate of the financial asset or financial liability to reflect the change that is required by the reform. A change in the basis for determining the contractual cash flows is required by interest rate benchmark reform if the following conditions are met:

- the change is necessary as a direct consequence of the reform; and
- the new basis for determining the contractual cash flows is economically equivalent to the previous basis – i.e. the basis immediately before the change.

When changes were made to a financial asset or financial liability in addition to changes to the basis for determining the contractual cash flows required by interest rate benchmark reform, the Group first updated the effective interest rate of the financial asset or financial liability to reflect the change that is required by interest rate benchmark reform. After that, the Group applied the policies on accounting for modifications to the additional changes.

The amendments also provide an exception to use a revised discount rate that reflects the change in interest rate when remeasuring a lease liability because of a lease modification that is required by interest rate benchmark reform. The Group has no lease contracts where changes to rental amounts are affected by the interest rate benchmark reform.

Notes to the Consolidated Financial Statements *continued*

Adoption of new and revised standards continued

The Phase 2 amendments provide a series of temporary exceptions from certain hedge accounting requirements when a change required by interest rate benchmark reform occurs to a hedged item and/or hedging instrument. The temporary exceptions permit the hedging relationship to be continued without interruption. The Group applied the following reliefs as and when uncertainty arising from interest rate benchmark reform was no longer present with respect to the timing and amount of the interest rate benchmark-based cash flows of the hedged item or hedging instrument:

- the Group amended the designation of a hedging relationship to reflect changes that were required by the reform without discontinuing the hedging relationship; and
- when a hedged item in a cash flow hedge was amended to reflect the changes that were required by the reform, the amount accumulated in the cash flow hedge reserve was deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.

Further details on the implementation of the reform are reported in note 3.3.2 Market risk.

The IASB issued 'Covid-19-related Rent Concessions beyond 30 June 2021 (Amendment to IFRS 16)' in March 2021 which was adopted by the UK in May 2021. The amendment extends, by one year, the original May 2020 amendment that 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. The Group has not needed to apply this practical expedient.

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 2021 and 31 December 2020. 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

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 and equity investments, 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 inception during the financial year, adjusted by an unearned premium reserve, which represents the proportion of the premiums inception 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, a monthly 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 include both arrangement and administration services. Arrangement services are provided at a point in time as the benefits from obtaining the insurance policy occur at a specific time. The customer benefits from administration services throughout the policy period; as the Group performs its obligation on an as-needed basis, the allocated element of administration services are spread evenly over the term of the policy.

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.

Revenue from any goods provided are accounted for at the point of sale.

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.

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 which are wholly or partly to take the form of PPOs. These are covered in more detail in note 2.3. 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 the value of incurred claims (gross and net) at the balance sheet date. Also included in the estimation of incurred 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 reserves based on a management best estimate, which includes a prudence margin that exceeds the internal 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 and claims are generally accounted for in the same accounting period as the direct business 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.

Notes to the Consolidated Financial Statements *continued*

1.6 Reinsurance continued

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. Changes in the provision affect the Group by changing the carrying value of the net reinsurance asset with the movement being 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 are 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 ("ROU") 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 ROU 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 ROU 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 ROU 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 ROU 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 completed quarterly by independent registered valuers and in accordance with guidance issued by the Royal Institution of Chartered Surveyors. 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.

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.

Notes to the Consolidated Financial Statements *continued***1.13 Financial assets continued****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 at fair value on the date the derivative contract is entered into, and subsequently remeasured to their fair value at the end of each reporting period. 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 Assets held for sale

Non-current assets, including investment property, are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use and a sale is considered highly probable. Investment property is measured at fair value less costs to sell. Other non-current assets are measured at the lower of their carrying amount and fair value less costs to sell.

An impairment loss is recognised in the income statement for any initial or subsequent write down of the asset to fair value less costs to sell. A gain is recognised for any subsequent increase in fair value less costs to sell of an asset but not in excess of any cumulative impairment loss previously recognised. A gain or loss not previously recognised by the date of the sale is recognised at the date of derecognition.

Non-current assets classified as held for sale are presented separately from the other assets in the balance sheet and are not depreciated or amortised.

1.16 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.

1.17 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.

1.18 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.

1.19 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'.

1.20 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.

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.

1.21 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).

Notes to the Consolidated Financial Statements *continued*

1.21 Share-based payment *continued*

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.

1.22 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.

1.23 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.

1.24 Accounting developments

New IFRS standards and amendments that are issued, but not yet effective for the 31 December 2021 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 EU¹ 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 EU¹ in November 2017.

Note:

1. On 31 December 2020, all EU-adopted international accounting standards became UK-adopted international accounting standards.

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 its 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 its 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 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 43. The amount of change in the fair value during the period for these financial assets was:

- AFS debt securities £94.5 million decrease (2020: £96.7 million increase);
- HTM debt securities £1.7 million decrease (2020: £0.2 million decrease);
- infrastructure debt £2.1 million decrease (2020: £1.1 million increase); and
- commercial real estate loans £0.5 million decrease (2020: £3.8 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 43 and the amount of change in the fair value during the period was an increase of £26.9 million (2020: £64.5 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 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 £366.0 million (2020: £374.6 million). The carrying value of these financial assets at 31 December 2021 was £368.1 million (2020: £377.2 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, and adopted by the UK in January 2021, which delays the effective date of IFRS 9 so as to remain in line with IFRS 17.

'Amendments to IFRS 9: Prepayment Features with Negative Compensation' was issued in October 2017 and is endorsed by the UK 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.

As the vast majority of the Group's insurance contracts have a coverage period that is 12 months or less, the Group intends to adopt the premium allocation approach ("**PAA**") for all insurance and reinsurance contract groups. Applying the PAA, an entity measures the liability for remaining coverage ("**LRC**") of a group of insurance contracts on initial recognition as the premiums received less any insurance acquisition cash flows paid. Subsequently, the liability for remaining coverage of a group of insurance contracts increases with premiums received and decreases to reflect an allocation of the total amount of the expected premiums receipts to profit or loss on a straight-line basis as insurance services are provided. The measurement of the Group's liability for incurred claims ("**LIC**") will require the Group to determine a probability-weighted best estimate of future fulfilment cash flows, discounted to reflect the time value of money with a risk adjustment to compensate for non-financial risk.

A dedicated programme of activity throughout the year has ensured the Group remains on track to complete the necessary data and technology changes required to transition to IFRS 17 and IFRS 9 from 1 January 2023, with a period of parallel run planned for 2022.

The Group also continues to refine its accounting policy choices and accounting judgements under IFRS 17 and therefore it is not possible to accurately estimate the likely impact of IFRS 17 to the Group's financial statements at this stage.

The standard is yet to be endorsed by the UK.

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 if 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 settlement of a liability.

In July 2020 a further amendment was made: 'Classification of Liabilities as Current or Non-current – Deferral of Effective Date (Amendments 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.

The new guidance is effective for annual periods starting on or after 1 January 2023 but is yet to be adopted by the UK.

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 but are yet to be adopted by the UK.

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 from 1 January 2022 but are yet to be adopted by the UK.

The following amendments are effective from 1 January 2023 but have not yet been adopted by the UK.

In February 2021 the IASB issued 'Definition of Accounting Estimates (Amendments to IAS 8)' which introduces a new definition of 'accounting estimates'. The amendments are designed to clarify the distinction between changes in accounting estimates and changes in accounting policies and the correction of errors.

Also, in February 2021 the IASB issued 'Disclosure of Accounting policies (Amendments to IAS 1 and IFRS Practice Statement 2)' to help entities to provide accounting policy disclosures that are more useful by:

- replacing the requirement for entities to disclose their 'significant' accounting policies with a requirement to disclose their 'material' accounting policies; and
- adding guidance on how entities apply the concept of 'materiality' in making decisions about accounting policy disclosures.

In May 2021 the IASB issued 'Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)' which narrows the scope of the initial recognition exception under IAS 12 'Income Taxes' so that it no longer applies to transactions that give rise to equal taxable and deductible temporary differences.

Notes to the Consolidated Financial Statements *continued***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 181 to 189. 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.

It has been determined, following the successful implementation of the Group's new Motor platform, that 'impairment provisions - intangible assets' is no longer a critical accounting judgement or source of estimation uncertainty. This is because the Group's most significant intangible asset, the Motor IT platform, has begun amortisation over the period of its expected useful economic life.

2.1 Impairment provisions – financial assets**Accounting judgement**

The Group's financial assets are classified as AFS or HTM debt securities or loans and receivables. 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.

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.

The majority of the Group's financial assets are classified as AFS debt securities (31 December 2021: £4,084.6 million; 31 December 2020: £4,103.1 million). Impairment losses and exchange differences arising from translating the amortised cost of foreign currency monetary AFS financial assets are recognised in the income statement. Other changes in fair value are recognised in a separate component of equity. No impairments have been recognised in the AFS portfolio.

Had all the declines in AFS debt securities asset values met the criteria above at 31 December 2021, the Group would have suffered a loss of £24.8 million (2020: £3.0 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.

The Group has a small portfolio of investments classified as HTM (31 December 2021: £91.2 million; 31 December 2020: £103.9 million). These assets are measured at amortised cost and there have been no impairment losses.

The Group has a portfolio of investments classified as loans and receivables, comprising infrastructure debt and commercial real estate loans (total 31 December 2021: £451.6 million; 31 December 2020: £471.2 million). There was an impairment of £2.1 million within the loans and receivables portfolio in the year ended 31 December 2021 (2020: £2.7 million).

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 2021 of £317.0 million (2020: £292.1 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 43).

Sensitivity analysis for the investment property portfolio has been independently calculated by our register valuers by flexing inputs of internal models to a reasonable alternative yield to ascertain the impact on property valuations (see note 20).

2.3 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 2021 amounted to £2,548.4 million (2020: £2,591.7 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 minus 1.75% in Northern Ireland.

The Group reserves its large bodily injury claims at the relevant discount rate for each jurisdiction, with the overwhelming majority now case 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. Sensitivities for the impact of a potential change in the Ogden discount rate are shown in note 3.3.1.

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 expected return on the assets backing these long-term liabilities.

Higher claims inflation remains a risk, given the continuing rise in consumer price and wage inflation. CPI is at its highest level for the past decade and is not expected to decline until 2023. Pressure is likely to remain strong on wages, with potential implications for the cost of care. Global supply chain issues remain problematic, resulting in a risk of price increases for products and components in short supply. A range of general and specific claims inflation scenarios for goods and services have therefore been considered in the reserving process.

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 as well as input costs and replacement costs for damage claims. The sensitivity analysis in note 3.3.1 continues to look at a 100 basis point change in the claims inflation assumed in the actuarial best estimate over the next two years and therefore continues to remain relevant and within the Group's booked reserve margin.

The table in note 35 to the financial statements provides an analysis of outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2021 and 31 December 2020 and further details on sources of estimation uncertainty. Details of sensitivity analysis to the discount rate applied to PPO claims are shown in note 3.3.1.

Notes to the Consolidated Financial Statements *continued*

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 89.

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 the 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 2.3.

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}	
	2021 £m	2020 £m
At 31 December		
PPOs³		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	43.0	45.9
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(58.9)	(62.7)
Ogden discount rate⁴		
Impact of the Group reserving at a discount rate of 0.75% compared to minus 0.25% (2020: 0.75% compared to minus 0.25%)	42.5	43.7
Impact of the Group reserving at a discount rate of minus 1.25% compared to minus 0.25% (2020: minus 1.25% compared to minus 0.25%)	(59.4)	(61.1)
Claims inflation		
Impact of a decrease in claims inflation by 100 basis points for two consecutive years	37.3	32.4
Impact of an increase in claims inflation by 100 basis points for two consecutive years	(37.6)	(32.2)

Notes:

1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at the balance sheet date 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 the 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 2021. 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 adjusters 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.

Notes to the Consolidated Financial Statements *continued*

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 continue to develop its risk management systems and monitoring tools over 2022 for physical risk building on the work undertaken to complete the Climate Biennial Exploratory Scenario ("CBES") in 2021. 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 78 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 windstorm/storm surge loss. The programme renews annually on 1 July and has a retention of £150 million and an upper limit of £1,150 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.

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.

The Investment Committee has 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 zero emissions by 2050 in line with the aims of the Race to Zero campaign; 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, compared to a 2020 baseline.

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.

Notes to the Consolidated Financial Statements *continued*

3. Risk management continued

3.3.2 Market risk

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	Local government	Sovereign	Supranational	Debt securities total
At 31 December 2021	£m	£m	£m	£m	£m
Australia	215.0	—	—	—	215.0
Austria	17.7	—	—	—	17.7
Belgium	31.6	—	—	—	31.6
Canada	99.1	—	—	—	99.1
Cayman Islands	4.0	—	—	—	4.0
China	1.0	—	—	—	1.0
Czech Republic	1.0	—	—	—	1.0
Denmark	15.6	—	—	—	15.6
Finland	29.4	12.1	—	—	41.5
France	301.6	5.9	—	—	307.5
Germany	243.3	—	—	—	243.3
Ireland	1.4	—	—	—	1.4
Italy	21.0	—	—	—	21.0
Japan	48.6	—	—	—	48.6
Mexico	13.1	—	—	—	13.1
Netherlands	125.1	—	—	—	125.1
New Zealand	11.0	—	—	—	11.0
Norway	17.9	10.1	—	—	28.0
Portugal	4.9	—	—	—	4.9
South Africa	10.6	—	—	—	10.6
South Korea	3.0	—	—	—	3.0
Spain	74.3	—	—	—	74.3
Sweden	65.8	—	—	—	65.8
Switzerland	57.3	—	—	—	57.3
United Arab Emirates	3.5	—	—	—	3.5
United Kingdom	1,134.0	—	29.7	—	1,163.7
USA	1,546.1	—	5.9	—	1,552.0
Zambia	1.2	—	—	—	1.2
Supranational	—	—	—	14.0	14.0
Total	4,098.1	28.1	35.6	14.0	4,175.8

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 2020					
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
United Arab Emirates	3.6	—	—	—	3.6
United Kingdom	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

Notes to the Consolidated Financial Statements *continued*3. Risk management *continued*

3.3.2 Market risk

The table below analyses the distribution of debt securities by industry sector classifications.

At 31 December	2021		2020	
	£m	%	£m	%
Basic materials	82.6	2%	104.5	3%
Communications	203.4	5%	212.2	5%
Consumer, cyclical	410.3	10%	358.0	9%
Consumer, non-cyclical	361.4	9%	426.7	10%
Diversified	19.2	0%	20.8	0%
Energy	152.8	4%	184.2	4%
Financial	2,050.2	49%	1,897.0	45%
Industrial	250.5	6%	280.3	7%
Sovereign, supranational and local government	77.7	2%	82.1	2%
Technology	121.5	3%	103.9	3%
Transport	13.4	0%	13.4	0%
Utilities	432.8	10%	523.9	12%
Total	4,175.8	100%	4,207.0	100%

The table below analyses the distribution of infrastructure debt by industry sector classifications.

At 31 December	2021		2020	
	£m	%	£m	%
Social, of which:				
Education	110.3	44%	115.7	44%
Health	67.2	26%	70.3	26%
Other	49.0	20%	50.7	19%
Transport	24.3	10%	27.8	11%
Total	250.8	100%	264.5	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 debt securities investments in US dollar and Euro debt securities, the Group hedges its exposure to US dollar and Euro interest rate risk using swaps, excluding £348.6 million of US dollar short-duration, high-yield bonds (2020: £361.8 million), £123.9 million of US dollar subordinated financial debt and £96.2 million of Euro subordinated financial debt (2020: £99.9 million and £71.4 million, respectively) and £nil million short-duration Euro credit (2020: £58.7 million).

The Group is exposed to the following interest rate benchmarks within its hedging relationships: GBP SONIA, USD SOFR and EURIBOR. The first two have been subject to interest rate benchmark reform during 2021 (historically both LIBOR). 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 2021. 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 throughout 2021.

In the course of 2020 and 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 documentation for infrastructure debt and commercial real estate loans was amended in 2021 to include LIBOR fall-back clauses to the existing loan agreements in line with Loan Market Association guidance; and
- these fall-back clauses will be added to any new agreements.

In November 2021, the transition from USD LIBOR interest rate swaps to SOFR swaps for all US dollar hedge exposures was completed in line with accounting standards.

All legacy commercial real estate loans (issuance pre-April 2021) transitioned on the Q4 2021 interest payment date to GBP SONIA.

Not all the infrastructure loans as at 31 December 2021 have transitioned away from GBP LIBOR over to GBP SONIA. Where legal documentation has yet to be completed, in the immediate future reference of rates will be linked to synthetic GBP LIBOR.

The table below discloses in more detail for the transition from LIBOR to GBP SONIA for all sterling illiquid assets.

Non-derivative floating rate financial instruments prior to transition	Maturing in	Number of instruments	Nominal exposure (£m)	Transition progress
Private placement linked to LIBOR	2025	1	13.5	Transitioned to SONIA
Commercial real estate loans linked to LIBOR	2022 - 2026	27	200.8	Transitioned to SONIA
Infrastructure debt linked to LIBOR	2025 - 2040	29	250.8	- 6 loans completed transition to SONIA; - 10 loans on which arrangements to transition to SONIA are agreed and awaiting execution; - 12 loans are in the process of agreeing documentation to transition to SONIA; and - one loan will be prepaid in full in the first quarter of 2022 and will not transition to SONIA.

The Group's designated interest rate hedging instruments and hedged items as at 31 December 2021 are set out in the table below.

Hedge type	Instrument type	Maturing in	Nominal	Hedged item
Fair value hedges	Pay USD fixed, receive USD SOFR interest rate swaps	2023 - 2032	US\$1,108 million	Portfolio fair value hedge of the USD SOFR component of US dollar denominated fixed rate debt securities
	Pay Euro fixed, receive 6-month EURIBOR interest rate swaps	2024 - 2042	€109 million	Portfolio fair value hedge of the 6-month EURIBOR component of Euro denominated fixed rate debt securities

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 2021, the value of these property investments was £317.0 million (2020: £292.1 million). The property investments are located in the UK.

Notes to the Consolidated Financial Statements *continued***3. Risk management continued****3.3.2 Market risk continued****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 £1,376.5 million (2020: £1,331.9 million) of investments in US dollar bonds and Euro securities through £197.7 million (2020: £231.1 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.

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
		Less than 1 year	1 – 5 years	Over 5 years	
At 31 December 2021	£m	£m	£m	£m	£m
Derivative assets					
At fair value through the income statement					
Foreign exchange contracts (forwards)	1,695.4	27.8	—	—	27.8
Interest rate swaps	250.0	2.4	—	—	2.4
Designated as hedging instruments					
Foreign exchange contracts (forwards)	10.0	—	—	—	—
Interest rate swaps	901.0	(0.9)	3.6	3.0	5.7
Total	2,856.4	29.3	3.6	3.0	35.9

	Notional amounts	Maturity and fair value			Total
		Less than 1 year	1 – 5 years	Over 5 years	
At 31 December 2021	£m	£m	£m	£m	£m
Derivative liabilities					
At fair value through the income statement					
Foreign exchange contracts (forwards)	1,318.9	19.1	—	—	19.1
Designated as hedging instruments					
Foreign exchange contracts (forwards)	4.1	0.1	0.1	—	0.2
Interest rate swaps	9.1	—	—	0.2	0.2
Total	1,332.1	19.2	0.1	0.2	19.5

	Notional amounts	Maturity and fair value			Total
		Less than 1 year	1 – 5 years	Over 5 years	
At 31 December 2020	£m	£m	£m	£m	£m
Derivative assets					
At fair value through the income statement					
Foreign exchange contracts (forwards)	2,182.8	63.5	—	—	63.5
Interest rate swaps	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
		Less than 1 year	1 – 5 years	Over 5 years	
At 31 December 2020	£m	£m	£m	£m	£m
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

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	
	2021	2020	2021	2020
	£m	£m	£m	£m
Spread				
Impact of a 100 basis points increase in spreads on financial investments ^{2,3}	—	—	(144.3)	(151.2)
Interest rate				
Impact of a 100 basis points increase in interest rates on financial investments and derivatives ^{2,3,4}	11.8	12.5	(100.6)	(114.1)
Investment property				
Impact of a 15% decrease in property markets	(47.5)	(43.8)	(47.5)	(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, commercial real estate loans and HTM debt securities 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 £13.7 million (2020: £15.1 million) and a 100 basis points increase in interest rates would have been £4.8 million (2020: £4.4 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 2021, the Group has pledged £26.3 million in cash (2020: £65.8 million) to cover initial margins and out-of-the-money derivative positions. At 31 December 2021, counterparties have pledged £5.4 million in cash and £2.2 million in UK Gilts (2020: £12.0 million in cash and £8.1 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.

Notes to the Consolidated Financial Statements *continued***3. Risk management** continued**3.3.3 Credit risk** continued

Counterparty default risk continued

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.

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.

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 2021				
Reinsurance assets	1,205.1	—	6.7	1,211.8
Insurance and other receivables	762.4	0.3	0.1	762.8
Derivative assets	35.9	—	—	35.9
Debt securities	4,175.8	—	—	4,175.8
Infrastructure debt	250.8	—	—	250.8
Commercial real estate loans	200.8	—	—	200.8
Cash and cash equivalents ¹	955.7	—	—	955.7
Total	7,586.5	0.3	6.8	7,593.6

	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

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 2021 of £1,366.2 million (2020: £1,282.8 million) that can be further analysed as: secured £15.5 million (2020: £16.2 million); unsecured £1,193.7 million (2020: £1,125.2 million); and subordinated £157.0 million (2020: £141.4 million).

The tables below analyse the credit quality of debt securities that are neither past due nor impaired.

At 31 December 2021	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ and below £m	Total £m
Corporate	58.5	334.7	1,913.3	1,439.4	352.2	4,098.1
Supranational	14.0	—	—	—	—	14.0
Local government	10.1	18.0	—	—	—	28.1
Sovereign	5.9	29.7	—	—	—	35.6
Total	88.5	382.4	1,913.3	1,439.4	352.2	4,175.8

At 31 December 2020	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ and below £m	Total £m
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

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 201.

At 31 December 2021	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ and below £m	Not rated £m	Total £m
Reinsurance assets	—	660.1	528.2	1.9	—	14.9	1,205.1
Insurance and other receivables ¹	—	37.6	27.3	13.0	—	684.5	762.4
Derivative assets	—	7.9	9.9	18.1	—	—	35.9
Infrastructure debt	—	—	67.9	175.9	7.0	—	250.8
Commercial estate loans	17.7	73.3	66.9	34.1	8.8	—	200.8
Cash and cash equivalents ²	792.9	26.2	133.0	3.6	—	—	955.7
Total	810.6	805.1	833.2	246.6	15.8	699.4	3,410.7

At 31 December 2020	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ and below £m	Not rated £m	Total £m
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 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

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 business 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.

Notes to the Consolidated Financial Statements *continued***3. Risk management continued****3.3.4 Operational risk continued****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.

3.3.5 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 2021						
Debt securities	507.0	972.7	1,293.2	1,281.0	121.9	4,175.8
Infrastructure debt	14.6	34.4	34.2	101.7	65.9	250.8
Commercial real estate loans	87.0	54.0	59.8	—	—	200.8
Cash and cash equivalents ¹	955.7	—	—	—	—	955.7
Total	1,564.3	1,061.1	1,387.2	1,382.7	187.8	5,583.1

	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

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.

	Less than 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 2021							
Subordinated liabilities	272.0	20.8	20.8	52.0	265.2	630.8	513.6
Insurance liabilities ¹	1,182.2	995.1	480.1	385.8	1,549.1	4,592.3	3,680.5
Borrowings	59.2	—	—	—	—	59.2	59.2
Lease liabilities	11.2	17.9	14.6	31.7	32.8	108.2	84.2
Provisions	95.8	0.5	0.1	—	—	96.4	96.4
Trade and other payables, including insurance payables	450.6	6.4	0.3	—	—	457.3	457.3
Total	2,071.0	1,040.7	515.9	469.5	1,847.1	5,944.2	4,891.2

	Less than 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

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	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 2021							
Derivative assets	27.4	3.1	3.2	2.8	—	36.5	35.9
Derivative liabilities	(19.4)	(0.1)	—	—	—	(19.5)	(19.5)
Total	8.0	3.0	3.2	2.8	—	17.0	16.4

	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							
Derivative assets	69.2	2.3	0.1	1.9	—	73.5	73.4
Derivative 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

3.4 Capital management

At 31 December 2021, the Group's capital position was comprised of shareholders' equity of £2,550.2 million (31 December 2020: £2,699.7 million) and Tier 1 notes of £346.5 million (31 December 2020: £346.5 million). In addition, the Group's balance sheet also included £513.6 million of subordinated loan capital (31 December 2020: £516.6 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 £1.03 billion above an estimated SCR of £1.35 billion as at 31 December 2021 (31 December 2020: £1.22 billion and £1.34 billion respectively). The Group's capital requirements and solvency position are produced and presented to the Board on a regular basis.

Notes to the Consolidated Financial Statements *continued*

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 2021 (2020: £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.

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 2021.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
Gross written premium	1,560.8	577.8	380.0	653.0	3,171.6
Gross earned premium	1,597.8	579.8	372.5	617.9	3,168.0
Reinsurance premium	(124.5)	(26.4)	(3.0)	(56.7)	(210.6)
Net earned premium	1,473.3	553.4	369.5	561.2	2,957.4
Investment return	99.8	12.5	3.7	30.3	146.3
Instalment income	69.4	18.3	3.0	6.6	97.3
Other operating income	33.9	1.0	9.7	2.1	46.7
Total income	1,676.4	585.2	385.9	600.2	3,247.7
Insurance claims	(1,086.8)	(287.7)	(177.2)	(363.6)	(1,915.3)
Insurance claims recoverable from/(payable to) reinsurers	139.8	7.3	(8.1)	57.6	196.6
Net insurance claims	(947.0)	(280.4)	(185.3)	(306.0)	(1,718.7)
Commission expenses	(48.2)	(38.1)	(42.3)	(112.3)	(240.9)
Operating expenses before restructuring and one-off costs	(366.4)	(124.9)	(93.5)	(121.5)	(706.3)
Total expenses	(414.6)	(163.0)	(135.8)	(233.8)	(947.2)
Operating profit	314.8	141.8	64.8	60.4	581.8
Restructuring and one-off costs					(101.5)
Finance costs					(34.3)
Profit before tax					446.0
Underwriting profit	111.7	110.0	48.4	21.4	291.5
Loss ratio	64.3%	50.7%	50.2%	54.5%	58.1%
Commission ratio	3.3%	6.9%	11.4%	20.0%	8.1%
Expense ratio	24.8%	22.5%	25.3%	21.7%	23.9%
Combined operating ratio	92.4%	80.1%	86.9%	96.2%	90.1%

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2021.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
Goodwill	130.4	45.8	28.7	10.1	215.0
Assets held for sale	29.2	3.5	1.1	7.4	41.2
Other segment assets	6,467.2	750.1	268.4	1,566.7	9,052.4
Segment liabilities	(4,551.2)	(550.3)	(166.5)	(1,143.9)	(6,411.9)
Segment net assets	2,075.6	249.1	131.7	440.3	2,896.7

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.

Notes to the Consolidated Financial Statements *continued*

4. Segmental analysis continued

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.

5. Net earned premium

	2021 £m	2020 £m
Gross earned premium:		
Gross written premium	3,171.6	3,180.4
Movement in unearned premium reserve	(3.6)	8.9
	3,168.0	3,189.3
Reinsurance premium paid and payable:		
Premium payable	(186.4)	(231.0)
Movement in reinsurance unearned premium reserve	(24.2)	2.2
	(210.6)	(228.8)
Total	2,957.4	2,960.5

6. Investment return

	2021 £m	2020 £m
Investment income:		
Interest income from:		
Debt securities	90.9	98.6
Cash and cash equivalents	0.2	2.5
Infrastructure debt	4.4	5.8
Commercial real estate loans	6.0	6.5
Interest income	101.5	113.4
Rental income from investment property	14.5	13.7
	116.0	127.1
Net realised gains/(losses):		
AFS debt securities	7.9	1.1
Derivatives	(5.2)	69.9
Investment property (note 20)	0.2	—
	2.9	71.0
Net unrealised gains/(losses):		
Impairment of loans and receivables	(2.1)	(2.7)
Derivatives	(8.1)	(90.2)
Investment property (note 20)	37.6	(10.1)
	27.4	(103.0)
Total	146.3	95.1

The table below analyses the realised and unrealised gains and losses on derivative instruments included in investment return.

	Realised 2021 £m	Unrealised 2021 £m	Realised 2020 £m	Unrealised 2020 £m
Derivative (losses)/gains:				
Foreign exchange forward contracts ¹	39.9	(42.5)	57.4	(50.8)
Associated foreign exchange risk	(22.8)	24.7	28.1	(45.7)
Net gains/(losses) on foreign exchange forward contracts	17.1	(17.8)	85.5	(96.5)
Interest rate swaps ¹	(26.3)	48.9	(26.2)	(23.0)
Associated interest rate risk on hedged items	4.0	(39.2)	10.6	29.3
Net (losses)/gains on interest rate derivatives	(22.3)	9.7	(15.6)	6.3
Total	(5.2)	(8.1)	69.9	(90.2)

Note:

1. All foreign exchange forward contracts and certain interest rate swaps are measured at fair value through the income statement. There are also interest rate swaps designated as hedging instruments.

Notes to the Consolidated Financial Statements *continued*

7. Other operating income

	2021	2020
	£m	£m
Revenue from vehicle recovery and repair services	19.7	24.0
Vehicle replacement referral income	13.1	12.2
Legal services income	7.2	8.8
Other income ¹	6.7	4.9
Total	46.7	49.9

Note:

1. Other income includes fee income from insurance intermediary services.

8. Net insurance claims

	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	2021	2021	2021	2020	2020	2020
	£m	£m	£m	£m	£m	£m
Current accident year claims paid	1,058.6	(1.1)	1,057.5	1,056.4	(18.1)	1,038.3
Prior accident year claims paid	793.2	(88.7)	704.5	876.6	(123.0)	753.6
Movement in insurance liabilities	63.5	(106.8)	(43.3)	(202.6)	124.3	(78.3)
Total	1,915.3	(196.6)	1,718.7	1,730.4	(16.8)	1,713.6

Claims handling expenses for the year ended 31 December 2021 of £188.4 million (2020: £208.2 million) have been included in the claims figures above.

9. Commission expenses

	2021	2020
	£m	£m
Commission expenses	201.2	180.9
Expenses incurred under profit participations	39.7	73.8
Total	240.9	254.7

10. Operating expenses

	2021	2020
	£m	£m
Staff costs ^{1,2}	268.8	270.3
IT and other operating expenses ^{1,2,3}	157.0	220.2
Marketing	112.0	106.6
Insurance levies	89.0	80.4
Depreciation, amortisation and impairment of intangible and ROU assets ^{1,4}	97.1	86.3
Loss on termination of property lease ^{1,5}	83.9	—
Total other operating expenses (including restructuring and one-off costs)	807.8	763.8
Of which restructuring and one-off costs ^{1,5}	101.5	39.4
Total excluding restructuring and one-off costs	706.3	724.4

Notes:

1. Restructuring and one-off costs of £101.5 million (2020: £39.4 million) are included as follows: staff costs of £7.8 million (2020: £14.7 million), other operating expenses of £9.3 million (2020: £24.2 million), depreciation of £0.5 million (2020: £0.5 million) and loss on termination of property lease of £83.9 million (2020: £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 the year ended 31 December 2021, depreciation and amortisation includes a £2.1 million impairment charge (2020: £6.6 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to the development of new systems, and a £0.5 million impairment charge (2020: £nil), which relates to ROU property assets.
5. As part of the review of the Group's office site property strategy 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 loss on terminating the lease was £83.9 million and the value of the fixed asset capitalised was £19.8 million.

The table below analyses the number of people employed by the Group's operations.

	At 31 December		Average for the year	
	2021	2020	2021	2020
Insurance operations	6,976	8,022	7,502	8,010
Repair centre operations	1,408	1,441	1,432	1,454
Support	1,402	1,344	1,382	1,388
Total	9,786	10,807	10,316	10,852

The aggregate remuneration of those employed by the Group's operations comprised:

	2021	2020
	£m	£m
Wages and salaries	392.8	393.5
Social security costs	42.6	43.6
Pension costs	26.1	26.2
Share-based payments	18.4	18.5
Total	479.9	481.8

The table below analyses Auditor's remuneration in respect of the Group's operations.

	2021	2020
	£m	£m
Fees payable for the audit of:		
The Company's annual accounts	0.2	0.2
The Company's subsidiaries	1.9	1.9
Total audit fees	2.1	2.1
Audit-related assurance services	0.2	0.2
Non-audit services	0.3	0.6
Total	2.6	2.9

Aggregate Directors' emoluments

The table below analyses the total amount of Directors' remuneration in accordance with Schedule 5 to the Accounting Regulations.

	2021	2020
	£m	£m
Salaries, fees, bonuses and benefits in kind	3.5	3.8
Gains on exercise of share options	0.8	—
Total	4.3	3.8

Further information about the remuneration of individual Directors is provided in the Directors' Remuneration Report.

At 31 December 2021, no Directors (2020: no Directors) had retirement benefits accruing under the defined contribution pension scheme in respect of qualifying service. During the year ended 31 December 2021, two Directors exercised share options (2020: one Director).

Notes to the Consolidated Financial Statements *continued*

11. Finance costs

	2021	2020
	£m	£m
Interest expense on subordinated liabilities ¹	33.6	29.1
Net interest received on interest rate swap ²	(5.3)	(4.1)
Unrealised losses on interest rate swap ²	5.8	1.9
Unrealised gains on designated hedging instrument ²	—	(1.2)
Unrealised losses on associated interest rate risk on hedged item ²	—	0.9
Amortisation of arrangement costs, discount on issue and fair value hedging adjustment of subordinated liabilities	(3.0)	(1.3)
Interest expense on lease liabilities	3.2	6.0
Total	34.3	31.3

Notes:

- On 5 June 2020, the Group issued subordinated Tier 2 notes at a fixed rate of 4.0%. See note 34.
- As described in note 34, 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 designated 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

	2021	2020
	£m	£m
Current taxation:		
Charge for the year	102.6	95.2
Over-provision in respect of prior year	(8.3)	(0.5)
	94.3	94.7
Deferred taxation (note 13):		
Credit for the year	(1.1)	(11.1)
Under-provision in respect of prior year	9.1	0.6
	8.0	(10.5)
Current taxation	94.3	94.7
Deferred taxation (note 13)	8.0	(10.5)
Tax charge for the year	102.3	84.2

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 (2020: 19.0%).

	2021	2020
	£m	£m
Profit before tax	446.0	451.4
Expected tax charge	84.7	85.8
Effects of:		
Disallowable expenses	5.0	1.3
Lease surrender	17.3	—
Non-taxable items	(0.6)	—
Effect of change in corporation taxation rate ¹	(1.7)	0.1
Under provision in respect of prior year	0.8	0.1
Revaluation of property	—	0.1
Deductible Tier 1 notes coupon payment in equity	(3.2)	(3.2)
Tax charge for the year	102.3	84.2
Effective income tax rate	22.9%	18.7%

Note:

- In the Finance Act 2021 the UK Government enacted, on 10 June 2021, an increase in the UK corporation tax rate from 19% to 25% effective from 1 April 2023. As a consequence the closing deferred tax assets and liabilities have been recognised at the tax rates expected to apply when the temporary differences reverse. The impact of these changes on the tax charge for the year is set out in the table above.

13. Current and deferred tax

The aggregate current and deferred tax relating to items that are credited to equity is £0.7 million (2020: £0.2 million).

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 2020	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)
(Charge)/credit to the income statement	(4.0)	(0.5)	(8.9)	4.9	0.5	—	(8.0)
(Charge)/credit to other comprehensive income	—	(0.8)	—	—	—	17.1	16.3
Charge direct to equity	—	—	—	—	(0.1)	—	(0.1)
At 31 December 2021	6.2	(3.1)	(4.7)	—	3.5	(2.4)	(0.5)

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 2021 of £12.8 million (2020: £5.0 million) in relation to capital losses of which £10.4 million (2020: £5.0 million) relates to realised losses and £2.4 million (2020: £nil) relates to unrealised losses.

14. Dividends and appropriations

	2021	2020
	£m	£m
Amounts recognised as distributions to equity holders in the period:		
2021 interim dividend of 7.6 pence per share paid on 3 September 2021	101.9	—
2020 final dividend of 14.7 pence per share paid on 20 May 2021	198.9	—
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
	300.8	295.9
Coupon payments in respect of Tier 1 notes ¹	16.6	16.6
	317.4	312.5
Proposed dividends:		
2021 final dividend of 15.1 pence per share	199.4	—
2020 final dividend of 14.7 pence per share	—	199.3

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 2021 have not been included as a liability in these financial statements.

On 7 March 2022, the Board approved a share buyback programme of up to £100 million to be completed during 2022.

On 8 March 2021, the Group announced that the Board had approved a share buyback programme of up to £100 million which was completed on 15 November 2021 in accordance with its terms.

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 2021 by £1.7 million (2020: £1.6 million).

Notes to the Consolidated Financial Statements *continued***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.

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.

	2021 £m	2020 £m
Earnings attributable to owners of the Company	343.7	367.2
Coupon payments in respect of Tier 1 notes	(16.6)	(16.6)
Profit for the calculation of earnings per share	327.1	350.6
Weighted average number of Ordinary Shares (millions)	1,335.8	1,356.5
Effect of dilutive potential of share options and contingently issuable shares (millions)	20.8	18.6
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	1,356.6	1,375.1
Basic earnings per share (pence)	24.5	25.8
Diluted earnings per share (pence)	24.1	25.5

On 8 March 2021, the Group announced that the Board had approved a share buyback programme of up to £100 million, which was completed on 15 November 2021 in accordance with its terms. Across the programme, the Group repurchased and cancelled 33,838,593 ordinary shares for an aggregate consideration of £101,043,742 (including related transaction costs).

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.

	2021 £m	2020 £m
Net assets	2,550.2	2,699.7
Goodwill and other intangible assets ¹	(822.5)	(786.8)
Tangible net assets	1,727.7	1,912.9
Number of Ordinary Shares (millions)	1,330.7	1,364.6
Shares held by employee trusts (millions)	(13.4)	(12.8)
Closing number of Ordinary Shares (millions)	1,317.3	1,351.8
Net asset value per share (pence)	193.6	199.7
Tangible net asset value per share (pence)	131.2	141.5

Note:

- 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.

Return on equity

The table below details the calculation of return on equity.

	2021 £m	2020 £m
Earnings attributable to owners of the Company	343.7	367.2
Coupon payments in respect of Tier 1 notes	(16.6)	(16.6)
Profit for the calculation of return on equity	327.1	350.6
Opening shareholders' equity	2,699.7	2,643.6
Closing shareholders' equity	2,550.2	2,699.7
Average shareholders' equity	2,625.0	2,671.7
Return on equity	12.5%	13.1%

17. Goodwill and other intangible assets

	Goodwill £m	Other intangible assets £m	Total £m
Cost			
At 1 January 2020	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
Acquisitions and additions	0.8	108.6	109.4
Disposals and write-off ¹	—	(12.0)	(12.0)
At 31 December 2021	215.0	1,182.1	1,397.1
Accumulated amortisation and impairment			
At 1 January 2020	—	456.5	456.5
Amortisation charge for the year	—	49.8	49.8
Impairment losses ²	—	6.6	6.6
At 31 December 2020	—	512.9	512.9
Amortisation charge for the year	—	71.6	71.6
Disposals and write-off ¹	—	(12.0)	(12.0)
Impairment losses ²	—	2.1	2.1
At 31 December 2021	—	574.6	574.6
Carrying amount			
At 31 December 2021	215.0	607.5	822.5
At 31 December 2020	214.2	572.6	786.8

Notes:

1. Disposals and write-off include fully amortised intangible assets no longer utilised by the Group in its operating activities.
2. 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 £72.8 million (2020: £370.7 million). The reduction of £297.9 million is primarily due to the launch of the Group's Motor platform in H1 2021. The assets still in development at 31 December 2021 relate mainly to finance and core technology projects which are expected to be ready for use in 2022. These assets are tested for impairment during the Group's annual impairment review at each reporting date.

Other intangible assets relate mainly to internally generated software. For year ended 31 December 2021 other intangible assets additions, which are internally generated, are £105.9 million (2020: £140.7 million).

Goodwill arose on the acquisition of U K Insurance Limited (£141.0 million), Churchill Insurance Company Limited (£70.0 million) and accident repair networks (£4.0 million) and is allocated to reportable segments. The addition to goodwill in the year ended 31 December 2021 of £0.8 million arose from the purchase of the business and assets of a vehicle repair workshop on 21 February 2021. The acquisition is to further expand the Group's wholly owned DLG Auto Services network.

Notes to the Consolidated Financial Statements *continued***17. Goodwill and other intangible assets continued**

The fair value of the identifiable assets and liabilities of the acquisition are presented in the table below.

	Fair value recognised on acquisition £m
ROU assets	1.1
Property, plant and equipment	0.1
Lease liabilities	(1.1)
Goodwill	0.8
Total consideration paid in cash	0.9

Goodwill represents the value attributed to the business by the Group as part of its ongoing strategy of developing its repair network. The Group measured the acquired lease liabilities and matching ROU asset using the present value of the remaining lease payments at the date of acquisition. No disclosure has been made for revenue and profit before tax generated as the Group does not manage its business at this level.

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.

	2021 £m	2020 £m
Motor	130.4	129.6
Home	45.8	45.8
Rescue and other personal lines	28.7	28.7
Commercial	10.1	10.1
Total	215.0	214.2

There is no goodwill impairment for the year ended 31 December 2021 (2020: £nil).

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		Recoverable amount in excess of carrying value £m	Sensitivity: impact on recoverable amount of a:		
	Terminal growth rate %	Pre-tax discount rate %		1% decrease in terminal growth rate £m	1% increase in pre-tax discount rate £m	1% decrease in forecast pre- tax profit ¹ £m
Motor	1.5	11.3	1,754.8	(259.1)	(370.5)	(377.9)
Home	1.5	11.3	754.7	(68.3)	(97.9)	(100.8)
Rescue and other personal lines	1.5	11.3	629.1	(55.9)	(79.7)	(80.3)
Commercial	1.5	11.3	397.0	(52.9)	(76.0)	(79.7)

Note:

1. Reflects a 1% decrease in the profit for each year of the Group's Strategic Plan, which is five years.

18. Property, plant and equipment

	Land and buildings £m	Other equipment £m	Total £m
Cost			
At 1 January 2020	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
Additions	19.8	9.5	29.3
Disposals	—	(7.4)	(7.4)
Assets held for sale	(42.9)	(12.7)	(55.6)
At 31 December 2021	56.7	185.3	242.0
Accumulated depreciation and impairment			
At 1 January 2020	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
Depreciation charge for the year	1.2	10.9	12.1
Disposals	—	(5.1)	(5.1)
Assets held for sale	(4.3)	(4.1)	(8.4)
At 31 December 2021	4.4	123.8	128.2
Carrying amount			
At 31 December 2021	52.3	61.5	113.8
At 31 December 2020	72.3	73.8	146.1

The Group is satisfied that the aggregate fair value of property, plant and equipment is not less than its carrying value.

Notes to the Consolidated Financial Statements *continued***19. Right-of-use assets**

	Property £m	Motor vehicles £m	IT equipment £m	Total £m
Cost				
At 1 January 2020	209.9	14.0	1.2	225.1
Additions	4.2	1.8	—	6.0
Modifications ¹	(16.1)	—	—	(16.1)
Disposals	(2.6)	(3.2)	—	(5.8)
At 31 December 2020	195.4	12.6	1.2	209.2
Additions	4.5	1.2	—	5.7
Modifications	27.8	—	—	27.8
Disposals	(111.1)	(2.9)	—	(114.0)
At 31 December 2021	116.6	10.9	1.2	128.7
Accumulated depreciation and impairment				
At 1 January 2020	68.7	6.7	0.5	75.9
Depreciation charge for the year	11.0	3.6	0.2	14.8
Modifications ¹	(13.5)	—	—	(13.5)
Disposals	(2.6)	(3.2)	—	(5.8)
At 31 December 2020	63.6	7.1	0.7	71.4
Depreciation charge for the year	7.3	3.2	0.3	10.8
Disposals	(27.2)	(2.9)	—	(30.1)
Impairment losses	0.5	—	—	0.5
At 31 December 2021	44.2	7.4	1.0	52.6
Carrying amount				
At 31 December 2021	72.4	3.5	0.2	76.1
At 31 December 2020	131.8	5.5	0.5	137.8

Note:

1. Modifications were previously reported in disposals. Comparative data for the year ended 31 December 2020 has been re-presented accordingly.

20. Investment property

	Retail £m	Retail Warehouse £m	Supermarkets £m	Office £m	Industrials £m	Hotels £m	Alternative sector £m	Total £m
At 1 January 2021	31.5	19.9	52.0	10.0	105.3	55.5	17.9	292.1
Fair value adjustments	(1.5)	2.7	4.9	(0.4)	28.9	2.9	0.3	37.8
Disposals	—	—	—	(9.6)	—	—	—	(9.6)
Transferred to assets held for sale (note 30)	(3.4)	—	—	—	—	—	—	(3.4)
Capitalised expenditure	—	0.1	—	—	—	—	—	0.1
At 31 December 2021¹	26.6	22.7	56.9	—	134.2	58.4	18.2	317.0

	Retail £m	Retail Warehouse £m	Supermarkets £m	Office £m	Industrials £m	Hotels £m	Alternative sector £m	Total £m
At 1 January 2020	37.6	24.3	49.7	12.9	88.0	59.4	19.8	291.7
Acquisitions at cost	—	—	—	—	10.5	—	—	10.5
Fair value adjustments	(6.1)	(4.4)	2.3	(2.9)	6.8	(3.9)	(1.9)	(10.1)
At 31 December 2020¹	31.5	19.9	52.0	10.0	105.3	55.5	17.9	292.1

Note:

1. The cost included in the carrying value at 31 December 2021 is £215.8 million (2020: £233.4 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 2020.

Lease agreements with tenants are drawn up in line with local practice and the Group has no exposure to leases that include contingent rents.

The following table provides a sensitivity analysis for +/- 5 basis points and +/- 50 basis points movement in tenants' rental income and impact on property valuation in sterling.

		-50bp	-5bp	Baseline as at 31 December 2021	+5bp	+50bp
Equivalent yield	%	3.749	3.749	4.549	3.749	4.904
Value	£m	236.6	308.6	317.0	325.1	399.9

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

The Group did not acquire or dispose of any subsidiaries in the year ended 31 December 2021 (31 December 2020: one acquisition).

For the years ended 31 December 2021 and 31 December 2020, Brolly UK Technology Limited was exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of section 479 A(2)(d).

Notes to the Consolidated Financial Statements *continued***22. Reinsurance assets**

	2021	2020
	£m	£m
Reinsurers' share of general insurance liabilities	1,169.6	1,071.6
Impairment provision ¹	(37.5)	(46.3)
Total excluding reinsurers' unearned premium reserves (note 35)	1,132.1	1,025.3
Reinsurers' unearned premium reserve (note 36)	79.7	103.9
Total	1,211.8	1,129.2

Note:

1. Impairment provision relates to reinsurance debtors, allowing for the risk that reinsurance assets may not be collected, or where one or more reinsurers' credit rating has been significantly downgraded and it may have difficulty in meeting its obligations.

Movements in reinsurance asset impairment provision

	2021	2020
	£m	£m
At 1 January	(46.3)	(40.5)
Additional provision	(3.2)	(13.7)
Released to income statement	12.0	7.9
At 31 December	(37.5)	(46.3)

23. Deferred acquisition costs

	2021	2020
	£m	£m
At 1 January	172.2	176.2
Additions	400.7	361.6
Recognised in the income statement	(386.3)	(365.6)
At 31 December	186.6	172.2

24. Insurance and other receivables

	2021	2020
	£m	£m
Receivables arising from insurance contracts:		
Due from policyholders ¹	609.2	655.8
Impairment provision of policyholder receivables	(1.7)	(2.2)
Due from agents, brokers and intermediaries ¹	81.3	94.8
Impairment provision of agent, broker and intermediary receivables	(0.1)	(0.3)
Amounts due from reinsurers	41.0	51.8
Other debtors	33.1	48.3
Total	762.8	848.2

Note:

1. For the year ended 31 December 2020, there has been no net impact to the total of insurance and other receivables of £848.2 million. Following an exercise to re-present certain debtor balances, the comparatives for receivables due from policyholders and due from agents, brokers and intermediaries have been re-presented by £41.2 million (2020 as originally reported: receivables due from policy holders £614.6 million; receivables due from agents, brokers and intermediaries: £136.0 million).

Movement in impairment provisions during the year

	Policyholders	Agents, brokers and intermediaries	Total
	£m	£m	£m
At 1 January 2021	2.2	0.3	2.5
Additional provision	3.6	0.2	3.8
Released to income statement	(4.1)	(0.4)	(4.5)
At 31 December 2021	1.7	0.1	1.8

25. Prepayments, accrued income and other assets

	2021	2020
	£m	£m
Prepayments	89.1	95.1
Accrued income and other assets	36.0	30.9
Total	125.1	126.0

26. Derivative financial instruments

	2021	2020
	£m	£m
Derivative assets		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	27.8	63.5
Interest rate swaps	2.4	8.2
Designated as hedging instruments:		
Foreign exchange contracts (forwards) ¹	—	0.1
Interest rate swaps	5.7	1.6
Total	35.9	73.4
Derivative liabilities		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	19.1	12.3
Designated as hedging instruments:		
Foreign exchange contracts (forwards) ¹	0.2	—
Interest rate swaps	0.2	44.9
Total	19.5	57.2

Note:

1. 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 2021 was £26.1 million (2020: £26.2 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 a trustee who is required by law to act in the interests of the scheme and of all the relevant stakeholders. The trustee of the pension scheme is 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 2021 is 20 years (2020: 20 years) using accounting assumptions.

The table below sets out the principal assumptions used in determining the defined benefit scheme obligations.

	2021	2020
	%	%
Rate of increase in pension payment	2.6	2.2
Rate of increase in deferred pensions	2.6	2.2
Discount rate	2.0	1.4
Inflation rate	3.3	2.9

No assumption has been made for salary growth as there are no obligations in the scheme that are linked to future increases in salaries.

Notes to the Consolidated Financial Statements *continued***27. Retirement benefit obligations** continued**Post-retirement mortality assumptions**

	2021	2020
Life expectancy at age 60 now:		
Males	87.5	87.5
Females	89.4	89.3
Life expectancy at age 60 in 20 years' time:		
Males	89.3	89.3
Females	91.2	91.1

The table below analyses the fair value of the scheme assets by type of asset.

	2021	2020
	£m	£m
Index-linked bonds	32.3	30.0
Government bonds	27.9	33.6
Liquidity fund ¹	0.5	1.5
Dynamic bond fund ²	41.6	42.3
Defined contribution section funds ³	5.4	—
Other	0.5	0.3
Total	108.2	107.7

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 dynamic bond fund targets positive returns on a three-year rolling basis. It is invested to maximise the total return from a globally diversified portfolio, predominantly comprising high-yielding corporate and government bonds.
3. The defined contribution section funds relate to members in that section who have a defined benefit underpin that exceeds the value of the defined contribution funds. The investments are largely in a diversified growth fund. The corresponding liability is included in the defined benefit scheme obligation (see the movement in net pension surplus table on page 223).

The majority of debt instruments held directly or through the liquidity fund have quoted prices in active markets.

Movement in net pension surplus

	Fair value of defined benefit scheme assets £m	Present value of defined benefit scheme obligations £m	Net pension surplus £m
At 1 January 2020	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 losses of defined benefit scheme			
Experience gains	—	2.4	2.4
Losses from change in demographic assumptions	—	(1.7)	(1.7)
Losses 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
Income statement:			
Net interest income/(cost) ¹	1.5	(1.4)	0.1
Administration costs	(0.8)	—	(0.8)
Statement of comprehensive income:			
Remeasurement gains			
Return on plan assets excluding amounts included in the net interest on the defined benefit asset	2.2	—	2.2
Actuarial gains of defined benefit scheme			
Experience losses	—	(5.8)	(5.8)
Gains from change in demographic assumptions	—	0.2	0.2
Gains from change in financial assumptions	—	7.2	7.2
Benefits paid	(2.4)	2.4	—
At 31 December 2021	108.2	(96.1)	12.1

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.

	2021 £m	2020 £m	2019 £m	2018 £m	2017 £m
Present value of defined benefit scheme obligations	(96.1)	(98.7)	(90.3)	(78.6)	(87.3)
Fair value of defined benefit scheme assets	108.2	107.7	100.0	95.6	101.7
Net pension surplus	12.1	9.0	9.7	17.0	14.4
Experience (losses)/gains on scheme liabilities	(5.8)	2.4	0.4	—	1.5
Return on plan assets excluding amounts included in the net interest on the defined benefit asset	2.2	9.0	4.4	(3.5)	1.0

Notes to the Consolidated Financial Statements *continued***27. Retirement benefit obligations continued****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	
	2021	2020	2021	2020
	£m	£m	£m	£m
Discount rate				
0.25% increase in discount rate	—	(0.1)	(4.8)	(4.9)
0.25% decrease in discount rate	0.2	0.1	4.8	4.9
Inflation rate				
0.25% increase in inflation rate	—	—	2.4	2.5
0.25% decrease in inflation rate	—	—	(2.4)	(2.5)
Life expectancy				
1-year increase in life expectancy	0.1	0.1	3.0	3.6
1-year decrease in life expectancy	(0.1)	(0.1)	(3.0)	(3.6)

The most recent funding valuation of the Group's defined benefit scheme was carried out as at 1 October 2020. This showed an excess of assets over liabilities. The Group agreed with the trustee to make contributions of up to £1.5 million per annum in 2022, 2023 and 2024, 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 2022 (2021: £nil).

28. Financial investments

	2021	2020
	£m	£m
AFS debt securities		
Corporate	4,006.9	4,021.0
Supranational	14.0	21.3
Local government	28.1	35.6
Sovereign	35.6	25.2
Total	4,084.6	4,103.1
HTM debt securities		
Corporate	91.2	103.9
Total debt securities	4,175.8	4,207.0
Total debt securities		
Fixed interest rate ¹	4,158.3	4,184.5
Floating interest rate	17.5	22.5
Total	4,175.8	4,207.0
Loans and receivables		
Infrastructure debt	250.8	264.5
Commercial real estate loans	200.8	206.7
Total loans and receivables	451.6	471.2
Equity investments²	6.2	3.2
Total	4,633.6	4,681.4

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 2021 was £1,005.6 million (2020: £971.1 million).
- An insurtech-focused equity fund which is valued based on external valuation reports received from a third-party fund manager.

29. Cash and cash equivalents and borrowings

	2021 £m	2020 £m
Cash at bank and in hand	162.8	224.9
Short term deposits with credit institutions ¹	792.9	995.2
Cash and cash equivalents	955.7	1,220.1
Bank overdrafts ²	(59.2)	(51.9)
Cash and bank overdrafts³	896.5	1,168.2

Notes:

1. This represents money market funds.
2. 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.
3. 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 2021 was 0.16% (2020: 0.25%) and average maturity was 10 days (2020: 10 days).

30. Assets held for sale

	2021 £m	2020 £m
Property, plant and equipment	36.8	—
Investment property	4.4	—
Total assets held for sale	41.2	—

The Group is able to reduce the number of head office sites it needs by changing the way it uses its premises so that they support collaboration, training and teamwork rather than being an everyday place of work for most people.

Assets held for sale at 31 December 2021 relate to head office sites in Birmingham, Ipswich and Leeds (including retail space within the Leeds property) that is no longer required.

A net impairment loss of £9.4 million is included within operating expenses (as part of restructuring and one-off costs) for the write down of the carrying value of these three properties to their held for sale values.

31. Share capital

Issued and fully paid: equity shares	2021			2020		
	Number of shares	Share capital	Transfer to capital redemption reserve	Number of shares	Share capital	Transfer to capital redemption reserve
Ordinary Shares of 10 10/11 pence each ¹	millions	£m	£m	millions	£m	£m
At 1 January	1,364.6	148.9	1.1	1,375.0	150.0	—
Shares cancelled following buyback ^{2,3}	(33.9)	(3.7)	3.7	(10.4)	(1.1)	1.1
At 31 December	1,330.7	145.2	4.8	1,364.6	148.9	1.1

Notes:

1. The shares have full voting dividend and capital distribution rights (including on wind-up) attached to them; these do not confer any rights of redemption.
2. On 8 March 2021, the Group announced that the Board had approved a share buyback programme of up to £100 million, which was completed on 15 November 2021 in accordance with its terms. Across the programme, the Group repurchased and cancelled 33,838,593 ordinary shares for an aggregate consideration of £101,043,742 (including related transaction costs) as reflected in retained earnings. The shares have subsequently been cancelled giving rise to a capital redemption reserve of an equivalent amount as required by the Companies Act 2006.
3. 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 (including transaction costs) 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 2021, 13,442,422 Ordinary Shares (2020: 12,753,755 Ordinary Shares) were owned by the employee share trusts at a cost of £41.4 million (2020: £40.3 million). These Ordinary Shares are carried at cost and at 31 December 2021 had a market value of £37.5 million (2020: £40.7 million).

Notes to the Consolidated Financial Statements *continued***32. Other reserves****Movements in the AFS investments revaluation reserve**

	2021	2020
	£m	£m
At 1 January	83.9	47.5
Revaluation during the year – gross	(84.1)	47.4
Revaluation during the year – tax	15.1	(10.1)
Net gains transferred to income statement on disposals – gross	(7.9)	(1.1)
Net gains transferred to income statement on disposals – tax	2.0	0.2
At 31 December	9.0	83.9

Capital reserves

	2021	2020
	£m	£m
Capital contribution reserve ¹	100.0	100.0
Capital redemption reserve ²	1,354.8	1,351.1
Total	1,454.8	1,451.1

Notes:

1. Arose on the cancellation of a debt payable to a shareholder.
2. £1,350.0 million arose on the reduction of nominal value of each share in issue with a corresponding transfer to capital redemption reserve. Further additions of £3.7 million in 2021 and £1.1 million in 2020 were made when shares repurchased through buyback were cancelled.

33. Tier 1 notes

	2021	2020
	£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.

34. Subordinated liabilities

	2021 £m	2020 £m
£250 million 9.25% subordinated Tier 2 notes due 2042	255.2	258.5
£260 million 4.0% subordinated Tier 2 notes due 2032	258.4	258.1
Subordinated Tier 2 notes	513.6	516.6

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.

£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.

Notes to the Consolidated Financial Statements *continued***35. Insurance liabilities**

	2021	2020
	£m	£m
Insurance liabilities	3,680.5	3,617.0

Gross insurance liabilities

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total
Accident year	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Estimate of ultimate gross claims costs:											
At end of accident year	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	1,955.8	
One year later	(163.3)	(117.6)	20.7	(30.0)	(86.7)	(116.2)	(62.3)	(67.2)	(116.8)		
Two years later	(118.9)	(153.0)	(38.4)	(143.5)	(53.3)	(103.1)	(52.0)	(56.1)			
Three years later	(49.3)	(21.0)	(144.9)	(62.4)	(82.8)	(42.4)	(9.5)				
Four years later	(9.9)	(102.1)	(50.2)	(22.9)	(46.1)	(21.0)					
Five years later	(79.2)	(50.8)	(51.6)	(22.0)	(16.7)						
Six years later	(36.2)	(27.4)	(33.6)	(9.0)							
Seven years later	(23.8)	(14.0)	(6.5)								
Eight years later	(1.6)	(0.3)									
Nine years later	(1.3)										
Current estimate of cumulative claims	1,889.2	1,697.8	1,790.0	1,828.3	1,872.1	1,934.6	2,176.3	1,987.1	1,730.5	1,955.8	
Cumulative payments to date	(1,876.7)	(1,686.1)	(1,708.4)	(1,713.7)	(1,745.0)	(1,748.3)	(1,832.2)	(1,582.0)	(1,230.7)	(907.7)	
Gross liability recognised in balance sheet	12.5	11.7	81.6	114.6	127.1	186.3	344.1	405.1	499.8	1,048.1	2,830.9
2011 and prior											770.9
Claims handling provision											78.7
Total											3,680.5

Net insurance liabilities

Accident year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Estimate of ultimate net claims costs:											
At end of accident year	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	1,791.8	
One year later	(146.7)	(123.6)	(29.7)	(67.0)	(18.9)	(79.7)	(41.4)	(34.5)	(88.1)		
Two years later	(107.8)	(134.4)	(42.0)	(77.8)	(38.2)	(65.3)	(27.1)	(54.5)			
Three years later	(35.6)	(27.8)	(100.7)	(30.4)	(43.7)	(14.0)	(27.6)				
Four years later	(11.6)	(64.3)	(41.3)	(24.1)	(16.9)	(39.7)					
Five years later	(54.2)	(38.9)	(52.5)	(20.7)	(12.4)						
Six years later	(30.3)	(17.7)	(8.3)	(4.6)							
Seven years later	(14.6)	(10.6)	(8.0)								
Eight years later	(1.2)	0.4									
Nine years later	(1.5)										
Current estimate of cumulative claims	1,868.3	1,677.0	1,688.5	1,702.1	1,792.1	1,818.2	2,029.8	1,852.2	1,586.4	1,791.8	
Cumulative payments to date	(1,859.2)	(1,667.2)	(1,666.8)	(1,656.0)	(1,716.6)	(1,699.5)	(1,814.5)	(1,560.5)	(1,208.6)	(906.6)	
Gross liability recognised in balance sheet	9.1	9.8	21.7	46.1	75.5	118.7	215.3	291.7	377.8	885.2	2,050.9
2011 and prior											418.8
Claims handling provision											78.7
Total											2,548.4

Notes to the Consolidated Financial Statements *continued***35. Insurance liabilities continued****Movements in gross and net insurance liabilities**

	Gross £m	Reinsurance £m	Net £m
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 1 January 2020	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
Cash paid for claims settled in the year	(1,851.8)	89.8	(1,762.0)
Increase/(decrease) in liabilities:			
Arising from current-year claims	2,142.9	(166.1)	1,976.8
Arising from prior-year claims	(227.6)	(30.5)	(258.1)
At 31 December 2021	3,680.5	(1,132.1)	2,548.4
Claims reported	2,840.0	(885.2)	1,954.8
Incurred but not reported	761.8	(246.9)	514.9
Claims handling provision	78.7	—	78.7
At 31 December 2021	3,680.5	(1,132.1)	2,548.4

Movement in prior-year net claims liabilities by operating segment

	2021 £m	2020 £m
Motor	(127.1)	(100.6)
Home	(45.8)	(10.8)
Rescue and other personal lines	(23.8)	(5.6)
Commercial	(61.4)	(56.8)
Total	(258.1)	(173.8)

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 2021 and 31 December 2020. These represent the total cost of PPOs rather than any costs in excess of purely Ogden-based settlements.

	Discounted 2021 £m	Undiscounted 2021 £m	Discounted 2020 £m	Undiscounted 2020 £m
At 31 December				
Gross claims				
Approved PPO claims provisions	564.4	1,260.9	561.1	1,289.5
Anticipated PPOs	193.4	408.7	253.7	561.6
Total	757.8	1,669.6	814.8	1,851.1
Reinsurance				
Approved PPO claims provisions	(316.2)	(731.4)	(309.3)	(743.6)
Anticipated PPOs	(142.1)	(313.8)	(186.9)	(435.8)
Total	(458.3)	(1,045.2)	(496.2)	(1,179.4)
Net of reinsurance				
Approved PPO claims provisions	248.2	529.5	251.8	545.9
Anticipated PPOs	51.3	94.9	66.8	125.8
Total	299.5	624.4	318.6	671.7

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% (2020: 3.5%). The Group has estimated a rate of interest used for the calculation of present values as 3.5% (2020: 3.5%), which results in a real discount rate of 0% (2020: 0%). The Group will continue to review the inflation and discount rates used to calculate these insurance reserves.

36. Unearned premium reserve

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2020	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
Written in the period	3,171.6	(186.4)	2,985.2
Earned in the period	(3,168.0)	210.6	(2,957.4)
At 31 December 2021	1,500.7	(79.7)	1,421.0

Notes to the Consolidated Financial Statements *continued*

37. 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 Executive 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 2021 over 3.6 million Ordinary Shares with an estimated fair value of £11.3 million at the 2021 grant dates (2020: 4.7 million Ordinary Shares with an estimated fair value of £13.2 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.

	2021	2020
Weighted average assumptions during the year:		
Share price (pence)	315	290
Exercise price (pence)	0	0
Volatility of share price	26%	34%
Average comparator volatility	40%	48%
Expected life	3 years	3 years
Risk-free rate	0.16%	0.02%

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 of 1.1 million Ordinary Shares (2020: 1.0 million Ordinary Shares) with an estimated fair value of £3.2 million (2020: £2.9 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 1.4 million Ordinary Shares (2020: 1.8 million Ordinary Shares) under this plan with an estimated fair value of £4.5 million (2020: £4.6 million) using the market value at the date of grant.

The awards outstanding at 31 December 2021 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 2021, the Group offered all eligible employees a Free Share award granting 112 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 2020. 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 1.2 million Ordinary Shares with an estimated fair value of £3.7 million using the market value at the date of grant.

In 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.

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 2021, matching share awards were granted over 0.6 million Ordinary Shares (2020: 0.6 million Ordinary Shares) with an estimated fair value of £1.8 million (2020: £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.

Movement in total share awards

	Number of share awards	
	2021 millions	2020 millions
At 1 January	26.9	21.6
Granted during the year ¹	9.4	11.3
Forfeited during the year	(2.9)	(1.9)
Exercised during the year	(5.0)	(4.1)
At 31 December	28.4	26.9
Exercisable at 31 December	2.6	1.5

Note:

1. In accordance with the rules of the LTIP, Restricted Shares Plan and DAIP, additional awards of 1.5 million shares were granted during the year ended 31 December 2021 (2020: 1.3 million) in respect of the equivalent dividend.

In respect of the outstanding options at 31 December 2021, the weighted average remaining contractual life is 1.64 years (2020: 1.61 years). No share awards expired during the year (2020: nil).

The weighted average share price for awards exercised during the year ended 31 December 2021 was £3.06 (2020: £2.86).

The Group recognised total expenses in the year ended 31 December 2021 of £18.4 million (2020: £18.5 million) relating to equity-settled share-based compensation plans.

Further information on share-based payments, in respect of Executive Directors, is provided in the Directors' Remuneration Report.

38. Provisions

Movement in provisions during the year

	Regulatory levies	Restructuring	Other	Total
	£m	£m	£m	£m
At 1 January 2021	41.6	25.9	47.3	114.8
Additional provision	67.7	16.1	31.2	115.0
Utilisation of provision	(61.1)	(20.6)	(40.3)	(122.0)
Released to income statement	—	(7.7)	(3.7)	(11.4)
At 31 December 2021	48.2	13.7	34.5	96.4

Of the above, £nil (2020: £6.0 million) 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.

39. Trade and other payables, including insurance payables

	2021 £m	2020 £m
Trade creditors and accruals	230.9	293.5
Other taxes	99.1	100.4
Other creditors	73.6	89.1
Due to reinsurers	45.4	60.2
Due to agents, brokers and intermediaries	4.0	2.5
Deferred income	3.2	3.3
Due to insurance companies	1.1	0.9
Total	457.3	549.9

Notes to the Consolidated Financial Statements *continued*

40. Notes to the consolidated cash flow statement

	Notes	2021 £m	2020 £m
Profit for the year		343.7	367.2
Adjustments for:			
Investment return	6	(146.3)	(95.1)
Instalment income		(97.3)	(109.3)
Finance costs	11	34.3	31.3
Defined benefit pension scheme - net interest charge	27	(3.1)	0.7
Equity-settled share-based payment charge		18.4	18.5
Tax charge	12	102.3	84.2
Depreciation and amortisation charge		94.5	79.7
Impairment of intangible and ROU assets	17/19	2.6	6.6
Impairment provision movements on reinsurance contracts	22	(8.8)	5.8
Unrealised gain on assets held for sale	30	9.4	—
Loss on disposal of property, plant and equipment and ROU assets		86.2	4.9
Operating cash flows before movements in working capital		435.9	394.5
Movements in working capital:			
Net decrease in net insurance liabilities including reinsurance assets, unearned premium reserves and deferred acquisition costs		(21.1)	(91.3)
Net decrease/(increase) in insurance and other receivables		85.4	(1.6)
Net decrease/(increase) in accrued income and other assets ¹		0.9	(5.8)
Net (decrease)/increase in trade and other payables, including insurance payables and provisions		(111.0)	106.8
Cash generated from operations		390.1	402.6
Taxes paid		(118.4)	(134.0)
Cash flow hedges		0.1	0.2
Net cash generated from operating activities before investment of insurance assets		271.8	268.8
Interest received		234.6	260.0
Rental income received from investment property	6	14.5	13.7
Purchase of investment property	20	(0.1)	(10.5)
Proceeds on disposal of investment property	20	9.6	—
Proceeds on disposal/maturity of AFS debt securities		1,170.1	1,614.0
Proceeds from maturity of HTM debt securities		22.4	—
Advances made for commercial real estate loans		(44.3)	(46.3)
Repayments of infrastructure debt and commercial real estate loans		63.2	56.7
Purchase of AFS debt securities		(1,291.4)	(1,568.5)
Purchase of equity investments		(1.5)	(3.2)
Purchase of HTM debt securities		(9.9)	—
Cash generated from investment of insurance assets		167.2	315.9

Note:

- For the year ended 31 December 2020, the movement in prepayments of £4.1 million was disclosed in operating cash flows before movements in working capital. This movement has been included in cash generated from operations within the net decrease/(increase) in accrued income and other assets for the year ended 31 December 2021 and the comparative figure has been re-presented accordingly.

The table below details changes in liabilities arising from the Group's financing activities.

	Lease liabilities		Subordinated liabilities		Interest rate swap associated with subordinated debt ¹	
	2021 £m	2020 £m	2021 £m	2020 £m	2021 £m	2020 £m
At 1 January	(152.4)	(164.4)	(516.6)	(259.0)	8.2	9.0
Proceeds on issue of subordinated liabilities ²	—	—	—	(257.2)	—	—
Interest paid on subordinated liabilities	—	—	33.5	28.3	—	—
Interest rate swap cash settlement	—	—	—	—	(5.3)	(4.1)
Lease repayments	105.1	18.5	—	—	—	—
Financing cash flows	105.1	18.5	33.5	(228.9)	(5.3)	(4.1)
Additions/disposals of leases	(5.9)	(6.0)	—	—	—	—
Modifications of leases	(27.8)	5.5	—	—	—	—
Interest on lease liabilities ³	(3.2)	(6.0)	—	—	—	—
Amortisation of arrangement costs and discount on issue of subordinated liabilities	—	—	(0.6)	(0.5)	—	—
Amortisation of fair value hedging	—	—	3.6	1.8	—	—
Accrued interest expense on subordinated liabilities	—	—	(33.5)	(29.1)	—	—
Unrealised loss on associated interest rate risk on hedged item	—	—	—	(0.9)	—	—
Net accrued interest on interest rate swap	—	—	—	—	(0.1)	0.3
Fair value movement in interest rate swap	—	—	—	—	(0.5)	3.0
Non-cash changes	(36.9)	(6.5)	(30.5)	(28.7)	(0.6)	3.3
At 31 December	(84.2)	(152.4)	(513.6)	(516.6)	2.3	8.2

Notes:

- As described in note 34, 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 34, 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.
- Interest on lease liabilities were previously reported in financing cash flows. Comparative data for the year ended 31 December 2020 has been re-presented accordingly.

41. Commitments and contingent liabilities

The Group did not have any material commitments and contingent liabilities at 31 December 2021 (2020: none).

42. 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.

	2021 £m	2020 £m
Within one year	13.1	13.7
In the second to fifth year inclusive	38.4	38.6
After five years	70.0	66.5
Total¹	121.5	118.8

Note:

- At year ended 31 December 2021: £114.4 million of the total operating lease commitments where the Group is the lessor relates to the lease of investment properties detailed in note 20 (2020: £116.6 million).

Notes to the Consolidated Financial Statements *continued***42. Leases continued****Other lease disclosures**

The following table analyses the amounts that have been included in the income statement for leases.

	2021 £m	2020 £m
Depreciation of ROU assets	10.8	14.8
Gain on modification of leases	—	(2.6)
Loss on disposal of leases	83.9	—
Interest on lease liabilities	3.2	6.0
Short-term leases ²	0.8	0.8
Low-value leases ²	0.8	0.2
Impairment on ROU assets	0.5	—
Income from subleasing ROU assets	(0.1)	(0.2)
Total	99.9	19.0

Notes:

1. Total cash outflows in respect of leases was £106.7 million (2020: £18.7 million).
2. At years ended 31 December 2021 and 31 December 2020, expenses relating to short-term leases and leases of low-value assets were not included in the measurement of lease liabilities as they were not considered significant.

43. 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 2021					
Assets held at fair value:					
Investment property (note 20)	317.0	—	—	317.0	317.0
Derivative assets (note 26)	35.9	—	35.9	—	35.9
AFS debt securities (note 28)	4,084.6	35.6	4,049.0	—	4,084.6
Equity investments (note 28)	6.2	—	—	6.2	6.2
Other financial assets:					
HTM debt securities (note 28)	91.2	—	24.3	69.1	93.4
Infrastructure debt (note 28)	250.8	—	—	257.8	257.8
Commercial real estate loans (note 28)	200.8	—	—	198.3	198.3
Total	4,986.5	35.6	4,109.2	848.4	4,993.2
Liabilities held at fair value:					
Derivative liabilities (note 26)	19.5	—	19.5	—	19.5
Other financial liabilities:					
Subordinated liabilities (note 34)	513.6	—	543.7	—	543.7
Total	533.1	—	563.2	—	563.2
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 34)	516.6	—	589.0	—	589.0
Total	573.8	—	646.2	—	646.2

Differences arise between carrying value and fair value where the measurement basis of the asset or liability is not fair value (for example; 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 was one HTM debt security with fair value of £10.7 million (2020: £11.2 million) transferred from level 3 to level 2 due to market-observable valuation inputs. There were no other changes in the categorisation of assets between levels 1, 2 and 3 for assets and liabilities held by the Group since 31 December 2020.

Notes to the Consolidated Financial Statements *continued***43. Fair value continued**

The table below shows the unobservable inputs used by the Group in the fair value measurement of its investment property.

31 December 2021	Fair value £m	Valuation technique	Unobservable input	Range (weighted average)
Investment property	317.0 ¹	Income capitalisation	Equivalent yield	3.38% – 7.97% (average 4.55%)
			Estimated rental value per square foot	£1.81 – £35.00 (average £12.71)

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 2021	292.1	3.2
Additions at cost	–	1.5
Increase in fair value in the period through profit and loss (notes 6 & 20)	37.8	1.5
Disposals (note 20)	(9.6)	–
Transferred to assets held for sale (note 30)	(3.4)	–
Capitalised expenditure (note 20)	0.1	–
At 31 December 2021	317.0	6.2

44. Related parties

Transactions between the Group's subsidiary undertakings, which are related parties, have been eliminated on consolidation and accordingly are not disclosed.

Subject to the preceding sentence, there were no sales or purchases of products and services to or from related parties in the year ended 31 December 2021 (2020: £nil).

Compensation of key management

	2021 £m	2020 £m
Short-term employee benefits	11.9	11.9
Post-employment benefits	0.1	0.1
Share-based payments	7.2	7.6
Total	19.2	19.6

45. Post balance sheet events

As part of the Group's ongoing change of the core operational real estate portfolio, on 28 February 2022, the freehold interest in the Birmingham property with a carrying value of £24.4 million and impaired by £5.0 million to reflect the costs of remediation and estimated realisable value, was sold for £19.4 million.

On 4 March 2022, the Group's principal underwriter, U K Insurance Limited, entered into an agreement to extend its contract with NatWest Group until 2027 to continue to provide home insurance for its customers.

	Notes	2021 £m	2020 £m
Assets			
Investment in subsidiary undertakings	2	3,322.9	3,305.9
Other receivables	3	342.5	335.7
Current tax assets	4	6.4	5.5
Derivative financial instruments	5	0.2	0.1
Financial investments	6	45.2	—
Cash and cash equivalents	7	204.6	266.1
Total assets		3,921.8	3,913.3
Equity			
Shareholders' equity		2,937.9	2,936.6
Tier 1 notes	9	346.5	346.5
Total equity		3,284.4	3,283.1
Liabilities			
Subordinated liabilities	10	512.4	511.9
Borrowings	11	123.9	116.4
Derivative financial instruments	5	0.2	0.1
Trade and other payables	12	—	1.1
Deferred tax liabilities	4	0.9	0.7
Total liabilities		637.4	630.2
Total equity and liabilities		3,921.8	3,913.3

The attached notes on pages 241 to 245 form an integral part of these separate financial statements.

The profit for the year net of tax was £421.9 million (2020: £343.0 million).

The financial statements were approved by the Board of Directors and authorised for issue on 7 March 2022.

They were signed on its behalf by:



NEIL MANSER

CHIEF FINANCIAL OFFICER

Direct Line Insurance Group plc

Registration No. 02280426

Parent Company Statement of Comprehensive Income

For the year ended 31 December 2021

	2021	2020
	£m	£m
Profit for the year attributable to the owners of the Company	421.9	343.0
Other comprehensive loss		
Items that may be reclassified subsequently to the 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	421.9	342.9

Parent Company Statement of Changes in Equity

For the year ended 31 December 2021

	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 2020	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)
Total transactions with equity holders	(1.1)	1.1	4.8	—	(342.5)	(337.7)	—	(337.7)
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
Total comprehensive income for the year	—	—	—	—	421.9	421.9	—	421.9
Dividends and appropriations paid (note 13)	—	—	—	—	(317.4)	(317.4)	—	(317.4)
Shares cancelled following buyback	(3.7)	3.7	—	—	(101.0)	(101.0)	—	(101.0)
Credit to equity for equity-settled share-based payments	—	—	17.0	—	—	17.0	—	17.0
Shares distributed by employee trusts	—	—	(19.2)	—	—	(19.2)	—	(19.2)
Total transactions with equity holders	(3.7)	3.7	(2.2)	—	(418.4)	(420.6)	—	(420.6)
Balance at 31 December 2021	145.2	1,454.8	5.0	(0.1)	1,333.0	2,937.9	346.5	3,284.4

The attached notes on pages 241 to 245 form an integral part of these separate financial statements.

Notes to the Parent Company 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, 38A, 38B, 38C, 111 and 134 - 136 of IAS '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 corporate 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*

2. Investment in subsidiary undertakings

	2021 £m	2020 £m
At 1 January	3,305.9	3,137.4
Additional investment in subsidiary undertakings	17.0	168.5
At 31 December	3,322.9	3,305.9

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	Place 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
Finsure Premium Finance Limited ¹	01670887	United Kingdom	Non-trading company
Inter Group Insurance Services Limited ¹	02762848	United Kingdom	Dormant ⁷
UK Assistance Accident Repair Centres Limited ¹	02568507	United Kingdom	Motor vehicle repair services
UK Assistance Limited ¹	02857232	United Kingdom	Dormant ⁷
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
Brolly 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 ⁷
DL Support Services India Private Limited ⁶	See footnote 6	India	Support and operational services
DLG Legal Services Limited ²	08302561	United Kingdom	Legal services
DLG Pension Trustee Limited ¹	08911044	United Kingdom	Dormant ⁷
Farmweb Limited ¹	03207393	United Kingdom	Dormant ⁷
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
Intergroup Assistance Services Limited ¹	03315786	United Kingdom	Dormant ⁷
National Breakdown Recovery Club Limited ¹	02479300	United Kingdom	Dormant ⁷
Nationwide Breakdown Recovery Services Limited ¹	01316805	United Kingdom	Dormant ⁷
The National Insurance and Guarantee Corporation Limited ¹	00042133	United Kingdom	Dormant ⁷
UKI Life Assurance Services Limited ¹	03034263	United Kingdom	Dormant ⁷

Notes:

1. Registered office at: Churchill Court, Westmoreland Road, Bromley, BR1 1DP.
2. Registered office at: The Wharf, Neville Street, Leeds, LS1 4AZ.
3. U K Insurance Limited has a branch in the Republic of South Africa and a branch in the Republic of Ireland.
4. Registered office at: 22 Grenville Street, St Helier, JE4 8PX, Jersey.
5. On 15 September 2020, DL Insurance Services Limited acquired 100% of the issued share capital of Brolly UK Technology Limited. For the year ended 31 December 2021, Brolly UK Technology Limited is exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of section 479 A(2)(d).
6. Registered office at: ESC House, 155, 1st & 2nd Floor, Okhla Industrial Area Phase-3, New Delhi, 110020, India. Company registration number: U74140DL2014FTC265567.
7. These entities have not been audited, in accordance with the exemptions available for dormant entities under section 480 of the Companies Act 2006.
8. Under the Companies (Jersey) Law 1991, there is no requirement to file individual accounts and audit a private limited company.

3. Other receivables

	2021	2020
	£m	£m
Loans to subsidiary undertakings ¹	337.1	322.2
Trade receivables due from subsidiary undertakings	5.4	13.5
Total	342.5	335.7
Current	92.5	85.7
Non-current	250.0	250.0
Total	342.5	335.7

Note:

1. Included in loans to subsidiary undertakings is a £250 million unsecured subordinated loan to U K Insurance Limited. All loans are neither past due nor impaired.

4. Current and deferred tax

	2021	2020
	£m	£m
Per balance sheet:		
Current tax assets	6.4	5.5
Deferred tax liabilities	(0.9)	(0.7)

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
	2021	2021	2020	2020
	£m	£m	£m	£m
Derivative assets				
Designated as hedging instruments:				
Foreign exchange contracts ²	14.1	0.2	4.1	0.1
Total	14.1	0.2	4.1	0.1
Derivative liabilities				
Designated as hedging instruments:				
Foreign exchange contracts ²	14.1	0.2	4.1	0.1
Total	14.1	0.2	4.1	0.1

Notes:

1. The derivative assets and liabilities are both classified as level 2 within the Group's fair value hierarchy set out in note 43 of the consolidated financial statements.
2. The foreign exchange cash flow hedges have been entered into on behalf of the Group's subsidiary companies.

6. Financial investments

	2021	2020
	£m	£m
Fair value through other comprehensive income debt securities¹	45.2	—

Note:

1. At 31 December 2021, the fair value through other comprehensive income debt securities are corporate debt securities of £45.2 million classified as level 2 within the Group's fair value hierarchy which is set out in note 43 of the consolidated financial statements.

7. Cash and cash equivalents

	2021	2020
	£m	£m
Cash at bank and in hand	—	—
Short-term deposits with credit institutions ¹	204.6	266.1
Total	204.6	266.1

Note:

1. This represents money market funds.

Notes to the Parent Company Financial Statements *continued*

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 31 and 32 to the consolidated financial statements.

Of the Company's total equity, £1,333.0 million (2020: £1,329.5 million), being the total of its retained earnings less unrealised losses of £0.1 million (2020: £0.1 million), 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 33 to the consolidated financial statements.

10. Subordinated liabilities

	2021	2020
	£m	£m
£250 million 9.25% subordinated Tier 2 notes due 2042	254.1	253.7
£260 million 4.0% subordinated Tier 2 notes due 2032	258.3	258.2
Total	512.4	511.9

£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 2021 was £543.7 million (2020: £589.0 million).

11. Borrowings

	2021	2020
	£m	£m
Loans from fellow subsidiaries within the Group¹	123.9	116.4

Note:

- Included in the above is a loan of £93.8 million (2020: £71.4 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

	2021	2020
	£m	£m
Total payables to third parties	—	1.1

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 37 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 44 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 and Accounts.

Shareholder Information

Financial calendar¹

2022

Date	Event
08 March	Preliminary Results 2021 announcement
07 April	"Ex-dividend" date for 2021 final dividend
08 April	Record date for 2021 final dividend
25 April	Final date for election under the Dividend Reinvestment Plan
04 May	Trading update for the first quarter of 2022
10 May	Annual General Meeting
17 May	Payment date for 2021 final dividend
02 August	Half-year report 2022
11 August	"Ex-dividend" date for 2022 interim dividend
12 August	Record date for 2022 interim dividend
18 August	Final date for election under the Dividend Reinvestment Plan
09 September	Payment date for 2022 interim dividend
08 November	Trading update for the third quarter of 2022

Annual General Meeting

The 2022 AGM will be held at No 1 Minster Court, Mincing Lane, London, EC3R 7AA on 10 May 2022, 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 31 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 257. 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 authorised by the FCA, check the Financial Services Register at www.fca.org.uk/register.
- Beware of fraudsters claiming to be from an authorised 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 unauthorised firms to avoid at www.fca.org.uk/consumers/unauthorised-firms-individuals.
- Remember that if you buy or sell shares from an unauthorised 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.

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 and 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.
Adjusted solvency capital ratio	The ratio of Solvency II own funds to the solvency capital requirement, which excludes the Tier 2 subordinated debt which can first be called on 27 April 2022 from the Group's own funds.
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 liabilities in the Group's balance sheet is classified as Tier 2 capital for Solvency II purposes.
Carbon emissions	Scope 1 – covers direct emissions from owned or controlled sources, including fuels used in office buildings, accident repair centres and owned vehicles. Scope 2 – covers indirect emissions from the generation of purchased electricity, steam, heating and cooling for office buildings and accident repair centres. 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. Total Scope 3 – includes all other indirect emissions that occur in the Group's value chain and purchased goods and services, excluding investments.
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 253 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 251 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 251 alternative performance measures.)
Current-year combined operating ratio	This is calculated using the combined operating ratio less movement in prior-year reserves. (See page 251 alternative performance measures.)
Current-year normalised operating profit	This is calculated using the normalised operating profit adjusted for prior-year reserve movements. (See page 251 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 251 alternative performance measures.)
Finance costs	The cost of servicing the Group's external borrowings and including the interest on ROU 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 insurance contracts that were inceptioned 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 ROU 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 251 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 251 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 251 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.
Minimum capital requirement ("MCR")	The minimum amount of capital that an insurer needs to hold to cover its risks under the Solvency II regulatory framework. If an insurer's capital falls below the MCR then authorisation will be withdrawn by the regulator unless the insurer is able to meet the MCR within a short period of time.
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 251 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.
Ogden discount rate	The discount rate set by the Lord Chancellor and used by courts to calculate lump sum awards in bodily injury cases.

Glossary and Appendices *continued*

Term	Definition and explanation
Operating expenses	These are the expenses relating to business activities excluding restructuring and one-off costs. (See page 252 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 254 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 252 alternative performance measures.)
Right-of-use ("ROU") asset	A lessee's right to use an asset over the life of a lease, calculated at initial recognition as the present value of the lease payments, plus any initial direct costs less any incentives received. The ROU asset is depreciated over the lease term and is subject to impairment testing.
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 curb global temperature rise to well below 2°C above 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 248.
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.
Solvency capital requirement ("SCR")	The SCR is the amount of capital the regulator requires an insurer to hold to meet the requirements under the Solvency II regulatory framework. The Group uses a partial internal model to determine SCR.
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 252 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 252 alternative performance measures.)
Task Force on Climate-related Financial Disclosure ("TCFD")	Established by the Financial Stability Board, the TCFD developed a set of disclosure recommendations on the risks and opportunities presented by climate change. The TCFD aims to improve and increase climate-related disclosure by organisations and promotes the provision of clear, comprehensive and high-quality information.
Total Shareholder Return ("TSR")	Compares share price movement with reinvested dividends as a percentage of the share price.
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 248 to 250 and reconciled to the most directly reconcilable line items in the financial statements and notes. Note 4 on page 206 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 181 to 238.

Group APM	Closest equivalent IFRS measure	Definition and/or reconciliation	Rationale for APM
Adjusted solvency capital ratio	This measure is based on the Group's Solvency II balance sheet and therefore there is no IFRS equivalent	Adjusted solvency capital ratio is defined in the glossary on page 248 and reconciled on page 255.	This is a measure that shows the Group's solvency ratio excluding the Tier 2 subordinated debt which can first be called on 27 April 2022.
Combined operating ratio	Profit before tax	Combined operating ratio is defined in the glossary on page 248 and reconciled in note 4 on page 206.	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 248 and is reconciled in note 4 on page 206.	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 248 and is reconciled to the loss ratio (discussed below) on page 35.	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 248 and is reconciled on page 35.	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 248 and reconciled on page 254.	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 249 and is reconciled in note 4 on page 206.	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 249 and is reconciled on page 253.	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 249 and is reconciled on page 253.	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 249 and is reconciled in note 4 on page 206.	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 249 and is reconciled on page 253.	Expresses a relationship between the net investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.

Glossary and Appendices *continued*

Group APM	Closest equivalent IFRS measure	Definition and/or reconciliation	Rationale for APM
Normalised combined operating ratio	Profit before tax	Combined operating ratio and normalised combined operating ratio are defined in the glossary on page 248 and reconciled on page 253.	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 250 and reconciled in note 4 on page 206.	This shows the expenses relating to business activities excluding restructuring and one-off costs.
Operating profit	Profit before tax	Operating profit is defined in the glossary on page 250 and reconciled in note 4 on page 206.	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 250 and is reconciled on page 255.	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 250 and is reconciled in note 16 on page 214.	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 250 and reconciled in note 16 on page 214.	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 250 and is reconciled in note 4 on page 206.	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	2021 £m	2020 £m
Investment income	6	116.0	127.1
Hedging to a sterling floating rate basis ³	6	(13.3)	(20.3)
Net investment income		102.7	106.8
Net realised and unrealised gains/(losses) excluding hedging		43.6	(11.7)
Total investment return	6	146.3	95.1
Opening investment property		292.1	291.7
Opening financial investments		4,681.4	4,673.4
Opening cash and cash equivalents		1,220.1	948.6
Opening borrowings		(51.9)	(52.3)
Opening derivatives asset ⁴		8.0	81.8
Opening investment holdings		6,149.7	5,943.2
Closing investment property	20	317.0	292.1
Closing financial investments	28	4,633.6	4,681.4
Closing cash and cash equivalents	29	955.7	1,220.1
Closing borrowings	29	(59.2)	(51.9)
Closing derivatives asset ⁴		14.3	8.0
Closing investment holdings		5,861.4	6,149.7
Average investment holdings ⁵		6,005.6	6,046.5
Investment income yield ¹		1.9%	2.1%
Net investment income yield ¹		1.7%	1.8%
Investment return yield ¹		2.4%	1.6%

Notes:

1. See glossary on page 249 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 44 (Investment holdings).
5. Mean average of opening and closing balances.

Normalised combined operating ratio¹

	Home 2021	Home 2020	Commercial 2021	Commercial 2020	Total 2021	Total 2020
Loss ratio	50.7%	55.6%	54.5%	51.4%	58.1%	57.9%
Commission ratio	6.9%	8.1%	20.0%	18.7%	8.1%	8.6%
Expense ratio	22.5%	23.4%	21.7%	25.4%	23.9%	24.5%
Combined operating ratio	80.1%	87.1%	96.2%	95.5%	90.1%	91.0%
Effect of weather						
Loss ratio	5.5%	3.4%	0.1%	0.4%	1.1%	0.7%
Commission ratio	(0.4%)	(0.2%)	—	—	(0.1%)	—
Combined operating ratio normalised for weather	85.2%	90.3%	96.3%	95.9%	91.1%	91.7%

Note:

1. See glossary on page 248 for definition.

Glossary and Appendices *continued***Normalised operating profit¹**

	Total 2021 £m	Total 2020 £m
Operating profit	581.8	522.1
Effect of:		
Normalised weather – claims	(31.1)	(20.8)
Normalised weather – profit share	2.0	1.3
Normalised operating profit	552.7	502.6
Prior-year adjustments		
Prior-year reserve movement	258.1	173.8
Prior-year normalised operating profit	258.1	173.8
Current-year normalised operating profit	294.6	328.8
Current-year normalised operating profit ratio	53%	65%

Note:

1. See glossary on page 250 for definition.

Operating expenses¹

	Note ²	2021 £m	2020 £m
Operating expenses (including restructuring and one-off costs)	10	807.8	763.8
Less restructuring and one-off costs	10	(101.5)	(39.4)
Operating expenses	10	706.3	724.4

Notes:

1. See glossary on page 250 for definition.

2. See notes to the consolidated financial statements.

Return on tangible equity¹

	2021 £m	2020 £m
Profit before tax	446.0	451.4
Add back restructuring and other one-off costs	101.5	39.4
Coupon payments in respect of Tier 1 notes	(16.6)	(16.6)
Adjusted profit before tax	530.9	474.2
Tax charge (2021 and 2020 UK standard tax rate of 19%)	(100.9)	(90.1)
Adjusted profit after tax	430.0	384.1
Opening shareholders' equity	2,699.7	2,643.6
Opening goodwill and other intangible assets	(786.8)	(702.5)
Opening shareholders' tangible equity	1,912.9	1,941.1
Closing shareholders' equity	2,550.2	2,699.7
Closing goodwill and other intangible assets	(822.5)	(786.8)
Closing shareholders' tangible equity	1,727.7	1,912.9
Average shareholders' tangible equity ²	1,820.3	1,927.0
Return on tangible equity	23.6 %	19.9 %

Notes:

1. See glossary on page 250 for definition.
2. Mean average of opening and closing balances.

Adjusted solvency capital ratio¹

	2021 £bn
Total eligible own funds	2.38
Less: Tier 2 subordinated debt which can first be called towards the end of April 2022	(0.25)
Add back: ineligible Tier 3 capital	0.03
	2.16
Solvency capital requirement	1.35
Adjusted solvency capital ratio	160 %

Note:

1. See glossary on page 248 for definition.

Forward-looking Statement

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", "will" or "would" 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, the industry in which the Group operates and the Group's approach to climate-related matters. 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, reduction in expense ratio, investment income yield, net realised and unrealised gains, capital expenditure and, risk appetite range; and targets, goals and plans relating to climate and the Group's approach and strategy in connection with climate-related risks and opportunities. 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 and/or they rely on assumptions that may or may not transpire to be correct. 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 coronavirus 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 Cooperation 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;
- the impact of the FCA pricing practices report and the rules and regulations arising as a result of that report and of responses by insurers, customers and other third parties and of interpretations of such rules by any relevant regulatory authority;
- market-related risks such as fluctuations in interest rates, exchange rates and credit spreads;
- the policies and actions and/or new principles, rules and/or changes to, or changes to interpretations of principles, rules and/or regulations, of regulatory authorities and bodies (including changes made directly or indirectly as a result of Brexit or related to capital and solvency requirements or related to the Ogden discount rate or rates or made 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;
- 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, enforcements, fines and requirements and of court, arbitration, regulatory or ombudsman decisions, judgements and awards (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 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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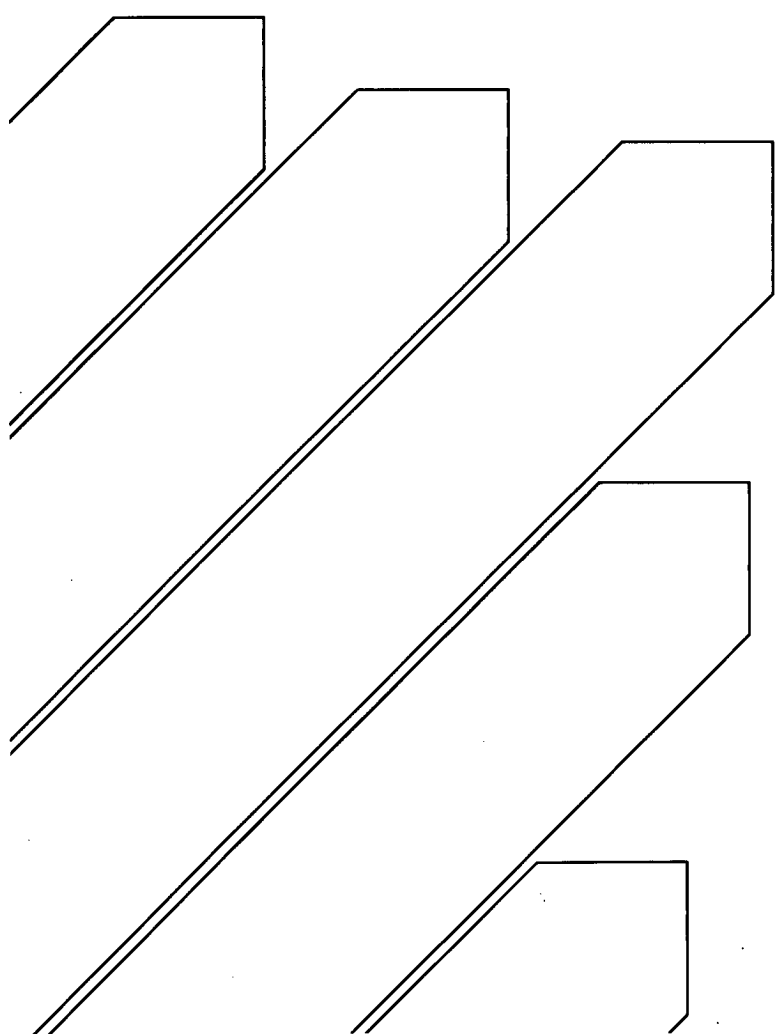
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