



**Task Force on Climate-Related Financial Disclosures Report**

An aerial photograph of a winding asphalt road cutting through a dense, lush green forest. Several cars are visible on the road, including a red car, a white car, a blue car, and a grey car. The road curves sharply to the right and then back to the left.

# **TCFD Report 2022**

# Task Force on Climate-related Financial Disclosures

Please note that all page references found within this document refer to our 2022 Annual Report and Accounts which can be found on <https://www.directlinegroup.co.uk/annual-report-2022.html>

## Introduction

Our 2022 disclosure against the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD") reports on our progress to date and outlines the actions we are taking to strengthen our strategic response to climate change.

The Group, as at the time of publication, has complied with the requirements of Listing Rule 9.8.6R by including climate-related financial disclosures consistent with 9 of the 11 TCFD Recommendations and Recommended Disclosures for all sectors including the supplemental guidance for insurance companies. The Group has reported against all 11 recommended disclosures and believes its disclosure against 9 of the 11 recommendations meets the objectives of the TCFD framework, with the two outstanding recommendations explained below.

For metrics and targets disclosure recommendations (a) and (b) of the TCFD framework, we aim to explore further how we strengthen alignment to the following specific components of these recommendations in future reporting. We aim to:

- explore how we incorporate additional metrics within our disclosure, including cross-industry metrics as recommended by the TCFD, to support measurement and management of transition risks and opportunities;
- assess disclosure of the extent to which our insurance underwriting activities, where relevant, are aligned with a well below 2°C scenario; and
- assess disclosure, where data and methodologies allow, the weighted average carbon intensity or GHG emissions associated with commercial property and specialty lines of business.

## Governance

### Our approach

The Group's approach to the governance of its sustainability strategy is underpinned by our Vision and Purpose (see page 10) 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 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:

## Highlights in the year

- **Received approval of our carbon reduction plans**, confirming that our emissions reduction targets are in line with a 1.5°C pathway, making us one of the first personal lines general insurers in the UK to gain approval by the Science Based Targets initiative ("SBTi").
- **Expanded our electric vehicle insurance package**, which is now offered to all Direct Line Motor customers to support the transition to a low-carbon economy and make it easier for customers to insure electric vehicles.
- **Incorporated a climate-related measure in our LTIP**, which now includes a measure of performance against our approved science-based emissions reduction targets.

- Each year, the Board assesses the strategic plan (the "Plan") in conjunction with the Group's Own Risk and Solvency Assessment ("ORSA"), which considers material risks to the Plan, including climate change-related risks.
- 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, including the establishment and monitoring of Science-Based Targets and the Group's participation in the Bank of England's Climate Biennial Exploratory Scenario ("CBES"). The Chair of each Committee reports to the Board after each Committee meeting.

## 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 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 at least twice a year. The Committee played a key role in reviewing and challenging the actions and responses to the Bank of England's CBES exercise.
- The **Investment Committee** meets a minimum of three 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 two times a year, monitoring the Board's overall structure, size, composition and balance of skills. This Committee is also responsible for monitoring the Group's observance of corporate governance best practice.
- The **Sustainability Committee** scrutinises progress against the sustainability strategy to ensure that we continue to make progress under our Customer, People, Society, Planet and Governance pillars. The Committee meets a minimum of four times a year and has overseen: the setting of the Group's Science-Based Targets; activity undertaken by the Group to move towards becoming a net zero business; and Group involvement in climate debates, including the ABI's



Climate Change Roadmap, the Partnership for Accounting Financials' methodology for underwriting emissions disclosures and the Sustainable Markets Initiative Insurance Task Force. During the year, the Committee has discussed prominent public policy challenges such as flooding and accelerating the transition to electric vehicles. From 2023, the Committee will also receive biannual updates on the Group's performance against its science-based emissions reduction targets, following their approval by the SBTi in 2022.

- The **Remuneration Committee** meets a minimum of four times a year and considers how executive remuneration can be used to drive progress on climate related matters. It has introduced an emissions measure in our LTIP based on the greenhouse gas reduction targets approved by the SBTi.

More information on the structure of the Board and Board Committees can be found within the Corporate Governance report on page 110.

### 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 matters:

- the acting CEO has overall responsibility for climate change and environmental matters;
- the CRO is responsible for overseeing the management of climate change-related 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 financial 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 CRO and the Director of Investment and Capital Management 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, in the year, 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:

- monitoring and driving performance against the Group's 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.

Further information relating to our risk identification process and the processes by which management are informed about climate-related issues can be found on page 81.

### 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. Group Audit are represented at the Climate Executive Steering Group.

### Strategy

Climate change has far-reaching implications for economies and societies around the world. The physical and economic impacts that could result from further global warming may be significant and the extent of these impacts is dependent on the action taken to tackle climate change.

As a major UK insurer with over 9.6 million in-force policies from ongoing operations<sup>1</sup> we have a role to play in supporting the transition to a low carbon economy and we know that through our actions as a business we can contribute to climate risk mitigation.

The following pages examine the potential impacts of climate change on our business, in line with the TCFD recommendations, and outline the actions we are taking to strengthen our strategic response to one of the biggest challenges facing the world today.

### Climate change risks and opportunities

The potential impacts of climate change on organisations are classified into the following three categories by the TCFD:

- **physical risks** – resulting from the physical effects of climate change;
- **transition risks** – resulting from the transition to a lower-carbon economy; and
- **opportunities** – arising from efforts to mitigate and adapt to climate change.

We also recognise that litigation risks, which includes risks arising when parties who have suffered losses from climate change seek to recover them from those they believe may have been responsible, could also cause adverse impact. This could include direct climate-related litigation against the Group or insurance risk arising from the underwriting of liability products, for example. The Group considers the risks associated with this to be low due to low exposure in high-risk industry sectors.

### Materiality

We recognise that assessing and quantifying the level of impact from climate change is an emerging practice.

A greater level of estimation and assumption is required to address the long-term and forward-looking nature of climate-related risks and opportunities, which causes limitations in assessing materiality. Our intention is to explore further how we can enhance our approach to materiality, in the context of climate change, with more certainty.

More information on our current approach to measuring the impact of climate-related risk, and the integration of climate change in the Group's overall risk management processes, can be found on pages 74 and 81.

Note:

1. Ongoing operations – see footnote 1 on page 25.

### Defining the short-, medium- and long-term time horizons

Short	1 – 10 years
Medium	10 – 30 years
Long	30 years +

Our approach to defining the time horizons associated with climate-related risks and opportunities is to align closely with the scenarios considered in the Group's quantitative analysis of climate-related risk, which typically considers scenarios that span thirty years or longer (see page 75).

When defining the time horizons, the useful life of assets was considered. However, the Group's assets are primarily depreciated or amortised over a period of up to 10 years. As such, from a climate-related risk perspective, this falls into our short-term time horizon and therefore climate-related risk is not a significant input into determining asset useful economic lives.

The time horizons over which specific climate-related issues will manifest themselves vary significantly. However, in general, transition risks are likely to materialise more rapidly than physical risks, which are likely to be gradual and materialise over the longer term. The timing of climate-related litigation risk is less certain due to the nature of the exposure.

The key physical and transition risks and opportunities that could significantly impact the Group, as well as the time horizons over which they could manifest, is available further into our disclosure, see pages 78 to 81.

### Financial planning, performance and position

Without appropriate management, the risks posed by climate change could adversely impact the Group's financial performance and financial position.

To help quantify the potential impact of climate change we:

- perform scenario analysis, which enhances our understanding of the financial risks associated with the longer-term impacts of climate change and provides an indication of strategic resilience (see pages 75 to 77);
- undertake climate risk modelling to assess the most predominant physical drivers of risk in our property insurance products, enabling us to evaluate the potential impact to the Group's capital position (see page 82); and
- integrate climate risk into the Group's overall approach to risk management. This includes measuring the relative significance of climate-related risks to other risks in the Group Risk Taxonomy (see page 81).

### Financial planning

We have identified that limitations exist in aligning climate change and financial planning. A key issue relates to the modelling of climate change impact, which typically extends out to thirty or more years, a significantly longer period than our current financial plan.

Although limitations and uncertainties associated with the longer-term impacts of climate change exist, the prominence of climate-related considerations in our most recent planning continued to grow.

The Group's Plan reflects the strategic planning that is ongoing across the business and therefore covers any climate-related initiatives that are embedded within. These include:

- sustainability-related projects, such as the actions we are taking to reduce the carbon footprint of our accident repair centres and investment portfolio and the associated costs. More information on these actions can be found on page 80 and 81;
- the use of reinsurance in our property insurance business, acknowledging that the cost to obtain catastrophe reinsurance could be impacted by an increase in the frequency and severity of major weather events;
- development of propositions and channel expertise to support the transition to a low carbon economy, such as our electric vehicle offer, which is now available to all Direct Line Motor customers; and
- the reduction of our office footprint, seen, for example, through our planned move from our office site in Bromley to a smaller Central London hub in 2023.

We also monitor losses from major weather events, which include inland and coastal flooding, storm surge, freeze events and subsidence. We use sophisticated modelling techniques to determine the expected losses from major weather events in our Home and Commercial property book to set a weather load for budgeting purposes. The impact of major weather relative to this load for 2022 and prior years can be found on page 83.

### Financial performance and position

In preparing the financial statements, the Group has assessed the impact of climate change. While the risks associated with climate change remain uncertain looking forwards, the impact of major weather events is reflected in the Group's historical performance and position as at 31 December 2022. The potential impact of climate change on insurance risk is also discussed in further detail within note 3 to the consolidated financial statements (see page 200).

Areas of physical and transition risks the Group could be exposed to are outlined in the table on page 78. The financial impact of these risks can, if realised, be grouped broadly into the following:

- Adverse impacts to revenue and market share due to a failure to understand the scale of change in market demand for products and services due to climate-related policy, technology and consumer preference.
- Increased climate-related operating costs and capital expenditure due to the investments we make to reduce our carbon footprint and to progress towards our long-term emission reduction commitments.
- Changes in the value of our financial investments due to the influence of physical and transition risk impacting the wider economy.
- An increase in the frequency and severity of natural catastrophes and other weather-related events adversely impacting insurance liabilities.

We also recognise that our access to capital can be materially affected by factors including, but not limited to, financial performance and investment decisions, which have their own associated climate-related risks. In addition, our performance is assessed externally by ESG rating agencies, to which investors and other stakeholders are giving increasing prominence. Adverse impacts to our debt rating could negatively affect cost and access to sources of debt finance and subsequent interest rates.

In our approach to acquisitions and divestments, any climate-related risks and opportunities are expected to form part of our usual due diligence process.

### Scenario analysis

Our most recent scenario analysis activity took place during 2021, followed by a smaller round of analysis in early 2022.

The analysis was designed to enhance our management of climate-related financial risk and the scenarios used expanded on the Network for Greening the Financial System's ("NGFS") Net Zero 2050, Delayed Transition and Current Policies scenarios by including additional risk transmission channels and adding additional variables.

The exercise considered the financial impacts from these three distinct climate scenarios at a ten- and thirty-year time horizon, capturing a range of different combinations of transition and physical risks. Two of the scenarios represent routes to net zero greenhouse gas emissions and primarily explore transition risk from climate change:

- **Early Action** The transition to a net zero emissions economy started in 2021, so carbon taxes and other policies intensify relatively gradually over the scenario horizon. Global carbon dioxide emissions are reduced to net zero by around 2050. Global warming is limited to 1.8°C by the end of the scenario (relative to pre-industrial levels). Some sectors are more adversely affected by the transition than others, but the overall impact on GDP growth is muted, particularly in the latter half of the scenario, once a significant portion of the required transition has occurred and the productivity benefits of green technology begin to be realised.
- **Late Action** The implementation of policy to drive transition is delayed until 2031 and is then more sudden and substantial. Global warming is limited to 1.8°C by the end of the scenario (relative to pre-industrial levels). The more compressed nature of the transition results in material short-term macroeconomic disruption, which is particularly concentrated in carbon-intensive sectors. Output contracts sharply in the UK and international economies. The rapid sectoral adjustment associated with the sharp fall in GDP reduces employment and leads to some assets being stranded, with knock-on consequences for demand and spending. Risk premiums rise across multiple assets. An important indicator of the level of transition risks in these scenarios is the carbon price, reflecting that policymakers can induce the transition by increasing the implicit cost of emissions.

The third scenario primarily explores physical risks from climate change in the event that there are no new climate policies introduced beyond those already implemented:

- **No Additional Action** The absence of transition policies leads to a growing concentration of greenhouse gas emissions in the atmosphere and, as a result, global temperature levels continue to increase, reaching 3.3°C relative to pre-industrial levels by the end of the scenario. This leads to chronic changes in precipitation, ecosystems and sea level. UK and global GDP growth is permanently lower and macroeconomic uncertainty increases.



For each of the three scenarios, variable paths were provided for the underlying physical and transition risks and for mapping these risks onto macroeconomic and financial variables:

- Physical and transition risks: pathways for climate variables to represent the impact of climate risks and opportunities at the global and regional level.
- Macroeconomic and financial market conditions: impact of climate-related risks and opportunities at a global level, and at the level of key countries, regions, and sectors – reflecting the impacts of physical and transition variables in each scenario. Financial market conditions reflect the direct financial consequences of the paths of the macroeconomic variables.

Our analysis focused on changes in invested assets and insurance liabilities, and the variables provided formed the basis for the modelling. The stress assumed an instantaneous shock, effectively bringing forward the future climatic environment to today's balance sheet, with no allowance for changes in future premiums, asset allocation, expenses, reinsurance programmes and other future changes in business models.

The analysis was applied to the Group's Solvency II balance sheet as at 31 December 2020 and assumed fixed balance sheets, premiums, exposures and reinsurance arrangements.

### Summary of results

The results show the most material impact on the Group's Solvency II own funds arises in the No Additional Action Year 30 scenario, in which transition risk on the investment portfolio dominates the overall impact. These large impacts reflect the cumulative downward trend in asset values, with no stabilisation effects observed (unlike the other two scenarios) as extreme weather events increase in frequency and intensity, and continue to affect economic growth beyond the thirty-year horizon considered by the analysis.

The No Additional Action Year 30 scenario also shows the largest increases in insurance liabilities, in absolute terms, which is consistent with estimated increases in Gross Average Annual Losses (“AAL”) of around 150% for inland flooding and around 370% for coastal flooding. This could result in a material increase in weather load, reinsurance costs and capital load. While the short-term nature of the business, the ability to re-price annually and the risk mitigation provided by reinsurance arrangements are likely to limit the impact on general insurance liabilities, the modelling has illustrated that the increased physical effects of climate change could potentially result in some risks and perils becoming either uninsurable or unaffordable.

**Relative Impact – No Additional Action to Early Action**

The following graph illustrates the potential adverse impact to the Group’s Solvency II balance sheet value of investment assets and insurance liabilities at Year 30 under the Early Action, Late Action and No Additional Action scenarios.

The most adverse financial impact was from the No Additional Action scenario, which is set at 100% in the graph. When compared to the total impact under the No Additional Action scenario, the impact of the Late Action scenario was around 54% of the value and the impact under the Early Action scenario was around 39% of the value.

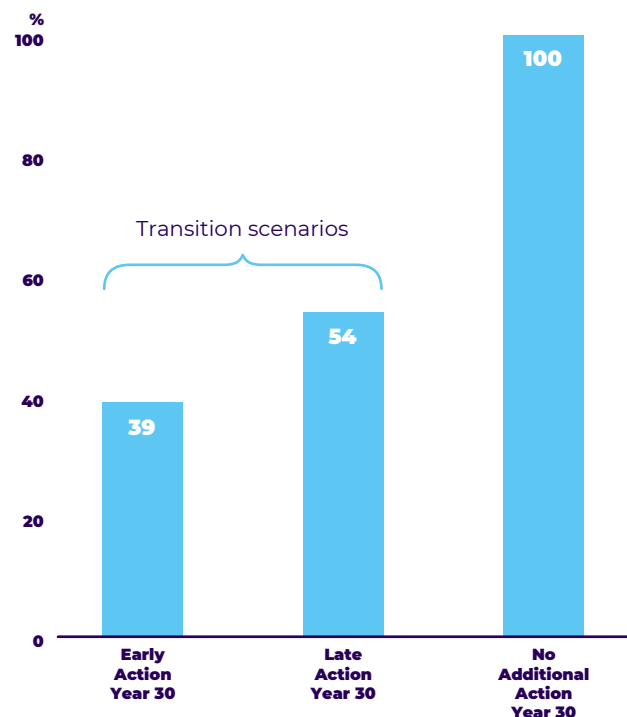


Figure 1: Year 30 impacts of scenarios relative to the largest No Additional Action scenario

In the Late Action scenario, the delay in policy implementation to transition to a low-carbon economy means there are no transition impacts over the initial ten-year time horizon. However, accelerated transition from 2031 results in greater impacts versus the Early Action scenario over the thirty-year time horizon. Whilst both of these transition scenarios saw material impacts on the investment portfolio, the most significant impacts on

both investments and insurance liabilities arose from the physical risk effects of no transition in the No Additional Action scenario (where no additional actions are taken beyond those already announced).

At the thirty-year time horizon, financial impacts in the No Additional Action scenario are nearly double those in the Late Action scenario, and physical risks also drove the largest impact on investment results in absolute terms. However, these impacts do not take into account the Group’s long-term commitments within its investment strategy, which includes the target of holding a net zero emissions investment portfolio by 2050 (see pages 80 and 84).

All three scenarios would lead to a breach in risk appetite, and the No Additional Action Year 30 scenario would also lead to a breach in SCR based on the Solvency II balance sheet as at year-end 2020. However, a set of clearly defined management actions could be deployed in each scenario to address the risks and allow the business to recover to above risk appetite (see page 77).

**Comparison of impact – insurance liabilities and investments**

The graph below shows the potential adverse impact on the Solvency II balance sheet value of investment assets and insurance liabilities under the Early Action, Late Action and No Additional Action scenarios at Year 10 and Year 30.

The graph outlines how the total impact for each scenario (set at 100%) is split between the impact on investments and insurance liabilities to illustrate their relative materiality. For example, in the No Additional Action Year 10 scenario, impacts are split broadly evenly, while in the corresponding Year 30 scenario, the impact on investments dominates.

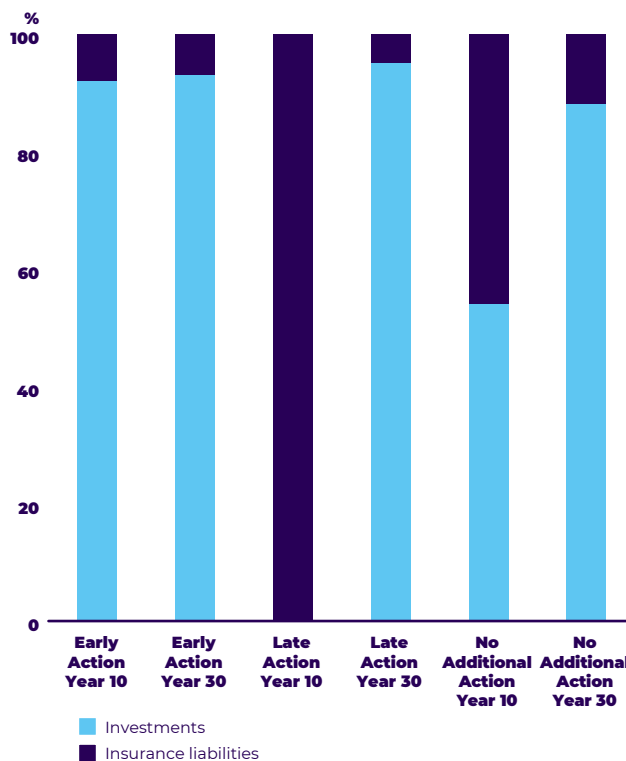


Figure 2: Share of impact – insurance liabilities and investments



Except in the Late Action Year 10 scenario, where there is no transition risk due to the assumed delay, in all scenarios the impact on investments is more material than on insurance liabilities. Additionally, insurance liabilities were considered gross of reinsurance and, in practice, factors such as the short-term nature of the business, the ability to re-price annually and the risk mitigation provided by reinsurance arrangements is likely to limit the impact on general insurance liabilities further.

### Physical risk by peril

The following graph illustrates the potential adverse impact of physical risk on the Solvency II balance sheet value of insurance liabilities at Year 30 under the Early Action, Late Action and No Additional Action scenarios.

The total impact (set at 100%) is further analysed by peril, for example in the No Additional Action scenario around 60% of the total impact is driven by inland flooding and 33% by coastal flooding.

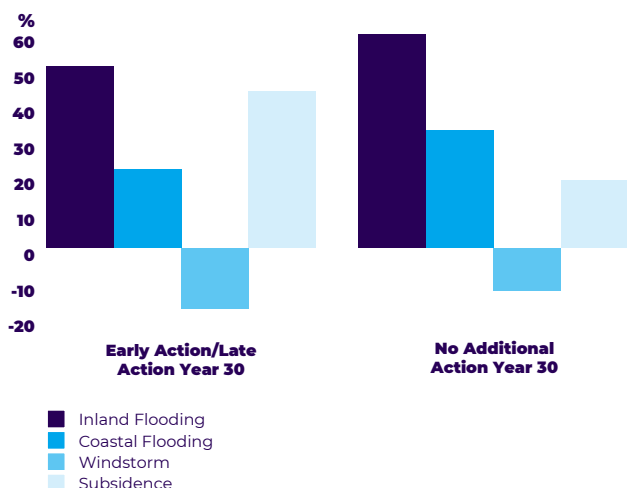


Figure 3: Split of physical risk impacts on insurance liabilities by peril

Figure 3 shows that, on a gross basis, the physical risk to insurance liabilities across all three scenarios was largely driven by inland flooding and coastal flooding, which included storm surge due to a rise in sea levels. However, the analysis shows that the changes to flood and storm surge risk vary regionally. Windstorm was assessed to have a small positive benefit over all scenarios as a result of changing atmospheric conditions driven by complex interactions of a number of variables, ultimately caused by rising temperatures.

### Management actions

Undertaking this analysis provided us with a framework to identify and assess the climate-related transition and physical risks that the business could be exposed to.

Taking into account the level of impacts that we have observed as part of this climate-related modelling, we identified a number of management actions that would be effective to mitigate these risks and respond to new opportunities.

Our Management Action Framework consists of three broad categories based on the purpose and nature of the action:

- **Contingent Management Actions** – These follow the Group’s existing Contingent Management Actions framework and would be deployed to mitigate the scenario impacts, assuming these arise as instantaneous shocks on the balance-sheet; potential action could include restricting capital distributions, for example.
- **Pre-emptive Management Actions** – These have been developed assuming that the business can observe the scenarios unfolding in real time and begin to adapt the business model in response to these emerging impacts; they cover areas such as repricing, de-risking of investments and reinsurance.
- **Strategic Management Actions** – These actions are aligned to the Group’s ongoing strategic activity as part of our contribution to the transition to a lower-carbon economy. They include: taking action to progress against our net zero ambitions and Science-Based Targets; understanding how we can support in improving the flood resilience of UK properties in flood-prone areas; and evaluating the impact of climate change on our underwriting footprint. Progress against these actions is overseen by the Climate Executive Steering Group. For further information on our Strategic Management Actions, see page 65.

### CBES second round

In early 2022, we participated in the second round of the Bank of England’s CBES exercise. The initial CBES exercise, that took place in 2021, was designed to test the resilience of the UK financial system to physical and transition risk from climate change to assist banks and insurers in enhancing their management of climate-related financial risk.

For general insurers the second round focused on management responses to the CBES scenarios and resulting challenges to the business models. More specifically, it probed how responses would change if losses were higher; encouraged additional thinking about dependencies and actions required by the government and other associated stakeholders; and further explored opportunities in the climate scenarios.

In response, the Group concluded that the climate-related management actions identified in the initial analysis would remain appropriate. However, the pre-emptive management actions of repricing and reinsurance, as well as the strategic management actions relating to flood resilience and underwriting footprint, would be accelerated after considering a scenario under which physical losses from climate change were materially higher.

The second round of analysis was based on the modelling outputs from the initial exercise, as in the short term re-running the CBES scenarios is unlikely to produce materially different results.

Going forward, we will continue to work towards developing scenarios specific to our own risk profile that focus on the most material aspects of our business and explore the sensitivity of potential impacts to key uncertainties. This will enable the Group to make use of scenario-testing output more effectively to further inform our strategic approach to mitigating climate-related impacts.

### Our strategic response

In order to ensure strategic resilience, we must manage the exposure against the potential risks from climate change and harness opportunities from the transition to a low-carbon economy. Our strategy focuses on driving change across three key areas of the business: our underwriting activities, which includes a focus on the operating segments that could be most affected by climate change; our operations; and our approach to investments. These are considered in turn on pages 79 to 81.

The following table outlines key physical and transition risks and opportunities that could significantly impact these areas as well as the time horizons over which they could manifest. Our definition of the time horizons can be found on page 74.

Category	Description	Examples of potential impact on the Group	Time horizon	Key area of impact
<b>Physical risks</b>	<b>Acute</b> – event driven risks such as flooding and storm surge. <b>Chronic</b> – longer-term shifts in climate patterns, such as a continued rise in average temperatures, changes in, and extreme variability of, precipitation and weather patterns and rising sea levels.	An increase in the frequency and severity of natural catastrophes and other weather-related events could adversely impact insurance liabilities.	<b>S</b>	<b>U</b>
		Disruption to our direct operations, which could include damage to our estate, impacting our ability to serve customers.	<b>S M L</b>	<b>O</b>
		Chronic risks could lead to significant changes in our underwriting criteria to maintain risk appetite, and/or higher costs to obtain catastrophe reinsurance to protect us against an accumulation of claims arising from a natural perils event.	<b>M L</b>	<b>U</b>
		Reduced returns from investments in companies whose operations are impacted by physical climate risks, and real asset investments directly impacted by physical climate risks.	<b>S M L</b>	<b>I</b>
<b>Transition risks</b>	Risks arising from the transition to a lower-carbon economy.  These are categorised by the TCFD as: – policy and legal risks; – technology risks; – market risks; and – reputational risks.	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 impact revenue and market share.	<b>S M</b>	<b>U O</b>
		Costs associated with the transition to a lower-carbon economy may increase over time and the adoption of new lower emissions technologies may be unsuccessful.	<b>S M</b>	<b>O</b>
		Insufficient progress against our net zero ambitions could cause stakeholder concern and reputational damage.	<b>S M L</b>	<b>U I O</b>
		Reduced returns from investments in high carbon intensity companies that are not taking action to transition to a low carbon economy, and real asset investments that are not compatible with the transition to a low carbon economy.	<b>S M L</b>	<b>I</b>
<b>Opportunities</b>	Efforts to mitigate and adapt to climate change can also produce commercial opportunities. These could allow us to help accelerate the transition and continue contributing to a sustainable economy.	Accelerating the speed of transition to a lower-carbon economy by, for example, supporting the move to greener transport solutions, particularly electric-powered cars, allows us to develop new insights and capabilities to help us build insurance solutions that best meet our customers’ evolving needs.	<b>S M</b>	<b>U</b>
		Investment in energy-efficient features and equipment across our office estate and accident repair centres could save on energy consumption and operating costs, reduce our footprint and improve operational and resource efficiencies.	<b>S M L</b>	<b>O</b>
		Potentially enhance risk-adjusted returns from our investments by aligning the investment portfolio with the transition to a low carbon economy whilst also enhancing our reputation as a responsible investor. Ensuring the investment portfolio is resilient against the physical effects of climate change.	<b>S M L</b>	<b>I</b>

#### Key

- S** Short-term                      **M** Medium-term                      **L** Long-term
- U** Underwriting                      **I** Investments                      **O** Operations



## Underwriting

### Property

The physical risks from climate change are most likely to manifest themselves as an insurance risk on our property insurance products.

Recent weather events that we have responded to highlight the importance of, and need for, insurance. In December, the prolonged period of sub-zero temperatures saw us help thousands of customers deal with burst pipes and water tanks and other related damage. The record-breaking temperatures experienced across the UK in Q3 led to a modest increase in subsidence claims in our Home business, and in early 2022, we supported our Home and Commercial customers following three significant storms: Dudley, Eunice and Franklin.

The frequency and severity of natural catastrophes and other weather-related events in the UK are key drivers in the Group's solvency capital requirements. The short-term nature of the business we underwrite, the ability to re-price annually, and the risk mitigation provided by reinsurance arrangements are important factors in how we manage our exposure.

However, acknowledging that, in general, the physical risks from climate change are likely to intensify over the longer-term, there remains a need to assess how this risk could impact the Group over a significantly longer period.

To support our assessment of the potential impact on insurance liabilities over the longer-term we undertake scenario analysis (see pages 75 to 77). The analysis helps us to quantify the financial implications of physical risk under different possible future climate scenarios. The outputs provide an indication of the Group's resilience and aid our strategic planning.

The outcomes of our most recent scenario analysis provided a framework to identify and assess climate-related risk and develop a set of contingent and pre-emptive management actions (page 77). The analysis also supported the development of our Strategic Management Actions which span across business areas and include action on:

- engaging with policymakers on the importance of flood defences in the UK to protect properties located in flood-prone areas;
- exploring how we can help shape the thinking around resilient repairs of properties affected by flooding; and
- further evaluating the impact of climate change on our underwriting footprint and risk appetite.

For more information on our Strategic Management Actions see page 65.

### Motor

As one of the largest motor insurers in the UK, the move to electric-powered vehicles is particularly pertinent. Supported by changes in technology and policy, such as Government plans to end the sale of new petrol and diesel cars in the UK by 2030, the speed of transition to electric continues to increase.

The transition to a low carbon economy presents new challenges, but also new opportunities. As part of our response, we are developing further insight into the future of vehicle technology and repair, growing our data and developing 'green' products to support our customers who are already making the switch to electric.

To date, our actions include:

- developing a full electric vehicle package which is offered to all new and renewing Direct Line Motor customers that provides access to electric vehicle essentials, discounts off our Green Flag Shop and insurance that covers batteries and charging cables (see page 67);
- establishing a dedicated Electric Vehicle Distribution and Strategy team, focused on evolving the Group's strategic response to the electric shift; and
- entering into new strategic partnerships, such as our new partnership with Motability Operations from September 2023, where we expect the number of electric vehicles we insure to grow significantly over the course of the ten-year partnership.

### Operations

Operating in a sustainable way is key to minimising our impact on the environment. Taking action to reduce our carbon footprint is also good for the sustainability of our business, and an important part of how we can mitigate against potential climate risks that could cause disruption to our operations.



### Science-Based Targets

We previously disclosed our aim to achieve net zero emissions by 2050 at the latest and to support our ambition, we announced we were setting Science-Based Targets.

In 2022, these targets were formally approved by the SBTi. This significant milestone in our carbon reduction strategy defines the path of how we reduce our carbon emissions further and underpins how we progress towards our ambition of becoming a net zero business.

The targets include an operational emissions target. This covers the Scope 1 and 2 GHG emissions generated from our direct operations, where we are aiming for a 46% reduction in absolute Scope 1 and 2 emissions from our office estate and accident repair centres by 2030, from a 2019 baseline.

More information on our Science-Based Targets can be found on page 66.

Although our journey to net zero emissions continues to gain momentum, we acknowledge that it will take time to facilitate the transition, which is why we continue to offset the carbon emissions<sup>1</sup> from our operations we cannot yet avoid (see pages 65 and 70).

We calculate and report our GHG emissions annually. Our most recent carbon emissions reporting can be found on page 69 and further disclosure on the progress we have made in reducing our footprint to date can be found on page 84.

With a history of taking action to reduce our environmental impact, we are well placed to drive down our emissions further.

In recent years we have taken steps to understand where the most carbon-intensive areas of our operations are. One area where we are prioritising our carbon reduction activity is across our accident repair centres.

Fundamental to serving our motor insurance customers, our 22 accident repair centres are embedding a range of solutions as part of our carbon reduction strategy led by colleagues in our Auto Services Sustainability Programme.

In support of our operational Science-Based Target (see page 66), action taken this year has included:

- expanding the use of hydrogenated vegetable oil in our accident repair centres as an alternative fuel for our recovery trucks, resulting in 543 tonnes of CO<sub>2</sub>e saved in 2022;
- fitting energy-saving LED lighting to a further six repair centres meaning nearly 70% of our Auto Services sites have now received these upgrades;
- installing a Power Factor Corrector in our Birmingham Auto Services site to maximise the efficiency of our electrical supply on-site. In 2021, installation at our Crawley repair centre delivered a 13% improvement in energy efficiency. We are exploring expanding this to include installation at more repair centres in 2023; and
- further exploring the feasibility of moving from gas powered paint booths to electric.

We are also reducing our office footprint which includes moving our head office from Bromley to a newer smaller Central London property in 2023.

### Supply chain

Our Sustainable Sourcing Approach, launched in 2021, aims to reduce the emissions in our supply chain. Our approach means we are engaging with our largest emitting suppliers to encourage them to sign up to SBTi targets or an equivalent. We are also 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 so we can evaluate whether it is viable to change our sourcing approach on appropriate contracts.

In 2022 we also set an internal emissions reduction target (see page 66) and we report the GHG emissions from our supply chain annually, these can be found on page 69.

Note:

1. Scope 1 and 2 emissions as well as elements of our Scope 3 emissions under our direct control (see page 69).

### Investments

In recent years, we have begun integrating 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 climate-related 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 the long term goal of our entire investment portfolio being net zero emissions by 2050 and in support of our aims we continue to implement key climate initiatives into our investment strategy. During 2022, we:

- received approval from the SBTi for our science-based GHG emission reduction targets in our investment portfolio (see below);
- became a signatory to the CDP's science-based targets campaign; a collective engagement campaign supported by over 300 financial institutions with over \$73 trillion in assets which encourages high emitters to set science-based emissions reduction targets; and
- continued to reduce the carbon intensity of our corporate bond portfolio in line with our aim of a 50% reduction by 2030 from a 2020 base year.

### Science-Based Targets

In support of our long-term goal of ensuring our entire investment portfolio is net zero emissions by 2050, in line with the aims of the Race to Zero campaign, we set four science-based GHG emission reduction targets in our investment portfolio.

In 2022, we received formal approval of these targets from the SBTi. The targets cover corporate bonds, commercial real estate and commercial real estate loans which, as at the end of 2022, covered 63% of AUM. More information on the targets can be found on page 66.

The actions detailed 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:

- Thermal coal screen whereby we restrict investment in firms generating more than 5% of revenues from either thermal coal mining or thermal coal power production unless the company is taking positive climate action<sup>1</sup>.
- 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 ESG targets covering areas such as carbon, energy, water and waste.

### 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. This year we have also signed up to the CDP's science-based targets collective engagement campaign which encourages high emitters to set science-based emissions reduction targets.

## Risk Management

### Enterprise Risk Management Strategy and Framework

The Enterprise Risk Management Strategy and 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. Further information can be found in the Risk management section of the Strategic report on page 87.

### Risk taxonomy

The effects of climate change are wide-ranging, affecting many risks across the risk universe. To allow for better recognition of internal and external drivers of climate-related risk and to provide a focal point for the reporting of risks relating to climate change, the Strategic Risk category has been broadened to include Climate Risk within Environmental, Social and Governance 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 by using Financial, Customer, Reputation and expert judgement inputs. This includes those risks relating to climate change, including climate-related litigation risks, and allows the Group to determine the relative significance of climate-related risks in relation to other risks.

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.

## 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.

We also use a variety of indicators across our product segments to assess, monitor and manage climate-related risks. A number of these key metrics can be found on pages 82 and 83.

### Regulatory monitoring

The Group monitors and reviews relevant outputs from the FCA, the PRA, and His Majesty's Treasury, to consider existing and emerging regulatory requirements.

During 2022, this included reviewing:

- the findings from the PRA's 2021 Climate Biennial Exploratory Scenario on financial risks from climate change;
- the Bank of England's letter from Sam Woods on the PRA's supervision of climate-related financial risk; and
- the minutes of the PRA and FCA's joint Climate Financial Risk Forum.

We continue to monitor future developments. 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. Updates on emerging risk and the actions being taken to address them are presented to the Risk Management Committee and the Board Risk Committee regularly, supplemented by deep dives on selected emerging risks. Each emerging risk is owned by an Executive sponsor to help ensure alignment of how it is managed to the strategic objectives and priorities; as well as a senior business leader who is responsible for day-to-day management of the risk.

Climate change is one of the Group's most prominent emerging risks, 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.

Both physical and transition risks could manifest themselves through a range of existing financial and non-financial risks, including insurance, market, operational and strategic risks. For more information on emerging risk and climate change see page 91.



### Climate risk modelling

The predominant direct physical drivers of risk to the Group's capital position are major UK floods and windstorms and these are modelled together with less material perils such as freeze and subsidence 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.

The majority of our 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 peril 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 typically 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.

The following pages focus on the metrics and targets we use across the three key areas of activity, as identified earlier in our disclosure: our underwriting activities; our operations; and our approach to investments.

#### Remuneration

We have now formally introduced a climate-related metric for our LTIP. This incorporates a carbon emissions measure based on our carbon emissions reduction targets that were approved by the SBTi in 2022. More information can be found in the Directors' Remuneration Report on page 141.

Our aim is to explore how we incorporate additional metrics, including cross-industry metrics as recommended by the TCFD, to support measurement and management of transition risks and opportunities in future reporting.

### Underwriting

#### Weather-related loss impact

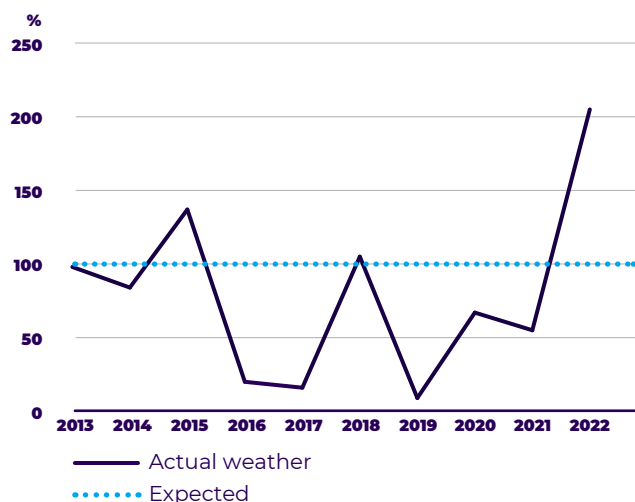
The predominant direct physical drivers of catastrophe weather risk from a capital perspective are major UK floods and windstorms. The last peak of windstorm activity was in the late 1980s and early 1990s; the last decade being particularly benign in comparison. By contrast, flood has seen more elevated 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 37). 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.

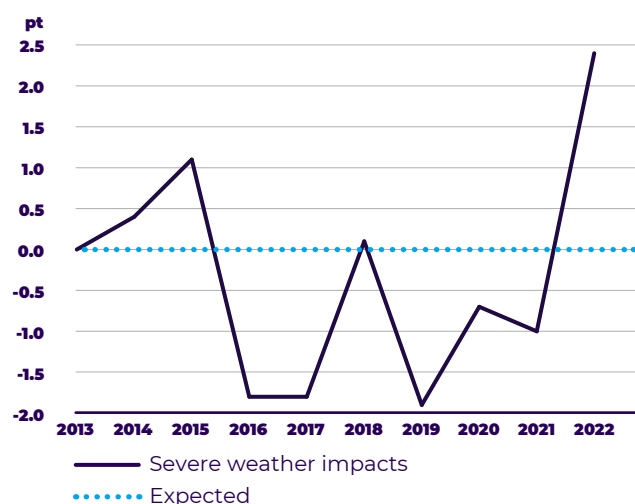
The following graph shows the impact of severe weather events relative to the weather load. In 2022, claims associated with severe weather exceeded our 2022 severe weather assumption, which is set at 100% in the graph.

### Severe weather claims (actual % of expected loss)



Both these graphs reflect the number of major weather events in the year that the Group responded to, including three significant storms in Q1, a rise in subsidence claims from extremely high temperatures in the summer and the December freeze event.

### Impact of severe weather on combined operating ratio<sup>1</sup> (pt)



Prior to 2022 the trends are reflective of relatively benign activity, although there is significant variability as shown in the graph. 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.

Note:

1. The 2022 and 2021 combined operating ratio used is for ongoing operations (see footnote 1 on page 25).

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 the Underwriting function and reviewed quarterly through relevant business forums. The key climate change-related activities are flood, subsidence and other 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.

### Flooding

Governments have been working with insurers since 2000 to help make flood risk insurance more affordable and in 2016 Flood Re was introduced. Every insurer that offers home insurance in the UK, the Group included, must pay into the Flood Re scheme. This levy raises around £135 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.

### Subsidence

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.

### Motor

The Group's motor market is diversified throughout the UK, and although weather-related factors will influence claims frequency it is a relatively small influence compared with other factors, for example used car prices. 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.

**Supplemental guidance for insurance companies**

The supplemental guidance for disclosure recommendations (a) and (b) of the metrics and targets section within the TCFD framework recommends that insurers:

- describe the extent to which their insurance underwriting activities, where relevant, are aligned with a well below 2.0°C scenario; and
- disclose the weighted average carbon intensity or GHG emissions associated with commercial property and specialty lines of business where data and methodologies allow.

The Group does not currently disclose information in relation to the above guidance. Our aim is to explore how we develop alignment to these recommendations in future reporting.

**Operational**

We calculate and report our GHG emissions annually. Our most recent reporting can be found on page 69 where we continue to break out our Scope 1 and Scope 2 emissions into separate performance figures across our office sites and accident repair centres. We also disclose our Scope 3 footprint, with greater clarity of the activities under our direct control, as well as our supply chain and homeworking emissions.

**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 2022, we saw a 70% reduction in energy-related emissions against this baseline; 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 delivered a 56% reduction in energy consumption against this baseline.

With hybrid working well embedded across the business, large numbers of our people continue to work from home regularly which has contributed to a reduction in our Scope 1 and 2 emissions. In recognition of this we have again calculated and reported homeworking emissions under the Scope 3 'Employee Commuting' category (see page 69).



Overall, in 2022, we saw an increase in emissions under our direct control when compared to 2021. This primarily reflects an increase in activities relating to vehicle repair which, in 2021, was less prevalent following the impact of Covid-19 on Motor claims frequency in the first half of the year. This increase was partly offset by a reduction in Scope 1 and 2 emissions in 2022, driven by a reduction in our office footprint and continued investment in energy efficiency measures across our estate. Our GHG emissions reporting can be found on page 69.

From 2023 we will report on progress against our Science-Based Targets which were approved in November 2022 (see below).

**Science-Based Targets**

We are pleased with the success we have made in reducing our Scope 1 and 2 emissions having met the two targets we set in 2013 and now want to enhance our carbon reduction strategy further.

In support of our net zero ambitions, we have set five Science-Based Targets, in line with a 1.5°C pathway, focused on the most carbon intensive areas of our business, one of which covering our operational emissions. These targets were approved by the SBTi in 2022.

Scope	Target
Operational	We target reducing absolute Scope 1 and 2 GHG emissions by 46% by 2030 from a 2019 base year.

More information on these targets, including how we will disclose progress against them can be found on page 66.

**Supply chain**

While we wait for the publication of the Science-Based Net Zero Targets for Financial Institutions from the SBTi, which is expected in 2023, we chose to set an internal emissions reduction target for our supply chain in 2022. This target forms part of our Sustainable Sourcing Approach, where we continue to encourage our largest emitting suppliers to sign up to SBTi targets or an equivalent (see page 66).

Other indicators we monitor and manage across our operational activity include our energy sources and consumption and the waste generated from our office sites. See page 67 for more information.

**Investments**

More than 180 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, we have set Science-Based Targets for our investment portfolio covering corporate bonds, commercial real estate and commercial real estate loans, these were approved by the SBTi in 2022.



## Science-Based Targets

As at the end of 2022 our investment portfolio targets covered 63% of AUM.

Asset Class	Target
Corporate Bonds	Align the Scope 1 and 2 portfolio temperature score by invested value from 2.44°C in 2019 to 2.08°C by 2027.  Align the Scope 1, 2 and 3 portfolio temperature score by invested value from 2.80°C in 2019 to 2.31°C by 2027.
Commercial Real Estate	Reduce GHG emissions by 58% per square metre by 2030 from a 2019 base year.
Commercial Real Estate Loans	Reduce GHG emissions by 58% per square metre by 2030 from a 2019 base year.

More information on these targets, including how we will disclose progress against them can be found on page 66.

The temperature score for corporate bonds is the implied level of warming above pre-industrial levels to which our portfolio is aligned based on the CDP's temperature rating data set. For an individual company the temperature rating is the level of warming to which a company's publicly stated emission reduction targets align. The targets are set on a linear pathway for the portfolio to reach 1.5°C by 2040 as is required by the SBTi.

We aim to achieve our corporate bond target by directing investment to companies with lower temperature scores as these are the ones taking most serious action to reduce emissions. We will also expect our external investment managers to engage with portfolio companies to encourage them to act by setting robust emissions reduction targets. We will also continue to target an interim 50% reduction in weighted average carbon intensity by 2030 from a 2020 base year for corporate bonds in order to ensure emissions are reducing over time.

For commercial real estate, targets were set using the SBTi sectoral decarbonisation approach for real estate which uses the IEA ETP 2017 Beyond 2°C scenario. Emissions for real estate relate to the energy use of buildings which is largely emissions from electricity and heating use. Work towards our real estate targets will require improving the energy efficiency of buildings, engaging with tenants to share energy use data and encouraging them to set their own emissions reduction targets.

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.

## 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 <sub>2</sub> e):	
– from activities for which the Company is responsible	67 and 69
– from buying electricity, heat, steam or cooling by the Group for its own use	67 and 69
Annual global energy consumption in kWh, being the aggregate of:	
– energy consumed from activities for which the Company is responsible	67
– energy consumed resulting from buying electricity, heat, steam or cooling by the Group for its own use	67
The proportion of GHG emissions and energy consumed relating to the UK and offshore area <sup>1</sup>	67 and 69
Methodology used to calculate emissions and energy consumption	70
At least one intensity metric in relation to emissions	70
Description of energy efficiency actions taken	68
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.	



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