CONTENTS

Report on the audit of the financial statements

Opinion

In our opinion:

- the financial statements of Direct Line Insurance Group plc (the "**Parent Company**") and its subsidiaries (together the "**Group**") give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("**IFRSs**") as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board ("**IASB**");
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 101 "Reduced Disclosure Framework" applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

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 41 on the Consolidated financial statements and related notes 1 to 17 on the Parent Company financial statements, excluding the capital adequacy disclosures in note 3 calculated in accordance with the Solvency II regime which are marked as unaudited.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the Parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's ("**FRC**") Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that no non-audit services prohibited by the FRC's Ethical Standard were provided to the Group or the Parent Company.

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

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: – valuation of insurance reserves: 1) The frequency and severity of bodily injury claims; and 2) The inflation and discount rate assumptions for valuing periodic payment orders ("**PPOs**"). – valuation of intangible assets; and – valuation of investments not held at fair value. These key audit matters are consistent with those identified in the prior period audit.
Materiality	The materiality that we used for the Group financial statements was £28 million which approximates 5.2% of three-year average profit before tax.
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 99% of the Group's net assets, 100% of the Group's gross earned premium and 98% of the Group's profit before tax.
Significant changes in our approach	There have been no significant changes in our approach.

Conclusions relating to going concern, principal risk and viability statements

Going concern

We have reviewed the Directors' statement on page 121 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and Parent Company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

We considered as part of our risk assessment the nature of the Group, its business model and related risks including where relevant the impact of Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the Directors' assessment of the Group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the Directors' plans for future actions in relation to their going concern assessment.

Principal risks and viability statement

Based solely on reading the Directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the Directors' assessment of the Group's and Parent Company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

– the disclosures on pages 46 and 47 that describe the principal risks and explain how they are being managed or mitigated;

– the Directors' confirmation on page 75 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity; or

– the Directors' explanation on page 49 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

We are also required to report whether the Directors' statement relating to the prospects of the Group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

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. We do not provide a separate opinion on these matters.

Valuation of insurance reserves

Refer to page 77 (Audit Committee Report), page 138 (Accounting policies) and page 174 (Financial statements).

The Group's insurance reserves total £4.0 billion (2017: £4.2 billion). The determination of the value of the insurance reserves requires significant judgement in the selection of key actuarial methodologies and assumptions. Small changes in these methodologies or assumptions can materially impact the valuation of these liabilities. We have identified the following two key areas of focus for our audit given their significance to the Group's result and the level of judgement involved. Therefore, we have also identified these as potential fraud risk areas.

1) The frequency and severity of large bodily injury claims

Key audit matter description

The insurance reserve valuation for large bodily injury claims has a significant impact on the Group's results, with the ultimate quantum of large bodily injury claims being 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 large claims, and actuarial assumptions being consistent with emerging data, internal processes and market factors. 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.

Furthermore, a key market factor occurring in 2018 was the Civil Liability Act, which came into force on 20 December 2018 after passing Royal Assent. Going forward this Act will result in the Government determining the Ogden discount rate, which is currently minus 0.75%, with reference to 'low risk' rather than 'very low' or 'zero risk' investments. The Government will also now conduct regular rate reviews at least every five years. In response to this legislative change the Group has moved to valuing its lump sum bodily injury reserves using an Ogden discount rate of 0%, rather than minus 0.75%, on the basis that the Civil Liability Act requires the Government to set the discount rate with reference to low risk rather than very low risk investments. The selection of the new rate required significant judgement by management and has resulted in a reduction in the insurance reserves of £55 million.

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 assessed the design and implementation of selected controls, including peer review of actuarial workings and committees where the key assumptions are challenged. 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 their work, we have tested the operating effectiveness of data reconciliations controls and performed reconciliations on the data back to the financial ledger.

Having done this, we worked with those specialists to:

- assess and challenge the methodologies and key assumptions, and their underlying rationale, adopted by the Group, including the potential risk of increased claims inflation caused by Brexit;
- review the estimated impact on reserves of recent paid and incurred claim developments using our in-house reserve software;
- inspect the Group's actuarial models and perform sensitivity testing and peer benchmarking on key assumptions;
- assess management's rationale for adopting a best estimate Ogden discount rate of 0%, and challenge its reasonableness in light of market benchmarking; and
- assess and challenge the methodology of the Group's Ogden sensitivity model.

Key *observations*
We have determined the estimate for the ultimate value of large bodily injury claims to be reasonable. In making this determination we observed that the frequency and severity assumptions used in determining the ultimate value are reasonable, albeit slightly prudent.

2) The inflation and discount rate assumptions for valuing 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 these liabilities totalling £875.9 million (2017: £898.7 million) on a discounted gross basis as detailed in note 2. PPOs are sensitive to the choice of inflation and discount rate used, with small rate changes resulting in material valuation differences. The significant judgement exercised by management in setting the inflation rate of 4% (2017: 4%) and discount rate of 4% (2017: 4%), increases the susceptibility of the balance to material misstatement due to error and fraud.

How the scope of our audit responded to the key audit matter
We have gained a detailed understanding over Management's process for setting these assumptions and assessed the design and implementation of key governance controls surrounding the setting of the PPO inflation rate and discount rate. In addition, we tested the operating effectiveness of a direct and precise business control, performed weekly, over the completeness of the PPO listing; this is a key data input which has a material impact on the PPO assumptions and hence the valuation.

We have worked with our actuarial specialists to:

- review and challenge the Group's PPO inflation assumption through inquiries with the Actuarial Director, reviewing relevant supporting documentation and benchmarking against market economic data, including the potential risk of increased claims inflation caused by Brexit;
- review the Group's sensitivity testing on the PPO inflation assumption;
- review and challenge the selected discount rate with reference to current and future performance of the assets backing the PPO liabilities, taking account of the uncertainty created for investment markets by Brexit; and
- challenge the consistency of the approach with that used in the 2017 year-end valuation and the appropriateness of maintaining that approach in light of the current economic climate and market benchmarking.

Key observations
We have determined that the inflation and discount rate assumptions used in the calculation of the PPO claims reserve are in the middle of a reasonable range. Given the current low yield environment, and the potential for increased risk of claims inflation in certain Brexit scenarios, we determined that these assumptions continue to require close monitoring going forward.

Valuation of intangible assets

Refer to page 77 (Audit Committee Report), page 138 (Accounting policies) and page 166 (Financial statements).

Key audit matter description
We have identified a key audit matter over the valuation of intangible assets totalling £354.1 million (2017: £258.8 million) as detailed in note 17. Our key audit matter specifically addresses those intangible assets relating to strategic projects that aim to improve the customer experience, support growth and increase efficiency across the Group.

Having decided to rework certain elements of the capitalised expenditure, which resulted in an impairment charge of £56.9 million in 2017, the Group has progressed in developing the asset with roll out scheduled to commence in 2019. Whilst this reduces the risk of delivery failure, in comparison to last year's audit, until the assets are complete there continues to be a risk of future impairment charges, with the determination of which requiring a significant level of judgement. As a result of these factors, we continue to identify this as a key audit matter as well as a potential fraud risk.

How the scope of our audit responded to the key audit matter
We assessed the design and implementation of key controls over the impairment of intangible assets. This included senior management review and approval of the impairment review.

In addition, we performed the following audit procedures:

- inquired of system integrators and programme managers, and inspected internal reports, system architecture maps and meeting minutes in order to challenge management on which components of the capital expenditure will ultimately be used in the end-state system;
- engaged our in-house IT consultants to assess the feasibility of the IT architecture in delivering the expected benefits across the Group; and
- challenged management on the reasonableness of the future cash flows for the assets. Whilst performing our work we leveraged our knowledge of the system based on our testing over the components of the capital expenditure.

Key observations
We have determined that the £nil impairment charge is reasonable. Based on the information available to date we deem the feasibility of successful project delivery and the expected benefits thereof to be reasonable.

Valuation of investments not held at fair value

Refer to page 77 (Audit Committee Report), page 139 (Accounting policies) and page 171 (Financial statements).

Key audit matter description
Investments that are not held at fair value are carried at amortised cost and represent a higher credit risk relative to the majority of DLG's investment portfolio. Our work primarily focused on the valuation of the Group's commercial real estate loan, infrastructure debt and private placement bond portfolios. Having recognised a £6 million (2017: £10 million) impairment on a non-performing loan in the year, these investments totalled £592.2 million (2017: £589 million) and represented 12.5% (2017: 11.7%) of the Group's investment portfolio.

The Group satisfies the exemption criteria within IFRS 4 Insurance Contracts and has decided to defer the application of IFRS 9 Financial Instruments until the expected effective date of the new insurance contracts standard IFRS 17 on 1 January 2022. Under IAS 39 Financial Instruments: Recognition and Measurement, management judgement continues to be required in determining if an incurred loss event has occurred and there is significant uncertainty in determining the fair value of the loans in the instance an event has occurred. As a result, we identified the valuation of investments not held at fair value as a key audit matter.

How the scope of our audit responded to the key audit matter
We have assessed the design and implementation and tested the operating effectiveness of the key controls that mitigate the risk over the valuation of investments not held at fair value. 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 audit procedures:

– traced a sample of interest payments to bank during the year to test for default or delinquency in interest payments;
– engaged our in-house complex pricing team to determine an independent fair value of these assets and identify any significant decreases in fair value below book cost;
– assessed the need for impairment on a collective basis through analysing significant macroeconomic and sector specific developments, such as the impact of Brexit on property valuations, as well as the high street decline; and
– challenged management on loans of interest where indicators could point to issuer financial difficulty, obtaining evidence to assess whether the position taken by management is reasonable.

Key observations
We have determined that the £6 million impairment charge arising on non-performing credit assets is reasonable. In performing our procedures, we did not note any other indicators of material impairment.

Our application of 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 (2017: £28.0 million).	£25.2 million (2017: £25.2 million).
Basis for determining materiality	Materiality was determined as approximately 5.2% (2017: 5.2%) of three-year average profit before tax, excluding the impact of the Ogden discount rate change on year-end results.	Materiality equates to less than 1% (2017: 1%) of shareholders' equity and is capped at 90% (2017: 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 we deemed appropriate due to the inherent volatility of profits in the insurance industry. We also elected to exclude the impact of the Ogden discount rate change on the 2016 results and the subsequent move to 0% in 2018 results due to the non-recurring nature of these events. We also considered this measure to be suitable having compared to other benchmarks: our materiality equates to 4.8% (2017: 5.1%) of statutory profit before tax, 0.9% (2017: 0.8%) of gross earned premium and 1.1% (2017: 1.1%) of equity.	We determined that the critical benchmark for the Parent Company was shareholder's equity. This is because the Parent Company is not a trading entity but rather receives 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, UK Insurance Limited, which makes up 100% of Group gross earned premium and 73% of Group statutory profit before tax, is scoped to a component materiality of £25.2 million (2017: £25.2 million).

We determine performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed materiality for the financial statements as a whole. We have set Group performance materiality at £19.6 million (2017: £19.6 million) and the audit testing for UK Insurance Limited is carried out to a performance materiality of £17.6 million (2017: £17.6 million).

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £1.4 million (2017: £1.4 million) for the Group financial statements, 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.

An overview of the scope of our audit

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 the Group level.

Consistent with the prior period, this resulted in two entities being subject to a full scope audit and a further two were subject to an audit of specified account balances where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group's operations. All entities within scope of the Group audit are based in the UK.

These four entities represent the principal trading and service operations of the Group and account for 99% (2017: 99%) of the Group's net assets, 100% (2017: 100%) of the Group's gross earned premium and 98% (2017: 98%) of the Group's profit before tax. They were also selected to provide an appropriate basis for undertaking audit work to address the risks of material misstatement identified above.

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 also performs the audit of the in-scope UK entities.

The Group audit team was responsible for all of the entities listed above, including the Parent Company.

Other information

We have nothing to report in respect of these matters

The Directors are responsible for the other information. The other information comprises the information included in the Annual Report, other than the financial statements and our auditor's report thereon.

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.

In connection with our audit of the financial statements, 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 audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. 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.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

– fair, balanced and understandable – the statement given by the Directors that they consider the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
– Audit Committee reporting – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
– Directors' statement of compliance with the UK Corporate Governance Code – the parts of the Directors' statement required under the Listing Rules relating to the Company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

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.

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.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud, are set out below.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

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, our procedures included the following:

– enquiring of management, internal audit, legal counsel, financial reporting, risk, IT, financial crime and the Audit Committee, including obtaining and reviewing supporting documentation, concerning the Group's policies and procedures relating to:
  a) identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  b) detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
  c) the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations.
– discussing among the engagement team and involving relevant internal specialists, including actuarial, tax, IT, valuations and pension specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the following areas: the valuation of the insurance reserves as well as the valuation of the intangible assets due to the estimates and judgements exercised by management; and
– obtaining an understanding of the legal and regulatory framework that the Group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the Group. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules and tax legislation. In addition, we considered compliance with the terms of the Group's regulatory solvency requirements when assessing the Group's ability to continue as a going concern.

Audit response to risks identified
As a result of performing the above, we identified valuation of insurance reserves and valuation of intangible assets as key audit matters. The key audit matters section of our report explains these matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

Our procedures to respond to risks identified included the following:

– reviewing the financial statement disclosures and testing the supporting documentation to assess compliance with relevant laws and regulations discussed above;
– enquiring of management, the Audit Committee and in-house legal counsel concerning actual and potential litigation and claims;
– performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
– reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with HMRC, PRA and FCA; and
– in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

Opinion 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.

Matters on which we are required to report by exception

Adequacy of explanations 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.

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.

Other matters

Audit tenure

Following the recommendation of the Audit Committee, we were appointed by the Board of Directors of the Royal Bank of Scotland Group plc 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 19 years, covering the years ending 31 December 2000 to 31 December 2018.

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).

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 full extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

COLIN RAWLINGS FCA (SENIOR STATUTORY AUDITOR)
for and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom

4 March 2019

CONSOLIDATED INCOME STATEMENT
For the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Gross earned premium	5	3,306.7	3,339.7
Reinsurance premium	5	(217.2)	(204.7)
Net earned premium	5	3,089.5	3,135.0
Investment return	6	154.6	175.4
Instalment income		119.9	116.4
Other operating income	7	72.1	62.9
Total income		3,436.1	3,489.7
Insurance claims	8	(1,966.9)	(1,571.1)
Insurance claims recoverable from / (payable to) reinsurers	8	55.1	(183.1)
Net insurance claims	8	(1,911.8)	(1,754.2)
Commission expenses	9	(200.4)	(286.4)
Operating expenses	10	(722.2)	(806.3)
Total expenses		(922.6)	(1,092.7)
Operating profit		601.7	642.8
Finance costs	11	(19.1)	(103.8)
Profit before tax		582.6	539.0
Tax charge	12	(108.9)	(105.0)
Profit for the year attributable to owners of the Company		473.7	434.0
Earnings per share:			
Basic (pence)	15	33.5	31.8
Diluted (pence)	15	33.1	31.5

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Profit for the year		473.7	434.0
Other comprehensive income			
Items that will not be reclassified subsequently to the income statement:			
Actuarial gain on defined benefit pension scheme	25	2.7	2.1
Tax relating to item that will not be reclassified	13	(0.4)	(0.4)
		2.3	1.7
Items that may be reclassified subsequently to the income statement:			
Cash flow hedges		0.5	(1.1)
Fair value (loss) / gain on AFS investments	30	(121.4)	8.8
Less: realised net gains on AFS investments included in income statement	30	(19.5)	(23.2)
Tax relating to items that may be reclassified	30	23.9	2.5
		(116.5)	(13.0)
Other comprehensive loss for the year net of tax		(114.2)	(11.3)
Total comprehensive income for the year attributable to owners of the Company		359.5	422.7

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET
As at 31 December 2018

	Notes	2018 £m	2017 £m
Assets			
Goodwill and other intangible assets	17	**566.8**	471.1
Property, plant and equipment	18	**156.2**	174.4
Investment property	19	**322.1**	309.3
Reinsurance assets	21	**1,208.7**	1,178.5
Current tax assets	13	**–**	0.1
Deferred acquisition costs	22	**171.0**	185.4
Insurance and other receivables	23	**875.9**	981.2
Prepayments, accrued income and other assets		**128.0**	146.2
Derivative financial instruments	24	**48.2**	84.4
Retirement benefit asset	25	**17.0**	14.4
Financial investments	26	**4,737.8**	5,040.4
Cash and cash equivalents	27	**1,154.4**	1,358.6
Assets held for sale	28	**–**	4.2
Total assets		**9,386.1**	9,948.2
Equity			
Shareholders' equity		**2,573.1**	2,715.1
Tier 1 notes	31	**346.5**	346.5
Total equity		**2,919.6**	3,061.6
Liabilities			
Subordinated liabilities	32	**259.5**	264.7
Insurance liabilities	33	**4,005.9**	4,225.7
Unearned premium reserve	34	**1,505.5**	1,600.3
Borrowings	27	**62.0**	54.1
Derivative financial instruments	24	**25.9**	12.0
Trade and other payables, including insurance payables	36	**554.1**	658.0
Deferred tax liabilities	13	**7.6**	31.1
Current tax liabilities	13	**46.0**	40.7
Total liabilities		**6,466.5**	6,886.6
Total equity and liabilities		**9,386.1**	9,948.2

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 4 March 2019. They were signed on its behalf by:

PENNY JAMES
CHIEF FINANCIAL OFFICER

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

	Share capital (note 29) £m	Employee trust shares £m	Capital reserves (note 30) £m	AFS revaluation reserve (note 30) £m	Foreign exchange translation reserve £m	Retained earnings £m	Shareholders' equity £m	Tier 1 notes (note 31) £m	Total equity £m
Balance at 1 January 2017	150.0	(34.3)	1,450.0	92.1	1.4	862.3	2,521.5	–	2,521.5
Profit for the year	–	–	–	–	–	434.0	434.0	–	434.0
Other comprehensive loss	–	–	–	(11.9)	(1.1)	1.7	(11.3)	–	(11.3)
Dividends paid (note 14)	–	–	–	–	–	(225.3)	(225.3)	–	(225.3)
Shares acquired by employee trusts	–	(19.6)	–	–	–	–	(19.6)	–	(19.6)
Credit to equity for equity-settled share-based payments (note 35)	–	–	–	–	–	14.8	14.8	–	14.8
Shares distributed by employee trusts	–	19.8	–	–	–	(19.8)	–	–	–
Tax on share-based payments	–	–	–	–	–	1.0	1.0	–	1.0
Issue of Tier 1 notes	–	–	–	–	–	–	–	346.5	346.5
Balance at 31 December 2017	150.0	(34.1)	1,450.0	80.2	0.3	1,068.7	2,715.1	346.5	3,061.6
Profit for the year	**–**	**–**	**–**	**–**	**–**	**473.7**	**473.7**	**–**	**473.7**
Other comprehensive loss	**–**	**–**	**–**	**(117.0)**	**0.5**	**2.3**	**(114.2)**	**–**	**(114.2)**
Dividends and appropriations paid (note 14)	**–**	**–**	**–**	**–**	**–**	**(503.8)**	**(503.8)**	**–**	**(503.8)**
Shares acquired by employee trusts	**–**	**(19.5)**	**–**	**–**	**–**	**–**	**(19.5)**	**–**	**(19.5)**
Credit to equity for equity-settled share-based payments (note 35)	**–**	**–**	**–**	**–**	**–**	**21.0**	**21.0**	**–**	**21.0**
Shares distributed by employee trusts	**–**	**18.4**	**–**	**–**	**–**	**(18.4)**	**–**	**–**	**–**
Tax on share-based payments	**–**	**–**	**–**	**–**	**–**	**0.8**	**0.8**	**–**	**0.8**
Balance at 31 December 2018	**150.0**	**(35.2)**	**1,450.0**	**(36.8)**	**0.8**	**1,044.3**	**2,573.1**	**346.5**	**2,919.6**

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Net cash generated from operating activities before investment of insurance assets	37	4.2	204.0
Cash generated from investment of insurance assets	37	468.1	341.9
Net cash generated from operating activities		472.3	545.9
Cash flows used in investing activities			
Purchases of property, plant and equipment	18	(13.3)	(22.4)
Purchases of goodwill and other intangible assets	17	(142.4)	(73.2)
Proceeds on disposals of assets held for sale		13.8	–
Proceeds on disposal of property, plant and equipment		0.1	0.3
Net cash used in investing activities		(141.8)	(95.3)
Cash flows used in financing activities			
Net proceeds from issue of Tier 1 notes	31	–	346.5
Repayment of subordinated liabilities		–	(326.8)
Dividends and appropriations paid	14	(503.8)	(225.3)
Finance costs		(19.3)	(31.7)
Purchase of employee trust shares		(19.5)	(19.6)
Net cash used in financing activities		(542.6)	(256.9)
Net (decrease) / increase in cash and cash equivalents		(212.1)	193.7
Cash and cash equivalents at the beginning of the year	27	1,304.5	1,110.8
Cash and cash equivalents at the end of the year	27	1,092.4	1,304.5

The attached notes on pages 136 to 181 form an integral part of these consolidated financial statements.

Corporate information

Direct Line Insurance Group plc is a public limited company registered in England and Wales (company number 02280426). The address of the registered office is Churchill Court, Westmoreland Road, Bromley, BR1 1DP, England.

1. Accounting policies

Basis of preparation

As required by the Companies Act 2006 and Article 4 of the EU IAS Regulation, the consolidated financial statements are prepared in accordance with IFRSs issued by the IASB as adopted by the EU. The Company's financial statements have been prepared in accordance with and in full compliance with IFRSs as issued by the IASB. The Company 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 40).

The Company's financial statements and the consolidated financial statements are presented in sterling, which is the functional currency of the Company.

Adoption of new and revised standards

The Group has adopted the following new amendments to IFRSs and International Accountings Standards ("**IASs**") that became mandatorily effective for the Group for the first time during 2018 however these had no material impact on the consolidated financial statements or performance.

IFRS 15 'Revenue from Contracts with Customers' introduces new recognition and disclosure requirements. Entities are required to recognise revenue as goods and services are transferred to the customer in proportion to the total consideration it expects to receive in exchange for those services. The Group has adopted the standard on a fully retrospective basis. This has not had a material impact on the consolidated financial statements.

Insurance contracts are out of scope of IFRS 15.

Amendments to IFRS 4: 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' was issued on 12 September 2016 and endorsed by the EU on 3 November 2017. These amendments permitted insurers who satisfied certain criteria to defer the effective date of IFRS 9 'Financial Instruments', to coincide with the expected effective date of IFRS 17 'Insurance Contracts', to 1 January 2022. The IASB permitted this option having considered potential asset and liability mismatching and temporary profit and loss volatility caused by introducing these new standards in different periods within a short period of time.

When first published, Amendments to IFRS 4 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 that the carrying value of its liabilities connected to insurance was greater than 90% of the carrying value of its total liabilities at 31 December 2015. In making this conclusion, the Group determined that the subordinated debt of £521.1 million and derivative liabilities of £46.4 million represented liabilities connected with insurance but not liabilities arising from contracts within the scope of IFRS 4. There have been no significant changes in the Group's activities since this assessment to require a reassessment of the criteria.

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 40. The amount of change in the fair value during the period for these financial assets was: AFS debt securities £103.7 million decrease, held-to-maturity ("**HTM**") debt securities £3.2 million decrease, infrastructure debt £18.2 million decrease and commercial real estate loans had a small increase.

Derivative assets do not have contractual terms that give rise on specified dates to cash flows that are solely payment of principal and interest on the principal amount outstanding. The fair value of these financial assets is disclosed in note 40 and the amount of change in the fair value during the period was £26.7 million.

In note 3.3.3 the Group has disclosed the carrying amount of financial assets at the end of the reporting period by credit risk rating grade, as defined in IFRS 7 'Financial Instruments: Disclosures'. The fair value and the carrying amount of financial assets that meet the solely payments of principal and interest criteria and, at the end of the reporting period do not have a low credit risk, was £393.9 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. This information will be available from Companies House once the individual financial statements have been approved and filed with Companies House.

The IASB amended IFRS 2 'Share-based Payment' to provide further clarity on: the effects of vesting conditions on the measurement of cash-settled share-based payment transactions; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash-settled to equity-settled.

The Group operates equity-settled share-based schemes only and has no obligation to withhold tax in respect of the employee's personal tax liability. These amendments have no impact on the Group's share-based payments accounting policy.

A number of further narrow scope amendments which became effective for the Group but do not have an impact on existing accounting policies, are as follows:

The IASB amended IAS 40 'Investment Property' to clarify when an entity should categorise a property as an investment property. Property should be transferred to or from investment property when there is evidence of a change in use meaning the property now satisfies, or ceases to satisfy, the definition of an investment property.

IFRIC 22 'Foreign Currency Transactions and Advance Consideration' clarifies how to determine the date of the transaction for the exchange rate to be used on the initial recognition where an entity pays or receives consideration in advance for foreign currency denominated contracts.

Annual Improvements to IFRS Standards 2014–2016 Cycle relating to IFRS 1 'First-time Adoption of International Financial Reporting Standards' – the amendment deletes certain short-term exemptions for first-time adopters, and IAS 28 'Investments in Associates and Joint Ventures' – the amendment provides clarification that measuring investees at fair value through profit or loss is an investment-by-investment choice.

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 2018 and 31 December 2017. 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 if the Group controls another entity, the existence and effect of the potential voting rights that are currently exercisable or convertible are considered.

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 2018 and 31 December 2017 to items considered material to the consolidated financial statements.

A subsidiary acquired is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated financial statements at fair value.

All intercompany transactions, balances, income and expenses between Group entities are eliminated on consolidation.

1.2 Foreign currencies

The Group's consolidated financial statements are presented in sterling which is the presentational currency of the Group. Group entities record transactions in the currency of the primary economic environment in which they operate (their functional currency), translated at the foreign exchange rate ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in the income statement.

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in the income statement except for differences arising on AFS non-monetary financial assets, which are recognised in other comprehensive income.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at the foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in the consolidated statement of comprehensive income. The amount accumulated in equity is reclassified from equity to the consolidated income statement on disposal or partial disposal of a foreign operation.

1.3 Contract classification

Insurance contracts are those contracts where the Group (the insurer) has accepted significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished.

1.4 Revenue recognition

Premiums earned

Insurance and reinsurance premiums comprise the total premiums receivable for the whole period of cover provided by contracts incepted during the financial year, adjusted by an unearned premium provision, which represents the proportion of the premiums incepted in the year or prior periods that relate to periods of insurance cover after the balance sheet date. Unearned premiums are calculated over the period of exposure under the policy, on a daily basis, 24ths basis or allowing for the estimated incidence of exposure under policies.

Premiums collected by intermediaries or other parties, but not yet received, are assessed based on estimates from underwriting or past experience and are included in insurance premiums. Insurance premiums exclude insurance premium tax or equivalent local taxes and are shown gross of any commission payable to intermediaries or other parties.

Cash back payments to policyholders under motor telematics policies represent a reduction in earned premiums.

Investment return

Interest income on financial assets is determined using the effective interest rate method. The effective interest rate method is a way of calculating the amortised cost of a financial asset (or group of financial assets) and of allocating the interest income over the expected life of the asset.

Rental income from investment property is recognised in the income statement on a straight-line basis over the period of the contract. Any gains or losses arising from a change in fair value are recognised in the income statement.

Instalment income

Instalment income comprises the interest income earned on policyholder receivables, where outstanding premiums are settled by a series of instalment payments. Interest is earned using an effective interest rate method over the term of the policy.

Other operating income

Vehicle replacement referral income

Vehicle replacement referral income comprises fees recognised at a point in time in respect of referral income received when a customer or a non-fault policyholder (claimant) of another insurer has been provided with a hire vehicle from a preferred supplier.

Income is recognised when the customer or claimant has been provided with a vehicle by the supplier.

Revenue from vehicle recovery and repair services

Fees in respect of services for vehicle recovery are recognised at a point in time on satisfaction of performance obligations. The cost of providing the service is incurred as the service is rendered.

1.4 Revenue recognition continued

The Group's income also comprises vehicle repair services provided to other third-party customers. Income in respect of repairs to vehicles is recognised upon completion of the repair obligations. The price is determined using market rates for the services and materials used after discounts have been deducted where applicable.

Legal services income

Legal services income represents the amount charged to clients for professional services provided during the year including recovery of expenses but excluding value added tax. Income relating to variable legal services fees is recognised on a best estimate basis.

Other income

Commission fee income in respect of services is recognised at a point in time on satisfaction of related performance obligations. Where fees have a variable element, income is recognised on a best estimate of the total consideration expected. 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 are wholly or partly to take the form of PPOs. These are covered in more detail in note 2.4. Costs for both direct and indirect claims handling expenses are also included.

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the incidence, timing and amount of claims and any specific factors such as adverse weather conditions. When calculating the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable probability parameters, the value of outstanding claims (gross and net) at the balance sheet date. Also included in the estimation of outstanding claims are factors such as the potential for judicial or legislative inflation.

Provisions for more recent claims make use of techniques that incorporate expected loss ratios and average claims cost (adjusted for inflation) and frequency methods. As claims mature, the provisions are increasingly driven by methods based on actual claims experience. The approach adopted takes into account the nature, type and significance of the business and the type of data available, with large claims generally being assessed separately. The data used for statistical modelling purposes is generated internally and reconciled to the accounting data.

The calculation is particularly sensitive to the estimation of the ultimate cost of claims for the particular classes of business at gross and net levels and the estimation of future claims handling costs. Actual claims experience may differ from the historical pattern on which the actuarial best estimate is based and the cost of settling individual claims may exceed that assumed. As a result, the Group sets provisions at a margin above the actuarial best estimate. This amount is recorded within claims provisions.

A liability adequacy provision is made for unexpired risks arising where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premium reserve in relation to such policies after the deduction of any acquisition costs deferred and other prepaid amounts (for example, reinsurance). The expected value is determined by reference to recent experience and allowing for changes to the premium rates. The provision for unexpired risks is calculated separately by reference to classes of business that are managed together after taking account of relevant investment returns.

1.6 Reinsurance

The Group has reinsurance treaties and other reinsurance contracts that transfer significant insurance risk.

The Group cedes insurance risk by reinsurance in the normal course of business, with the arrangement and retention limits varying by product line. Outward reinsurance premiums are generally accounted for in the same accounting period as the premiums for the related direct business being reinsured. Outward reinsurance recoveries are accounted for in the same accounting period as the direct claims to which they relate.

Reinsurance assets include balances due from reinsurance companies for ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a consistent manner with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract. Recoveries in respect of PPOs are discounted for the time value of money.

A reinsurance bad debt provision is assessed in respect of reinsurance debtors, to allow for the risk that the reinsurance asset may not be collected or where the reinsurer's credit rating has been downgraded significantly and this is taken as an indication of a reinsurer's difficulty in meeting its obligations under the reinsurance contracts. This also includes an assessment in respect of the ceded part of claims provisions to reflect the counterparty default risk exposure to long-term reinsurance assets particularly in relation to PPOs. Increases in this provision affect the Group by reducing the carrying value of the asset and the impairment loss is recognised in the income statement.

1.7 Deferred acquisition costs

Acquisition costs relating to new and renewing insurance policies are matched with the earning of the premiums to which they relate. A proportion of acquisition costs incurred during the year is therefore deferred to the subsequent accounting period to match the extent to which premiums written during the year are unearned at the balance sheet date.

The principal acquisition costs deferred are direct advertising expenditure, directly attributable administration costs, commission paid and costs associated with telesales and underwriting staff.

1.8 Goodwill and other intangible assets

Acquired goodwill, being the excess of the cost of an acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary, associate or joint venture acquired, is initially recognised at cost and subsequently at cost less any accumulated impairment losses. Goodwill arising on the acquisition of subsidiaries, associates and joint ventures is included in the balance sheet category 'goodwill and other intangible assets'. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the income statement over the assets' economic lives using methods that best reflect the pattern of economic benefits and is included in operating expenses. The estimated useful economic lives are as follows:

Software development costs	Up to 10 years

Expenditure on internally generated goodwill and brands 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 – note 1.11) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to the income statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Land is not depreciated. Estimated useful lives are as follows:

Freehold and 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 Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value based on valuations by independent registered valuers. Fair value is based on current prices for similar properties adjusted for the specific characteristics of each property. Any gain or loss arising from a change in fair value is recognised in the income statement.

Investment property is derecognised when it has been either disposed of or permanently withdrawn from use and no future economic benefit is expected from disposal. Any gains or losses on the retirement or disposal of investment property are recognised in the income statement in the year of retirement or disposal.

1.12 Financial assets

Financial assets are classified as AFS, HTM 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

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.

1.12 Financial assets continued

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.

Held-to-maturity

Non-derivative financial assets not designated as AFS or loans and receivables with fixed or determinable payments and fixed maturity where the intention and ability to hold them to maturity exists are classified as HTM.

Subsequent to initial recognition, HTM financial assets are measured at amortised cost using the effective interest rate method less any impairment losses.

Loans and receivables

Non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as AFS or HTM. Loans and receivables are initially recognised at fair value plus directly related transaction costs and are subsequently measured at amortised cost using the effective interest rate method less any impairment losses.

Impairment of financial assets

At each balance sheet date, the Group assesses whether there is any objective evidence that a financial asset or group of financial assets classified as AFS, HTM or loans and receivables is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Available-for-sale

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.

Held-to-maturity and loans and receivables

If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as HTM or loans and receivables has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets, discounted at the effective interest rate of the instrument at initial recognition.

Impairment losses are assessed individually where significant or collectively for assets that are not individually significant.

Impairment losses are recognised in the income statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for the impairment losses. If in a subsequent period the amount of the impairment loss reduces, and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance.

Insurance receivables

Insurance receivables comprise outstanding insurance premiums where the policyholders have elected to pay in instalments or amounts due from third parties where they have collected or are due to collect the money from the policyholder.

Receivables also include amounts due in respect of the provision of legal services.

For amounts due from policyholders, the bad debt provision is calculated based upon prior loss experience. For all balances outstanding in excess of three months, a bad debt provision is made. Where a policy is subsequently cancelled, the outstanding debt that is overdue is charged to the income statement and the bad debt provision is released back to the income statement.

Derivatives and hedging

Derivative financial instruments are recognised initially, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models.

Gains and losses arising from changes in the fair value of a derivative are recognised as they arise in the income statement unless the derivative is the hedging instrument in a qualifying hedge. The Group enters into fair value hedge relationships and a small amount of cash flow hedges.

Hedge relationships are formally documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in cash flows and fair values attributable to the hedged risk, consistent with the documented risk management strategy, or if the hedging instrument expires or is sold, terminated or exercised, hedge accounting is discontinued.

In a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised directly in equity. Any ineffective portion is recognised in the income statement.

In a fair value hedge, the gain or loss on the hedging instrument is recognised in the income statement. The gain or loss on the hedged item attributable to the hedged risk is recognised in the income statement and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item.

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.

1.13 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.

1.14 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.

1.15 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.

1.16 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. In respect of leasehold properties, a provision is recognised when the Group has a detailed formal plan to vacate the leasehold property, or significantly reduce its level of occupancy, the plan has been communicated to those affected and the future property costs under the lease exceed future economic benefits.

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.

1.17 Leases
Payments made under operating leases are charged to the income statement on a straight-line basis over the term of the lease.

1.18 Pensions and other post-retirement benefits
The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

Contributions to the Group's defined contribution pension scheme are recognised in the income statement when payable.

The Group's defined benefit pension scheme, as described in note 25, 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 net pension liability or asset, is charged or credited to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside the income statement and presented in other comprehensive income under 'Items that will not be reclassified subsequently to the income statement'.

1.19 Taxation
The tax charge or credit represents the proportion of the tax payable and receivable arising in the current year only.

The current tax charge is based on the taxable profits for the year as determined in accordance with the relevant tax legislation, after any adjustments in respect of prior years. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Provision for taxation is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date and is allocated over profits before taxation and 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.

1.20 Share-based payment
The Group operates a number of share-based compensation plans under which it awards Ordinary Shares and share options to its employees. Such awards are generally subject to vesting conditions that vary 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).

1.20 Share-based payment continued
The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility.

The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of the Company's Ordinary Shares).

The cost is expensed on a straight-line basis over the vesting period (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest.

The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

1.21 Capital instruments
The Group classifies a financial instrument that it issues as a financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms, or as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities.

The Tier 1 notes are classified as equity as they have a perpetual maturity and the Group has full discretion over interest payments, including ability to defer or cancel interest payments indefinitely.

The consideration for any Ordinary Share of the Company purchased by the Group for the benefit of the employee trusts is deducted from equity.

1.22 Dividends
Interim dividends on Ordinary Shares are recognised in equity in the period in which they are paid. Final dividends on Ordinary Shares are recognised when they have been approved at the AGM.

1.23 Accounting developments
New IFRSs and amendments that are issued, but not yet effective for the 31 December 2018 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 IFRS 9 as explained below.

The IASB issued IFRS 16 'Leases' in January 2016 to replace IAS 17 'Leases' and will be effective for reporting periods beginning on or after 1 January 2019, applied by the Group fully retrospectively from this date. IFRS 16 sets out the principles for recognition, measurement and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. There are two exemptions: for leases of a low value and for leases of a short-term nature of 12 months or less. At the start of the lease a lessee will recognise a liability for the lease payments and an asset, representing the right to use the asset during the lease term. Lessees will be required to separately recognise the interest on the lease liability and the depreciation expense on the right-of-use asset. Lessor accounting under IFRS 16 is substantially unchanged from the current approach under IAS 17.

The Group expects to recognise right-of-use assets of approximately £150.0 million on 1 January 2019 and lease liabilities of approximately £165.0 million. The reduction to equity after tax is approximately £15.0 million. From 1 January 2019 lease charges previously recognised as rental expenses in profit or loss will instead comprise depreciation and finance costs. The profit or loss impact, had this standard been adopted on 1 January 2018, would have been a reduction in operating expenses of approximately £5 million and an increase in finance costs of approximately £7 million in the 2018 consolidated income statement.

The actual impacts may differ from the amounts presented above when the Group presents its first financial statements from the initial date of application.

In July 2014, the IASB issued the final version of IFRS 9 which replaces IAS 39 'Financial Instruments: Recognition and Measurement' and all previous versions of IFRS 9; it was endorsed by the EU in 2016. IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets; it is effective for annual periods beginning on or after 1 January 2018.

In September 2016, the IASB issued amendments to IFRS 4 to address issues arising from the different effective dates of IFRS 9 and IFRS 17. The amendments to IFRS 4 were endorsed by the EU in November 2017.

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 Group satisfies the exemption criteria within IFRS 4 and has decided to defer the application of IFRS 9 until the expected effective date of the new insurance contracts standard IFRS 17, on 1 January 2022, applying the temporary exemption from applying IFRS 9 as introduced by the amendments to IFRS 4.

Amendments to IFRS 9: 'Prepayment Features with Negative Compensation' was issued in October 2017 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 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 and is expected to be effective for reporting periods beginning on or after 1 January 2022, with comparative figures required. IFRS 17 is a comprehensive new accounting standard for all insurance contracts covering recognition and measurement, presentation and disclosure. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers and to replace the requirements of IFRS 4 that allowed insurers to apply grandfathering of previous local accounting policies.

The core of IFRS 17 is the general model, supplemented by an optional simplified premium allocation approach which is permitted for the liability for the remaining coverage for short duration contracts (one year or less). The general model measures insurance contracts using the building blocks of:

discounted probability weighted cash flows; an explicit risk adjustment; and a contractual service margin representing the unearned profit of the contract which is recognised as revenue over the coverage period.

An assessment on the impact of IFRS 17 on the Group's financial statements is in progress. The Group expects to be able to apply the simplified premium allocation approach to most of its insurance and reinsurance contracts.

The following accounting developments are not expected to have a material impact on the Group's financial statements in future periods:

Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures was issued in October 2017 to clarify that an entity applies IFRS 9 to long-term interests in associates or joint ventures that form part of the net investment in the associate or joint venture but to which the equity method is not applied. The amendments are effective from 1 January 2019.

IFRIC 23 'Uncertainty over Income Tax Treatments' was issued in June 2017 and provides interpretation when there is uncertainty over income tax treatments under IAS 12 'Income Taxes'. This is effective from 1 January 2019.

Amendments to IAS 19 'Employee Benefits': Plan Amendment, Curtailment or Settlement was issued in February 2018. The amendments clarify the accounting when a plan amendment, curtailment or settlement occurs. This is effective from 1 January 2019.

In December 2017 the IASB issued 'Annual Improvements to IFRS Standards 2015-2017 Cycle' with an effective date of 1 January 2019, which included the following three amendments:

IFRS 3 'Business Combinations' and IFRS 11 'Joint Arrangements' – the amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business; the amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.

IAS 12 'Income Taxes' – the amendments clarify that all income tax consequences of dividends should be recognised in profit or loss, regardless of how the tax arises.

IAS 23 'Borrowing Costs'– the amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.

In March 2018 the IASB issued 'Amendments to References to the Conceptual Framework in IFRS Standards' – amending some references to previous versions of the *Conceptual Framework* in IFRS Standards and their accompanying documents and IFRS Practice Statements. This is effective from 1 January 2020.

In October 2018 the IASB issued 'Amendments to IFRS 3 Business Combinations' – this will permit a simplified assessment of whether an acquired set of activities and assets is a group of assets rather than a business. This is effective from 1 January 2020.

In October 2018 the IASB issued 'Amendments to IAS 1 and IAS 8 Definition of Material' – this clarifies and aligns the definition of 'material' and provides guidance to help improve consistency in the application of that concept whenever it is used in IFRS Standards. This is effective from 1 January 2020.

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 underline the preparation of its financial information. The Group's principal accounting policies are set out on pages 136 to 143. 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 and prudent.

In the absence of an applicable standard or interpretation, IAS 8 'Accounting policies, Changes in Accounting Estimates and Errors' requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of Financial Statements. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below.

2.1 Impairment provisions – financial assets

The Group makes a judgement that financial assets are impaired when there is objective evidence that an event or events since initial recognition of the assets have adversely affected the amount or timing of future cash flows from the asset. The determination of 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 and operational and financing cash flow or 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

– an event has occurred that could be reliably estimated and which had an impact on the financial asset or its future cash flows.

The Group has made a judgement that there was objective evidence of impairment of an asset within the loan and receivables portfolio in the year ended 31 December 2018. The Group has also made an estimation of the recoverable value of the loan and this resulted in an impairment charge of £6.0 million (2017: £9.5 million).

Had all the declines in AFS asset values met the criteria above at 31 December 2018, the Group would suffer a loss of £21.0 million (2017: £6.5 million), being the transfer of the total AFS reserve for unrealised losses to the income statement. These movements represent mark-to-market movements and where there is no objective evidence of any loss events that could affect future cash flows, no impairments have therefore been recorded for these movements.

2.2 Fair value

The Group has made the judgement that level 1 of the Group's fair value hierarchy set out in note 40 will include only sovereign debt securities issued by members of the G10 group of countries within the Group's AFS debt securities portfolio, with all other financial assets and liabilities carried at fair value included in level 2 as they are not considered to be quoted in a deeply liquid market.

The Group has also made the judgement that investment properties, most of the HTM debt securities, commercial real estate loans and infrastructure debt fall within level 3 of the Group's fair value hierarchy (note 40) as the valuation models used are driven predominantly by unobservable inputs: investment property valuations are derived from recent market transactions which are adjusted for specific characteristics of each property including the size, location and condition by reference to the benchmark property transactions.

2.3 Goodwill and other intangible assets

Goodwill impairment testing inherently involves estimation uncertainty in a number of areas including: the preparation of the five-year strategic plan and the extrapolation of cash flow forecasts beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the CGUs; estimation of market values of CGUs; and the valuation of the separable assets of each business whose goodwill is being reviewed. Details of a sensitivity analysis on the recoverable amount in excess of carrying value are shown in note 17.

Judgement is applied to determine whether intangible assets are impaired. In making this judgement, the Group considers: the projection of the economic benefits associated with each asset; subsequent re-measurement of these benefits through the development cycle and into use; the projected ultimate cost of each asset at each point through the development cycle due to specification changes; and the likelihood of obsolescence of any component parts. Details of intangible assets are shown in note 17.

2.4 General insurance: outstanding claims provisions and related reinsurance recoveries

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling costs. Outstanding claims provisions net of related reinsurance recoveries at 31 December 2018 amounted to £2,900.7 million (2017: £3,144.5 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 corresponding reinsurance recoveries and impairment provision are calculated on an equivalent basis, with similar estimation uncertainty, as discussed in note 1.6. The reinsurance bad debt provision is mainly for expected recoveries against future PPO payments.

The most common method of settling bodily injury claims is by a lump sum paid to the claimant and, in the cases where this includes an element of indemnity for recurring costs such as loss of earnings or ongoing medical care, settlement calculations have reference to a standardised annuity factor at a discount rate normally referenced to as the Ogden discount rate. The Ogden discount rate was at 2.5% from 2001 until 2017, when it was changed to minus 0.75% based on a 3-year average of yields on index-linked Government securities, in line with case law that claimants were entitled to invest their lump sum in a way which was very low or even zero risk. The Civil Liability Act 2018 changes this approach and instead requires the Government to reset the Ogden discount rate by reference to low risk rather than very low or zero risk investments. The process is due to conclude in 2019, but there is considerable uncertainty about its outcome and the date from which a new rate will apply.

The Group will continue to exercise judgement around the Ogden discount rate used in its reserves. Risks and uncertainties here are significant but the move to introduce additional asset classes into the assumed claimant portfolio points towards a higher rate than minus 0.75%. The Group has therefore made a judgement that it is likely that the Ogden discount rate will change and has selected an estimate of 0% to value its lump sum bodily injury reserves. An allowance for further movements in the Ogden discount rate is made within the Group's solvency II balance sheet and capital requirements. Details of the IFRS sensitivity analysis to the assumed 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 table below analyses the outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2018 and 31 December 2017. These represent the total cost of PPOs rather than any costs in excess of purely Ogden-based settlements.

At 31 December	Discounted 2018 £m	Undiscounted 2018 £m	Discounted 2017 £m	Undiscounted 2017 £m
Gross claims				
Approved PPO claims provisions	516.2	1,424.5	524.9	1,460.3
Anticipated PPOs	358.1	943.9	373.8	974.7
Total	874.3	2,368.4	898.7	2,435.0
Reinsurance				
Approved PPO claims provisions	(268.6)	(784.5)	(276.5)	(806.8)
Anticipated PPOs	(245.2)	(701.1)	(240.4)	(680.7)
Total	(513.8)	(1,485.6)	(516.9)	(1,487.5)
Net of reinsurance				
Approved PPO claims provisions	247.6	640.0	248.4	653.5
Anticipated PPOs	112.9	242.8	133.4	294.0
Total	360.5	882.8	381.8	947.5

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 made a judgement on 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. They do not allow for any future changes in PPO propensity. Anticipated PPOs consist of both existing large loss case reserves including allowances for development and claims yet to be reported to the Group. Reinsurance is applied at claim level and the net cash flows are discounted for the time value of money. The discount rate is consistent with the long duration of the claims payments and the assumed future indexation of the claims payments.

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 4% (2017: 4%). The Group has estimated a rate of interest used for the calculation of present values as 4% (2017: 4%), which results in a real discount rate of 0% (2017: 0%). The Group will continue to exercise judgement around the inflation and discount rates used to calculate these insurance reserves.

Details of sensitivity analysis to the discount rate applied to PPO claims are shown in note 3.3.1.

3. Risk management

3.1 Enterprise Risk Management Strategy and Framework

The Enterprise Risk Management Strategy and Framework sets out, at a high level, our approach and processes for managing risks. Further information can be found in the risk management section of the strategic report on page 45.

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

There is considerable uncertainty as to the effect of Brexit on the Group and we have proactively considered a variety of possible implications of a disruptive 'hard' Brexit, including of a financial and operational nature; these are referred to in the risk management section of the strategic report.

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.

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 change in the Ogden discount rate announced on 27 February 2017. This is the discount rate set by the Lord Chancellor and used by courts to calculate lump sum awards in bodily injury cases. The rate had been 2.5% since 2001 but was changed to minus 0.75% from 20 March 2017. The Group revised its reserve estimation to be based on the new rate for year ended 31 December 2016. However, this rate is expected to change again in 2019 following the passing of the Civil Liability Act 2018. In anticipation of change, the Group has revalued its reserves based on an assumed Ogden discount rate of 0% for the year ended 31 December 2018. The new Ogden discount rate may differ from this assumption, and consequently further reserve revaluation may be required, both in 2019 and going forwards as part of the new Ogden discount rate review process introduced by the Civil Liability Act.

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 (discount rate used for PPOs and separately the Ogden discount rate) with all other assumptions left unchanged. Other potential risks beyond the ones described could have an additional financial impact on the Group.

	Increase / (decrease) in profit before tax[1,2]	
At 31 December	2018 £m	2017 £m
PPOs[3]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	50.7	54.6
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(70.1)	(75.1)
Ogden discount rate[4]		
Impact of the Group reserving at a discount rate of 1% compared to 0% (2017: 0% compared to minus 0.75%)	56.2	68.4
Impact of the Group reserving at a discount rate of minus 1% compared to 0% (2017: minus 1.5% compared to minus 0.75%)	(76.3)	(102.9)

Notes:

1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at 31 December and should not be interpreted as predictions.
3. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0% for reserving. The PPO sensitivity has been calculated on the direct impact on the change in the real discount rate with all other factors remaining unchanged.
4. Ogden discount rate sensitivity has been calculated on the direct impact of a permanent change in the discount rate with all other factors remaining unchanged. The Group will consider the statutory discount rate when setting its reserves but not necessarily provide on this basis, as is the case at the year ended 31 December 2018. This is intended to ensure that reserves are appropriate for current and potential future developments.

The sensitivity above is calculated on the basis of a permanent change in the rate used for the actuarial best estimate reserves as at 31 December 2018. It does not take into account a change in the Ogden discount rate setting regime, nor any second order impacts such as those on the Group's PPO assumptions or reinsurance bad debt assumptions.

The reduction in sensitivity to a change in the Ogden discount rate since 31 December 2017 primarily reflects the overall reduction in bodily injury exposures. The reduction in exposure is due to continued positive prior-year development of claims reserves for large bodily injury claims, particularly for accident years where the reinsurance retention level was higher than the current level of £1.0 million.

There is the risk that claims are reserved or paid inappropriately, including the timing of such activity. However, there are claims management controls in place to mitigate this risk, as outlined below:

– claims are managed utilising a range of IT system-driven controls coupled with manual processes outlined in detailed policies and procedures to ensure claims are handled in an appropriate, timely and accurate manner;
– each member of staff has a specified handling authority, with controls preventing them handling or paying claims outside their authority, as well as controls to mitigate the risk of paying invalid claims. In addition, there are various outsourced claims handling arrangements, all of which are monitored closely by management, with similar principles applying in terms of the controls and procedures;
– loss adjustors are used in certain circumstances to handle claims to conclusion. This involves liaison with the policyholder, third parties, suppliers and the claims function;
– specialist bodily injury claims teams are responsible for handling these types of losses with the nature of handling dependent on the level and type of claim. Claims exceeding a certain threshold are referred to the technical and large loss teams who also deal with all other claim types above defined limits or within specific criteria; and
– a process is in place to deal with major weather and other catastrophic events, known as the 'Surge Demand Plan'. A surge is the collective name given to an incident which significantly increases the volume of claims reported to the Group's claims functions. The plan covers surge demand triggers, stages of incident, operational impact, communication and management information monitoring of the plan.

Underwriting risk

This is the risk that future claims experience on business written is materially different from the results expected, resulting in current-year losses. The Group predominantly underwrites personal lines insurance including motor, residential property, roadside assistance, creditor, travel and pet business. The Group also underwrites commercial risks primarily for low-to-medium risk trades within the small and medium-sized enterprises market. Contracts are typically issued on an annual basis which means that the Group's liability usually extends for a 12-month period, after which the Group is entitled to decline to renew or can revise renewal terms by amending the premium or other policy terms and conditions such as the excess as appropriate.

Underwriting risk includes catastrophe risk and the risk of loss, or of adverse change in the value of the insurance liabilities resulting from significant uncertainty of pricing, underwriting and provisioning assumptions related to extreme or exceptional circumstances.

3. Risk management continued

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-years catastrophe loss. The programme is structured with the retention and limits expressed as percentages of gross earned premium. At 31 December 2018 this was the equivalent of £969.0 million (114% of gross earned premium of the previous 12 months) in excess of a retained deductible of £126.5 million (14.9% of gross earned premium);
- 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
This is the risk that material change in the volume of policies written may result in losses or reduced profitability.

Pricing risk
This is the risk of economic loss arising from policies being incorrectly priced or accepted to achieve desired volume and profitability.

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 altering the definition and application of reinsurance policy wordings or the effectiveness or value for money of reinsurance.

The Group uses reinsurance to:

- protect the underwriting result against low-frequency, high-severity losses through the transfer of catastrophe claims volatility to reinsurers;
- protect the underwriting result against unforeseen volumes of, or adverse trends in, large individual claims in order to reduce volatility and to improve stability of earnings;
- reduce the Group's capital requirements; and/or
- transfer risk that is not within the Group's current risk appetite.

3.3.2 Market risk
Market risk is the risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.

The Group is mainly exposed to the following market risk factors:

- spread risk;
- interest rate risk;
- property risk; and
- currency risk.

The Group has policies and limits approved by the Investment Committee for managing the market risk exposure. These set out the principles that the business should adhere to for managing market risk and establishing the maximum limits the Group is willing to accept having considered strategy, risk appetite and capital resources.

The Group monitors its market risk exposure on a monthly 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 Group has a property portfolio and an infrastructure debt portfolio to generate a real return which, from an asset liability matching perspective, is used to offset the liability arising from longer duration PPOs.

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 stressed scenarios 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 asset liability matching, and investment management 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.

Interest rate risk
This is the risk of loss from all assets and liabilities for which the net asset value is sensitive to changes in the term structure of interest rates or interest rate volatility. 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 notes with fixed coupon rates with a nominal value of £250 million. £500 million were issued on 27 April 2012; at the same time the Group entered into a 10-year designated hedging instrument, to exchange the fixed rate of interest on these notes to a floating rate, to hedge exposure to interest rate risk and have a redemption date of 27 April 2042. £250 million was repurchased by the Group on 8 December 2017.

The Group also has perpetual Tier 1 notes with fixed coupon rates with a nominal value of £350 million that were issued on 7 December 2017.

The Group also invests in floating rate debt securities, whose investment income is influenced by the movement of the short-term interest rate. A movement of the short-term interest rate will affect the expected return on these investments.

The market value of the Group's financial investments with fixed coupons is affected by the movement of interest rates. For the majority of investments in US Dollar corporate bonds, excluding £405.2 million of short duration high yield bonds (2017: £403.9 million), the Group hedges the exposure of this portfolio to the US Dollar interest rate risk using swaps.

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 2018, the value of these property investments was £322.1 million (2017: £309.3 million). The property investments are located in the UK.

3. Risk management 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 corporate bonds.

The Group maintains exposure to US Dollar securities through £1,699.3 million (2017: £2,084.5 million) of investments in US Dollar corporate bonds and Euro securities through £79.4 million (2017: £110.4 million) of Euro corporate 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

As mentioned above, 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			
At 31 December 2018	**£m**	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	**Total £m**
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	**1,354.6**	19.2	–	–	**19.2**
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	**18.5**	1.2	0.2	–	**1.4**
Interest rate swaps	**1,198.3**	(2.7)	15.9	14.4	**27.6**
Total	**2,571.4**	**17.7**	**16.1**	**14.4**	**48.2**

	Notional amounts	Maturity and fair value			
At 31 December 2018	**£m**	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	**Total £m**
Derivative liabilities					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	**1,716.2**	20.6	–	–	**20.6**
Designated as hedging instruments:					
Interest rate swaps	**341.2**	0.4	0.4	4.5	**5.3**
Total	**2,057.4**	**21.0**	**0.4**	**4.5**	**25.9**

	Notional amounts	Maturity and fair value			
At 31 December 2017	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	Total £m
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	2,735.3	51.1	–	–	51.1
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	17.3	1.0	–	–	1.0
Interest rate swaps	1,794.9	(1.9)	21.5	12.7	32.3
Total	4,547.5	50.2	21.5	12.7	84.4

	Notional amounts	Maturity and fair value			
At 31 December 2017	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	Total £m
Derivative liabilities					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	579.9	11.3	–	–	11.3
Designated as hedging instruments:					
Interest rate swaps	113.1	0.5	(0.1)	0.3	0.7
Total	693.0	11.8	(0.1)	0.3	12.0

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	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Spread				
Impact of a 100 basis points increase in spreads on financial investments[2,3,5]	**–**	–	**(171.1)**	(183.5)
Interest rate				
Impact of a 100 basis points increase in interest rates on financial investments and derivatives[2,3,4,5]	**15.6**	17.3	**(101.1)**	(98.3)
Investment property				
Impact of a 15% decrease in property markets	**(48.3)**	(46.4)	**(48.3)**	(46.4)

Notes:

1. These sensitivities exclude the impact of taxation.
2. 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.
3. The increase or decrease in total equity does not reflect any fair value movement in infrastructure debt, HTM debt securities and commercial real estate loans that would not be recorded in the financial statements under IFRSs as they are classified as loans and receivables and HTM respectively, which are carried at amortised cost. It is estimated that a fair value reduction in these asset categories resulting from a 100 basis points increase in spreads would have been £22.2 million (2017: £23.7 million) and a 100 basis points increase in interest rate would have been £5.8 million (2017: £6.2 million).
4. 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.
5. The subordinated liabilities and associated interest rate swap are excluded from the sensitivity analysis.
6. The sensitivities set out above 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 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 2018, the Group has pledged £31.8 million in cash (2017: £28.2 million) and £2.9 million in UK Gilts (2017: £0.3 million) to cover initial margins and out-of-the-money derivative positions. At 31 December 2018, counterparties have pledged £24.0 million in cash and £7.6 million in UK Gilts (2017: £25.1 million in cash and £15.5 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 default in cash inflows and/or changes in market value of issuers of securities, counterparties and any debtors to which the Group is exposed. The Group is mainly exposed to the following credit risk factors:

– counterparty default risk; and

– concentration risk.

Counterparty default risk

This is the risk of loss from unexpected default of the counterparties and debtors of Group undertakings. This risk is monitored by three forums: the Investment risk forum monitors credit spreads as indicators of potential losses on investments incurred but not yet realised; the Credit risk forum monitors reinsurance and corporate insurance counterparty default risk; and the NIG credit committee is responsible for monitoring broker credit risk. The main responsibility of these forums is to ensure that all material aspects of counterparty default risk within the Group are identified, monitored and measured.

The main sources of counterparty default risk for the Group are:

– investments – this arises from the investment of funds in a range of investment vehicles permitted by the investment policy;

– reinsurance recoveries – counterparty exposure to reinsurance counterparties 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; and

– consumer credit – exposure from offering monthly instalments on annual insurance contracts.

3. Risk management continued

The Group cedes insurance risk to reinsurers but, in return, assumes counterparty default risk against which a reinsurance bad debt provision is assessed. The financial security of the Group's panel of reinsurers is therefore important and both the quality and amount of the assumed counterparty default risk are subject to an approval process whereby reinsurance is only purchased from reinsurers that hold a credit rating of at least A– at the time cover is purchased. The Group's leading counterparty exposures are reviewed on a quarterly basis by the Head of Reinsurance and Corporate Insurance. The Group aims to contract with a diverse range of reinsurers on its contracts to mitigate the credit and/or non-payment risks associated with its reinsurance exposures.

Certain reinsurance contracts have long durations as a result of bodily injury and PPO claims, and insurance reserves therefore include provisions beyond the levels created for shorter-term reinsurance bad debt. For these contracts, reinsurance is only purchased from reinsurers that hold a credit rating of at least A+ at the time cover is purchased.

The following tables analyse the carrying value of financial and insurance assets that bear counterparty default risk between those assets that have not been impaired by age in relation to due date, and those that have been impaired.

At 31 December 2018	**Neither past due nor impaired £m**	Past due 1 – 90 days £m	Past due more than 90 days £m	Assets that have been impaired £m	**Carrying value in the balance sheet £m**
Reinsurance assets	**1,208.7**	–	–	–	**1,208.7**
Insurance and other receivables	**836.0**	39.6	0.3	–	**875.9**
Derivative assets	**48.2**	–	–	–	**48.2**
Debt securities	**4,246.6**	–	–	–	**4,246.6**
Infrastructure debt	**289.6**	–	–	–	**289.6**
Commercial real estate loans	**201.6**	–	–	–	**201.6**
Cash and cash equivalents[1]	**1,154.4**	–	–	–	**1,154.4**
Total	**7,985.1**	**39.6**	**0.3**	**–**	**8,025.0**

At 31 December 2017	Neither past due nor impaired £m	Past due 1 – 90 days £m	Past due more than 90 days £m	Assets that have been impaired £m	Carrying value in the balance sheet £m
Reinsurance assets	1,178.5	–	–	–	1,178.5
Insurance and other receivables	942.5	38.2	0.5	–	981.2
Derivative assets	84.4	–	–	–	84.4
Debt securities	4,555.0	–	–	–	4,555.0
Infrastructure debt	316.4	–	–	–	316.4
Commercial real estate loans	169.0	–	–	–	169.0
Cash and cash equivalents[1]	1,358.6	–	–	–	1,358.6
Total	8,604.4	38.2	0.5	–	8,643.1

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 2018 of £1,125.2 million (2017: £1,197.4 million), that can be further analysed as: secured £63.0 million (2017: £63.5 million); unsecured £949.8 million (2017: £976.3 million); and subordinated £112.4 million (2017: £157.6 million).

Concentration risk

This is the risk of loss associated with inadequately diversified portfolios of assets and/or obligations, in particular:

– large exposures to individual credits (either bond issuers or deposit-taking institutions); and

– large exposures to different credits 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 similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

The table below analyses the distribution of debt securities by geographical area (commercial real estate loans and infrastructure debt are all within the UK).

At 31 December 2018	Corporate £m	Local government £m	Sovereign £m	Supranational £m	Debt securities total £m
Australia	169.5	–	–	–	169.5
Austria	11.3	–	–	–	11.3
Belgium	37.2	–	–	–	37.2
Bermuda	1.5	–	–	–	1.5
Canada	72.7	–	–	–	72.7
Cayman Islands	5.7	–	–	–	5.7
Denmark	12.0	–	–	–	12.0
Finland	22.5	12.0	–	–	34.5
France	217.1	7.5	–	–	224.6
Germany	200.5	–	–	–	200.5
Hong Kong	6.3	–	–	–	6.3
Ireland	13.8	–	–	–	13.8
Italy	38.7	–	–	–	38.7
Japan	33.9	–	–	–	33.9
Luxembourg	2.6	–	–	–	2.6
Mexico	14.3	–	–	–	14.3
Netherlands	139.9	–	–	–	139.9
New Zealand	27.0	–	–	–	27.0
Norway	15.8	10.0	–	–	25.8
Spain	35.2	–	–	–	35.2
Sweden	85.4	–	–	–	85.4
Switzerland	64.5	–	–	–	64.5
UK	1,081.6	–	156.9	–	1,238.5
USA	1,708.0	–	–	–	1,708.0
Supranational	–	–	–	43.2	43.2
Total	**4,017.0**	**29.5**	**156.9**	**43.2**	**4,246.6**

3. Risk management continued

The table below analyses the distribution of debt securities by geographical area (commercial real estate loans and infrastructure debt are all within the UK).

At 31 December 2017	Corporate £m	Local government £m	Sovereign £m	Supranational £m	Debt securities total £m
Australia	101.7	–	–	–	101.7
Austria	1.8	–	–	–	1.8
Belgium	39.6	–	9.5	–	49.1
Bermuda	6.4	–	–	–	6.4
Canada	35.6	–	–	–	35.6
Cayman Islands	16.8	–	–	–	16.8
Denmark	18.2	–	–	–	18.2
France	216.3	3.6	–	–	219.9
Germany	231.9	–	–	–	231.9
Hong Kong	3.9	–	–	–	3.9
Ireland	9.9	–	–	–	9.9
Italy	23.1	–	–	–	23.1
Japan	53.0	–	–	–	53.0
Luxembourg	4.5	–	–	–	4.5
Mexico	10.6	–	–	–	10.6
Netherlands	166.6	–	–	–	166.6
New Zealand	18.1	–	–	–	18.1
Norway	27.1	–	–	–	27.1
Singapore	25.0	–	–	–	25.0
South Korea	3.8	–	–	–	3.8
Spain	42.1	–	–	–	42.1
Sweden	80.6	8.6	–	–	89.2
Switzerland	104.5	–	–	–	104.5
UK	1,113.2	–	215.3	–	1,328.5
USA	1,919.8	–	–	–	1,919.8
Supranational	–	–	–	43.9	43.9
Total	4,274.1	12.2	224.8	43.9	4,555.0

The table below analyses the distribution of debt securities by industry sector classifications.

At 31 December	2018 £m	2018 %	2017 £m	2017 %
Basic materials	**104.4**	**2%**	110.3	3%
Communications	**241.9**	**6%**	239.2	5%
Consumer, cyclical	**312.8**	**8%**	374.9	8%
Consumer, non-cyclical	**449.8**	**11%**	494.4	11%
Diversified	**51.8**	**1%**	57.9	1%
Energy	**206.9**	**5%**	263.6	6%
Financial	**1,817.6**	**43%**	1,836.1	40%
Industrial	**233.3**	**5%**	216.2	5%
Sovereign, supranational and local government	**229.6**	**5%**	280.9	6%
Technology	**115.5**	**3%**	163.1	4%
Transport	**13.4**	**0%**	13.4	0%
Utilities	**469.6**	**11%**	505.0	11%
Total	**4,246.6**	**100%**	4,555.0	100%

The table below analyses the distribution of infrastructure debt by industry sector classifications.

At 31 December	2018 £m	2018 %	2017 £m	2017 %
Social, of which:				
Education	**125.8**	**44%**	140.5	44%
Healthcare	**76.0**	**26%**	84.3	27%
Other	**54.9**	**19%**	56.3	18%
Transport	**32.9**	**11%**	35.3	11%
Total	**289.6**	**100%**	316.4	100%

The tables below analyse the credit quality of debt securities that are neither past due nor impaired.

At 31 December 2018	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB– £m	BB+ and below £m	**Total £m**
Corporate	145.8	549.3	1,785.0	1,143.0	393.9	**4,017.0**
Supranational	38.7	4.5	–	–	–	**43.2**
Local government	10.0	19.5	–	–	–	**29.5**
Sovereign	–	156.9	–	–	–	**156.9**
Total	**194.5**	**730.2**	**1,785.0**	**1,143.0**	**393.9**	**4,246.6**

At 31 December 2017	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB– £m	BB+ and below £m	Total £m
Corporate	183.1	412.0	2,145.8	1,144.6	388.6	4,274.1
Supranational	39.3	4.6	–	–	–	43.9
Local government	–	12.2	–	–	–	12.2
Sovereign	–	224.8	–	–	–	224.8
Total	222.4	653.6	2,145.8	1,144.6	388.6	4,555.0

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 151.

At 31 December 2018	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	–	837.4	366.9	3.0	–	1.4	**1,208.7**
Insurance and other receivables[1]	–	7.0	15.7	16.1	–	797.2	**836.0**
Derivative assets	–	15.5	22.6	10.1	–	–	**48.2**
Infrastructure debt	–	–	78.7	210.9	–	–	**289.6**
Commercial real estate loans	–	58.6	117.2	25.8	–	–	**201.6**
Cash and cash equivalents[2]	997.0	39.6	59.1	58.7	–	–	**1,154.4**
Total	**997.0**	**958.1**	**660.2**	**324.6**	**–**	**798.6**	**3,738.5**

At 31 December 2017	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	–	823.2	349.5	1.0	–	4.8	1,178.5
Insurance and other receivables[1]	–	24.7	15.1	10.0	–	892.7	942.5
Derivative assets	–	34.5	33.4	16.5	–	–	84.4
Infrastructure debt	–	–	81.2	229.2	6.0	–	316.4
Commercial real estate loans	13.8	34.8	101.1	19.3	–	–	169.0
Cash and cash equivalents[2]	1,100.6	134.6	46.8	76.6	–	–	1,358.6
Total	1,114.4	1,051.8	627.1	352.6	6.0	897.5	4,049.4

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. Risk management continued

3.3.4 Operational risk

This is the risk of loss due to inadequate or failed internal processes, people, systems, or from external events. Material sources of operational risk for the Group include:

Change risk

This is the risk of failing to manage the Group's change portfolio resulting in conflicting priorities and failure to deliver strategic outcomes to time, cost or quality.

Technology and infrastructure risk

This is the risk that the IT infrastructure is insufficient to deliver the Group's strategy.

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 intragroup relationships. This includes both domestic and offshore outsourcing activities.

Information security risk

This is the risk of loss, 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 key controls relating to operational risk.

3.3.5 Liquidity risk

This is the risk of being unable to realise investments in order to settle financial obligations when they fall due.

The measurement and management of liquidity risk within the Group is undertaken within the limits and other policy parameters of the Group's liquidity risk appetite and is detailed within 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 in-flows and out-flows that is reviewed at least annually by the Investment Risk 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 are able to fund the repayment of liabilities as they crystallise.

At 31 December 2018	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	**Total £m**
Debt securities	411.5	907.1	1,153.4	1,612.3	162.3	**4,246.6**
Infrastructure debt	13.3	27.0	31.3	94.2	123.8	**289.6**
Commercial real estate loans	18.2	74.6	108.8	–	–	**201.6**
Cash and cash equivalents[1]	1,154.4	–	–	–	–	**1,154.4**
Total	**1,597.4**	**1,008.7**	**1,293.5**	**1,706.5**	**286.1**	**5,892.2**

At 31 December 2017	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	Total £m
Debt securities	492.5	1,017.9	1,109.5	1,710.2	224.9	4,555.0
Infrastructure debt	13.0	30.9	29.8	94.4	148.3	316.4
Commercial real estate loans	4.3	56.6	108.1	–	–	169.0
Cash and cash equivalents[1]	1,358.6	–	–	–	–	1,358.6
Total	1,868.4	1,105.4	1,247.4	1,804.6	373.2	6,399.0

Note:

1. This represents money market funds with no notice period for withdrawal and cash at bank and in hand.

The following table analyses the undiscounted cash flows of insurance and financial liabilities by contractual repricing or maturity dates, whichever is earlier.

At 31 December 2018	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	**Total £m**	Carrying value £m
Subordinated liabilities	23.1	46.3	261.6	–	–	**331.0**	259.5
Insurance liabilities[1]	1,175.0	1,025.1	547.1	452.9	2,299.9	**5,500.0**	4,005.9
Borrowings	62.0	–	–	–	–	**62.0**	62.0
Trade and other payables, including insurance payables	547.6	5.2	0.7	0.6	–	**554.1**	554.1
Total	**1,807.7**	**1,076.6**	**809.4**	**453.5**	**2,299.9**	**6,447.1**	**4,881.5**

At 31 December 2017	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	Total £m	Carrying value £m
Subordinated liabilities	23.1	46.3	284.7	–	–	354.1	264.7
Insurance liabilities[1]	1,144.6	1,035.0	560.4	573.3	2,448.7	5,762.0	4,225.7
Borrowings	54.1	–	–	–	–	54.1	54.1
Trade and other payables, including insurance payables	648.8	8.0	0.4	0.8	–	658.0	658.0
Total	1,870.6	1,089.3	845.5	574.1	2,448.7	6,828.2	5,202.5

Note:
1. Insurance liabilities exclude unearned premium reserves as there are no liquidity risks inherent in them.

3.4 Capital management

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 UKI 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 £0.89 billion above an estimated SCR of £1.26 billion as at 31 December 2018 (31 December 2017: £0.91 billion and £1.39 billion respectively). The Group's capital requirements and solvency position are produced and presented to the Board on a regular basis.

4. Segmental analysis

The Directors manage the Group primarily by product type and present the segmental analysis on that basis. The segments, which are all UK based, reflect the management structure whereby a member of the Executive Committee is accountable to the Chief Executive Officer for each of the operating segments:

Motor

This segment consists of personal motor insurance together with the associated legal protection cover. The Group sells motor insurance direct to customers through its own brands Direct Line, Churchill and Privilege, and through partnership brands such as vehicle manufacturers and through price comparison websites. The Motor segment includes results previously reported in the Run-off and restructuring segments. Comparative data has been re-presented accordingly.

Home

This segment consists of home insurance together with associated legal protection cover. The Group sells home insurance products through our brands Direct Line, Churchill and Privilege, and our partnership brands (RBS, NatWest and Prudential), as well as through price comparison websites.

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 price comparison websites.

Commercial

This segment consists of commercial insurance for small and medium-sized enterprises sold through our 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 price comparison websites.

4. Segmental analysis continued

No inter-segment transactions occurred in the year ended 31 December 2018 (2017: £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 2018.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	**Total Group £m**
Gross written premium	1,671.2	606.9	422.8	511.0	**3,211.9**
Gross earned premium	1,684.3	698.0	416.6	507.8	**3,306.7**
Reinsurance premium	(142.5)	(30.2)	(1.9)	(42.6)	**(217.2)**
Net earned premium	1,541.8	667.8	414.7	465.2	**3,089.5**
Investment return	105.9	15.9	5.2	27.6	**154.6**
Instalment income	89.2	21.9	2.5	6.3	**119.9**
Other operating income	48.3	2.7	15.8	5.3	**72.1**
Total income	1,785.2	708.3	438.2	504.4	**3,436.1**
Insurance claims	(1,026.7)	(421.0)	(277.1)	(242.1)	**(1,966.9)**
Insurance claims recoverable from / (payable to) reinsurers	46.7	7.7	(0.1)	0.8	**55.1**
Net insurance claims	(980.0)	(413.3)	(277.2)	(241.3)	**(1,911.8)**
Commission expenses	(30.9)	(62.6)	(19.0)	(87.9)	**(200.4)**
Operating expenses	(359.1)	(149.3)	(98.6)	(115.2)	**(722.2)**
Total expenses	(390.0)	(211.9)	(117.6)	(203.1)	**(922.6)**
Operating profit	**415.2**	**83.1**	**43.4**	**60.0**	**601.7**
Finance costs					**(19.1)**
Profit before tax					**582.6**

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	**Total Group £m**
Underwriting profit	**171.8**	**42.6**	**19.9**	**20.8**	**255.1**
Loss ratio	63.6%	61.8%	66.8%	51.8%	**61.8%**
Commission ratio	2.0%	9.4%	4.6%	18.9%	**6.5%**
Expense ratio	23.3%	22.4%	23.8%	24.8%	**23.4%**
COR	**88.9%**	**93.6%**	**95.2%**	**95.5%**	**91.7%**

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including the restructuring costs and Run-off segment.

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2018.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	**Total £m**
Goodwill	128.1	45.8	28.7	10.1	**212.7**
Other segment assets	6,755.0	788.1	210.3	1,420.0	**9,173.4**
Segment liabilities	(4,775.7)	(551.0)	(147.0)	(992.8)	**(6,466.5)**
Segment net assets	**2,107.4**	**282.9**	**92.0**	**437.3**	**2,919.6**

The segmental analysis of assets and liabilities is prepared using a combination of asset and liability balances directly attributable to each operating segment and an apportionment of assets and liabilities managed at a Group wide level. This does not represent the Group's view of the capital requirements for its operating segments.

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2017.

	Motor[1] £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
Gross written premium	1,670.4	799.1	421.1	501.5	3,392.1
Gross earned premium	1,603.0	819.4	419.2	498.1	3,339.7
Reinsurance premium	(132.4)	(28.9)	(1.6)	(41.8)	(204.7)
Net earned premium	1,470.6	790.5	417.6	456.3	3,135.0
Investment return	117.9	21.1	4.6	31.8	175.4
Instalment income	85.3	23.1	2.1	5.9	116.4
Other operating income	43.0	0.9	12.9	6.1	62.9
Total income	1,716.8	835.6	437.2	500.1	3,489.7
Insurance claims	(717.1)	(403.3)	(273.8)	(176.9)	(1,571.1)
Insurance claims (payable to) / recoverable from reinsurers	(135.8)	2.8	0.5	(50.6)	(183.1)
Net insurance claims	(852.9)	(400.5)	(273.3)	(227.5)	(1,754.2)
Commission expenses	(36.7)	(139.7)	(22.9)	(87.1)	(286.4)
Operating expenses	(430.8)	(166.6)	(97.4)	(111.5)	(806.3)
Total expenses	(467.5)	(306.3)	(120.3)	(198.6)	(1,092.7)
Operating profit	396.4	128.8	43.6	74.0	642.8
Finance costs					(103.8)
Profit before tax					539.0

Underwriting profit	150.2	83.7	24.0	30.2	288.1
Loss ratio	58.0%	50.6%	65.4%	49.9%	56.0%
Commission ratio	2.5%	17.7%	5.5%	19.1%	9.1%
Expense ratio	29.3%	21.1%	23.4%	24.4%	25.7%
COR	89.8%	89.4%	94.3%	93.4%	90.8%

	Motor[2]	Total Ongoing[2]
Loss ratio	60.9%	57.4%
Commission ratio	2.5%	9.1%
Expense ratio	28.5%	25.3%
COR	91.9%	91.8%

Notes:

1. The Motor segment for the year ended 31 December 2017 includes restructuring costs and the Run-off segment, which were total income of £0.7 million, net insurance claims of £43.1 million and operating expenses of £11.9 million.
2. Comparative ratios for the Motor segment and total Ongoing operations, prior to re-presentation of the restructuring costs and the Run-off segment. Ongoing operations for 2017 comprised total Group operations less the restructuring costs and the Run-off segment.

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2017.

	Motor[1] £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total £m
Goodwill	127.7	45.8	28.7	10.1	212.3
Other segment assets	7,297.5	708.8	204.3	1,525.1	9,735.7
Segment liabilities	(5,177.4)	(496.8)	(143.2)	(1,069.0)	(6,886.4)
Segment net assets	2,247.8	257.8	89.8	466.2	3,061.6

Note:

1. The Motor segment for the year ended 31 December 2017 includes the Run-off segment, which comprised other segment assets of £642.7 million and other segment liabilities of £512.8 million.

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

	2018 £m	2017 £m
Gross earned premium:		
Gross written premium	3,211.9	3,392.1
Movement in unearned premium reserve	94.8	(52.4)
	3,306.7	3,339.7
Reinsurance premium:		
Premium payable	(223.5)	(208.4)
Movement in reinsurance unearned premium reserve	6.3	3.7
	(217.2)	(204.7)
Total	3,089.5	3,135.0

6. Investment return

	2018 £m	2017 £m
Investment income:		
Interest income from debt securities	124.0	137.5
Interest income from cash and cash equivalents	6.2	3.0
Interest income from infrastructure debt	6.9	6.8
Interest income from commercial real estate loans	6.2	3.6
Interest income	143.3	150.9
Rental income from investment property	15.9	16.2
	159.2	167.1
Net realised (losses) / gains:		
AFS debt securities	19.5	23.2
Derivatives	(32.2)	175.0
Investment property (note 19)	–	1.6
	(12.7)	199.8
Net unrealised gains / (losses):		
Impairment of loans and receivables	(6.0)	(9.5)
Derivatives	1.4	(202.0)
Investment property (note 19)	12.7	20.0
	8.1	(191.5)
Total	154.6	175.4

The table below analyses the realised and unrealised gains and losses on derivative instruments included in investment return.

	Realised 2018 £m	Unrealised 2018 £m	Realised 2017 £m	Unrealised 2017 £m
Derivative (losses) / gains:				
Foreign exchange forward contracts[1]	(102.6)	(41.3)	107.8	62.5
Associated foreign exchange risk	72.6	41.3	68.4	(259.1)
Net (losses) / gains on foreign exchange forward contracts	(30.0)	–	176.2	(196.6)
Interest rate swaps[1]	22.1	(1.8)	1.8	(1.7)
Associated interest rate risk on hedged items	(24.3)	3.2	(3.0)	(3.7)
Net (losses) / gains on interest rate derivatives	(2.2)	1.4	(1.2)	(5.4)
Total	(32.2)	1.4	175.0	(202.0)

Note:
1. Foreign exchange forward contracts are measured at fair value through profit and loss and interest rate swaps are designated as hedging instruments.

7. Other operating income

	2018 £m	2017 £m
Vehicle replacement referral income	17.2	16.9
Revenue from vehicle recovery and repair services	11.7	11.3
Legal services income	11.2	11.0
Other income[1,2]	32.0	23.7
Total	72.1	62.9

Notes:
1. Other income includes salvage income and fee income from insurance intermediary services.
2. Other income includes a £9.6 million gain on the sale of a property in Bristol in January 2018.

8. Net insurance claims

	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	2018 £m	2018 £m	2018 £m	2017 £m	2017 £m	2017 £m
Current accident year claims paid	1,308.5	(0.2)	1,308.3	1,165.0	(0.2)	1,164.8
Prior accident year claims paid	878.2	(30.9)	847.3	847.0	(13.8)	833.2
(Decrease) / increase in insurance liabilities	(219.8)	(24.0)	(243.8)	(440.9)	197.1	(243.8)
Total	1,966.9	(55.1)	1,911.8	1,571.1	183.1	1,754.2

Claims handling expenses for the year ended 31 December 2018 of £192.9 million (2017[1]: £174.8 million) have been included in the claims figures above.

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including the Run-off segment. Comparative data has been re-presented accordingly.

9. Commission expenses

	2018 £m	2017 £m
Commission expenses	188.5	225.4
Expenses incurred under profit participations	11.9	61.0
Total	200.4	286.4

10. Operating expenses

	2018 £m	2017 £m
Staff costs[1]	269.9	280.1
Other operating expenses[1,2]	253.3	273.6
Marketing	121.2	113.7
Amortisation and impairment of other intangible assets[3]	46.7	111.0
Depreciation	31.1	27.9
Total	722.2	806.3

Notes:
1. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
2. Other operating expenses include IT costs, insurance levies, professional fees and property costs.
3. Amortisation and impairment of other intangible assets includes a £1.5 million impairment charge for the year ended 31 December 2018 (2017: £56.9 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.

The table below analyses the number of people employed by the Group's operations.

	At 31 December		Average for the year	
	2018	2017	2018	2017
Insurance operations	8,583	8,267	8,569	8,431
Repair centre operations	1,368	1,272	1,326	1,238
Support	1,278	1,269	1,266	1,280
Total	11,229	10,808	11,161	10,949

10. Operating expenses continued

The aggregate remuneration of those employed by the Group's operations comprised:

	2018 £m	2017 £m
Wages and salaries	374.9	363.6
Social security costs	41.2	40.4
Pension costs	28.7	25.5
Share-based payments	21.0	14.8
Total	465.8	444.3

The table below analyses Auditor's remuneration in respect of the Group's operations.

	2018 £m	2017 £m
Fees payable for the audit of:		
The Company's annual accounts	0.2	0.3
The Company's subsidiaries	1.7	1.6
Total audit fees	1.9	1.9
Audit-related assurance services	0.1	0.1
Other assurance services	0.1	–
Non-audit services	0.6	0.1
Total	2.7	2.1

Aggregate Directors' emoluments

The table below analyses the total amount of Directors' remuneration in accordance with Schedule 5 to the Accounting Regulations.

	2018 £m	2017 £m
Salaries, fees, bonuses and benefits in kind	5.9	5.6
Gains on exercise of share options	4.2	5.3
Total	10.1	10.9

Further information about the remuneration of individual Directors is provided in the Directors' remuneration report.

At 31 December 2018, no Directors (2017: no Directors) had retirement benefits accruing under the defined contribution pension scheme in respect of qualifying service. During the year ended 31 December 2018, four Directors exercised share options (2017: three Directors).

11. Finance costs

	2018 £m	2017 £m
Interest expense on subordinated liabilities	23.1	44.8
Net interest received on designated hedging instrument[1]	(3.8)	(8.0)
Unrealised losses on designated hedging instrument[1]	5.0	10.4
Unrealised gains on associated interest rate risk on hedged item[1]	(5.6)	(11.7)
Realised gain on associated interest rate risk on hedged item[1]	–	(11.3)
Premium paid to repurchase subordinated liabilities and associated transaction costs	–	77.4
Amortisation of arrangement costs and discount on issue of subordinated liabilities	0.4	2.2
Total	19.1	103.8

Note:

1. As described in note 32, on 27 April 2012 the Group issued subordinated guaranteed dated 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 designated hedging instrument to exchange the fixed rate of interest on the notes for a floating rate of 3-month LIBOR plus a spread of 706 basis points, which increased to 707 basis points with effect from 29 July 2013. On 8 December 2017, the Group redeemed £250 million nominal value of the notes.

12. Tax charge

	2018 £m	2017 £m
Current taxation:		
Charge for the year	114.4	114.4
(Over) / under provision in respect of prior year	(4.8)	5.3
	109.6	119.7
Deferred taxation (note 13):		
Credit for the year	(4.2)	(5.8)
Under / (over) provision in respect of prior year	3.5	(8.9)
	(0.7)	(14.7)
Current taxation	109.6	119.7
Deferred taxation (note 13)	(0.7)	(14.7)
Tax charge for the year	108.9	105.0

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] (2017: 19.25%).

	2018 £m	2017 £m
Profit before tax	582.6	539.0
Expected tax charge	110.7	103.8
Effects of:		
Disallowable expenses	5.4	5.4
Non-taxable items	(2.5)	(0.3)
Effect of change in corporation taxation rate	(0.2)	(0.2)
Over provision in respect of prior year	(1.3)	(3.7)
Deductible Tier 1 notes coupon payment in equity	(3.2)	–
Tax charge for the year	108.9	105.0
Effective income tax rate	18.7%	19.5%

Note:

1. In the Finance (No 2) Act 2015 the UK Government enacted a reduction in the UK corporation tax rate from 20% to 19% effective from 1 April 2017, and then the Finance Act 2016 enacted a further reduction to 17% effective from 1 April 2020. As a consequence, the closing deferred tax assets and liabilities have been recognised at the tax rates expected to apply when the assets or liabilities are settled. The impact of these changes on the tax charge for the year is set out in the table above.

13. Current and deferred tax

	2018 £m	2017 £m
Per balance sheet:		
Current tax assets	–	0.1
Current tax liabilities	(46.0)	(40.7)
Deferred tax liabilities	(7.6)	(31.1)

13. Current and deferred tax continued

The table below analyses the major deferred tax assets and liabilities recognised by the Group and movements thereon.

	Provisions and other temporary differences £m	Retirement benefit obligations £m	Depreciation in excess of capital allowances £m	Non-distributable reserve[1] £m	Investment properties £m	Share-based payments £m	AFS revaluation reserve £m	Total £m
At 1 January 2017	2.6	(2.1)	(1.0)	(23.4)	(8.2)	4.1	(18.0)	(46.0)
Credit to the income statement	–	–	1.5	4.8	8.2	0.2	–	14.7
(Charge) / credit to other comprehensive income	–	(0.4)	–	–	–	–	2.2	1.8
Charge direct to equity	–	–	–	–	–	(1.0)	–	(1.0)
Other movements	(0.6)	–	–	–	–	–	–	(0.6)
At 31 December 2017	2.0	(2.5)	0.5	(18.6)	–	3.3	(15.8)	(31.1)
Credit / (charge) to the income statement	0.3	(0.1)	(3.9)	4.9	–	(0.5)	–	0.7
(Charge) / credit to other comprehensive income	–	(0.4)	–	–	–	–	23.8	23.4
Charge direct to equity	–	–	–	–	–	(0.6)	–	(0.6)
At 31 December 2018	2.3	(3.0)	(3.4)	(13.7)	–	2.2	8.0	(7.6)

Note:

1. 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 2018 of £4.7 million (2017: £7.4 million) in relation to capital losses of which £4.7 million (2017: £4.1 million) relates to realised losses and £nil (2017: £3.3 million) relates to unrealised losses.

14. Dividends and appropriations

	2018 £m	2017 £m
Amounts recognised as distributions to equity holders in the period:		
2017 final dividend of 13.6 pence per share paid on 17 May 2018	186.1	–
2016 final dividend of 9.7 pence per share paid on 18 May 2017	–	132.4
2018 first interim dividend of 7.0 pence per share paid on 7 September 2018	95.8	–
2017 first interim dividend of 6.8 pence per share paid on 8 September 2017	–	92.9
2017 special dividend of 15.0 pence per share paid on 17 May 2018	205.3	–
	487.2	225.3
Coupon payments in respect of Tier 1 notes[1]	16.6	–
	503.8	225.3
Proposed dividends:		
2018 final dividend of 14.0 pence per share	192.5	–
2017 final dividend of 13.6 pence per share	–	187.0
2018 special dividend of 8.3 pence per share	114.1	–
2017 special dividend of 15.0 pence per share	–	206.3

Note:

1. 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 and special dividends for 2018 have not been included as a liability in these financial statements.

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 Restrictive Share Plan awards, which reduced the total dividends paid for the year ended 31 December 2018 by £2.4 million (2017: £1.6 million).

15. Earnings per share

Earnings per share is calculated by dividing earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the year.

Basic

Basic earnings per share is calculated by dividing the earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the period, excluding Ordinary Shares held as employee trust shares.

	2018 £m	2017 £m
Earnings attributable to owners of the Company	473.7	434.0
Coupon payments in respect of Tier 1 notes	(16.6)	–
Profit for the calculation of earnings per share	457.1	434.0
Weighted average number of Ordinary Shares (millions)	1,366.5	1,366.1
Basic earnings per share (pence)	33.5	31.8

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 adjusted for the dilutive potential Ordinary Shares. The Company has share options and contingently issuable shares as categories of dilutive potential Ordinary Shares.

	2018 £m	2017 £m
Earnings attributable to owners of the Company	473.7	434.0
Coupon payments in respect of Tier 1 notes	(16.6)	–
Profit for the calculation of earnings per share	457.1	434.0
Weighted average number of Ordinary Shares (millions)	1,366.5	1,366.1
Effect of dilutive potential of share options and contingently issuable shares (millions)	15.8	12.9
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	1,382.3	1,379.0
Diluted earnings per share (pence)	33.1	31.5

16. Net assets per share and return on equity

Net asset value per share is calculated as total shareholders' equity (which excludes Tier1 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.

At 31 December	2018 £m	2017 £m
Net assets	2,573.1	2,715.1
Goodwill and other intangible assets[1]	(566.8)	(471.1)
Tangible net assets	2,006.3	2,244.0
Number of Ordinary Shares (millions)	1,375.0	1,375.0
Shares held by employee share trusts (millions)	(10.4)	(9.9)
Closing number of Ordinary Shares (millions)	1,364.6	1,365.1
Net asset value per share (pence)	188.6	198.9
Tangible net asset value per share (pence)	147.0	164.4

Note:

1. Goodwill has arisen on acquisition by the Group of subsidiary companies and on acquisition of new accident repair centres. Intangible assets are primarily comprised of software development costs.

16. Net assets per share and return on equity continued

Return on equity

The table below details the calculation of return on equity.

	2018 £m	2017 £m
Earnings attributable to owners of the Company	473.7	434.0
Coupon payments in respect of Tier 1 notes	(16.6)	–
Profit for the calculation of return on equity	457.1	434.0
Opening shareholders' equity	2,715.1	2,521.5
Closing shareholders' equity	2,573.1	2,715.1
Average shareholders' equity	2,644.1	2,618.3
Return on equity	17.3%	16.6%

17. Goodwill and other intangible assets

	Goodwill £m	Other intangible assets £m	Total £m
Cost			
At 1 January 2017	211.3	569.9	781.2
Acquisitions and additions	1.0	72.2	73.2
At 31 December 2017	212.3	642.1	854.4
Acquisitions and additions	0.4	142.0	142.4
Disposals and write-off[1]	–	(4.7)	(4.7)
At 31 December 2018	212.7	779.4	992.1
Accumulated amortisation and impairment			
At 1 January 2017	–	272.3	272.3
Charge for the year	–	54.1	54.1
Impairment losses[2]	–	56.9	56.9
At 31 December 2017	–	383.3	383.3
Charge for the year	–	45.2	45.2
Disposals and write-off[1]	–	(4.7)	(4.7)
Impairment losses[2]	–	1.5	1.5
At 31 December 2018	–	425.3	425.3
Carrying amount			
At 31 December 2018	212.7	354.1	566.8
At 31 December 2017	212.3	258.8	471.1

Notes:

1. Disposals and write-off include fully amortised intangible assets no longer utilised by the Group in its operating activities.
2. The 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 £269.9 million (2017: £171.4 million). These assets are reviewed for potential indicators of impairment at each reporting date.

Goodwill arose on the acquisition of U K Insurance Limited (£141.0 million), Churchill Insurance Company Limited (£70.0 million) and accident repair networks (£1.7 million) and is allocated to reportable segments. The addition to goodwill in the year ended 31 December 2018 of £0.4 million arose on acquisition of a new accident repair centre.

The Group's testing for goodwill impairment includes the comparison of the recoverable amount of each CGU to which goodwill has been allocated with its carrying value and updated at each reporting date in the event of indications of impairment.

The table below analyses the goodwill of the Group by CGU.

	2018 £m	2017 £m
Motor	128.1	127.7
Home	45.8	45.8
Rescue and other personal lines	28.7	28.7
Commercial	10.1	10.1
Total	212.7	212.3

There have been no impairments in goodwill for the year ended 31 December 2018 (2017: £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 is held.

	Assumptions			Sensitivity: Impact on recoverable amount of a:		
CGU	Terminal growth rate %	Pre-tax discount rate %	Recoverable amount in excess of carrying value £m	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	3.0	11.5	1,112.3	(247.4)	(264.2)	(32.5)
Home	3.0	11.5	777.3	(81.8)	(112.0)	(10.6)
Rescue and other personal lines	3.0	11.5	557.7	(56.0)	(75.7)	(6.6)
Commercial	3.0	11.5	575.4	(85.0)	(114.8)	(10.0)

Note:

1. Reflects a 1% decrease in the profit for each year of the strategic plan, which is five years.

18. Property, plant and equipment

	Freehold land and buildings £m	Other equipment £m	Total £m
Cost			
At 1 January 2017	79.8	196.3	276.1
Additions	–	22.4	22.4
Disposals	–	(15.1)	(15.1)
At 31 December 2017	79.8	203.6	283.4
Additions	–	13.3	13.3
Disposals	–	(31.9)	(31.9)
At 31 December 2018	79.8	185.0	264.8
Accumulated depreciation and impairment			
At 1 January 2017	3.1	92.1	95.2
Depreciation charge for the year	1.1	26.8	27.9
Disposals	–	(14.1)	(14.1)
At 31 December 2017	4.2	104.8	109.0
Depreciation charge for the year	1.1	30.0	31.1
Disposals	–	(31.5)	(31.5)
At 31 December 2018	5.3	103.3	108.6

Carrying amount			
At 31 December 2018	74.5	81.7	156.2
At 31 December 2017	75.6	98.8	174.4

The Group is satisfied that the aggregate value of property, plant and equipment is not less than its carrying value.

19. Investment property

	2018 £m	2017 £m
At 1 January	309.3	329.0
Additions at cost	0.1	–
Increase in fair value during the year	12.7	21.6
Disposals	–	(41.3)
At 31 December	322.1	309.3

Note:

1. The cost included in the carrying value at 31 December 2018 is £252.5 million (2017: £252.4 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 2017.

Lease agreements with tenants are drawn up in line with local practice and the Group has no exposure to leases that include contingent rents.

20. 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	Place of incorporation and operation	Principal activity
DL Insurance Services Limited	United Kingdom	Management services
U K Insurance Limited	United Kingdom	General insurance

The Group did not dispose of any subsidiaries in the years ended 31 December 2018 and 31 December 2017.

21. Reinsurance assets

	Notes	2018 £m	2017 £m
Reinsurers' share of general insurance liabilities		1,159.9	1,141.1
Impairment provision[1]		(54.7)	(59.9)
Total excluding reinsurers' unearned premium reserves	33	1,105.2	1,081.2
Reinsurers' unearned premium reserve	34	103.5	97.3
Total		1,208.7	1,178.5

Note:

1. Impairment provision relates to reinsurance debtors, allowing for the risk that reinsurance assets may not be collected, or where the reinsurer's credit rating has been significantly downgraded and may have difficulty in meeting its obligations.

Movements in reinsurance asset impairment provision

	2018 £m	2017 £m
At 1 January	(59.9)	(50.7)
Additional provision	(7.5)	(9.6)
Release to income statement	12.7	0.4
At 31 December	(54.7)	(59.9)

22. Deferred acquisition costs

	2018 £m	2017 £m
At 1 January	185.4	203.1
Net decrease in the year	(14.4)	(17.7)
At 31 December	171.0	185.4

23. Insurance and other receivables

	2018 £m	2017 £m
Receivables arising from insurance contracts:		
Due from policyholders	740.4	840.4
Due from agents, brokers and intermediaries	82.9	71.3
Impairment provision of policyholder receivables	(0.9)	(1.2)
Impairment provision of agent, broker and intermediary receivables	(0.5)	(0.9)
Other debtors	54.0	71.6
Total	875.9	981.2

Movement in impairment provisions during the year

	Policyholders £m	Agents, brokers and intermediaries £m	Total £m
At 1 January 2018	1.2	0.9	2.1
Additional provision	24.7	0.2	24.9
Released to income statement	(25.0)	(0.6)	(25.6)
At 31 December 2018	0.9	0.5	1.4

24. Derivative financial instruments

	2018 £m	2017 £m
Derivative assets		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	19.2	51.1
Designated as hedging instruments:		
Foreign exchange contracts (forwards)[1]	1.4	1.0
Interest rate swaps	27.6	32.3
Total	48.2	84.4
Derivative liabilities		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	20.6	11.3
Designated as hedging instruments:		
Interest rate swaps	5.3	0.7
Total	25.9	12.0

Note:
1. Cash flow hedges in relation to supplier payments.

25. Retirement benefit obligations

Defined contribution scheme

The pension charge in respect of the defined contribution scheme for the year ended 31 December 2018 was £28.7 million (2017: £25.5 million).

Defined benefit scheme

The Group's defined benefit pension scheme was closed in 2003 although the Group remains the sponsoring employer for obligations to current and deferred pensioners based on qualifying years' service and final salaries. The defined benefit scheme is legally separated from the Group with trustees who are required by law to act in the interests of the scheme and of all the relevant stakeholders. The trustees of the pension scheme are responsible for the investment policy with regard to the assets of the scheme.

The weighted average duration of the defined benefit obligations at 31 December 2018 is 20 years (2017: 20 years) using accounting assumptions.

The table below sets out the principal assumptions used in determining the defined benefit scheme obligations.

	2018 %	2017 %
Rate of increase in pension payment	2.2	2.2
Rate of increase of deferred pensions	2.2	2.2
Discount rate	2.9	2.5
Inflation rate	3.3	3.3

25. Retirement benefit obligations continued

No assumption has been made for salary growth as there are no obligations in the scheme that are linked to future increases in salaries.

Post-retirement mortality assumptions

	2018	2017
Life expectancy at age 60 now:		
Males	87.3	87.5
Females	89.0	89.2
Life expectancy at age 60 in 20 years' time:		
Males	89.1	89.3
Females	90.9	91.1

The table below analyses the fair value of the scheme assets by type of asset.

	2018 £m	2017 £m
Index-linked bonds	30.4	28.7
Government bonds	24.9	17.7
Liquidity fund[1]	0.8	52.7
Absolute return bond fund[2]	39.4	–
Other	0.1	2.6
Total	95.6	101.7

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 exchange.
2. The absolute return bond fund is an investment in an open-ended fund incorporated in Luxembourg which targets positive returns in all market conditions. It is invested in short-term fixed income asset classes and seeks additional returns via a range of additional investments including certificate of deposits, rates and global currencies.

The majority of debt instruments have quoted prices in active markets. The absolute return bond fund holds bonds that, rather than being traded on exchange, are traded through agents, brokers or investment banks matching buyers and sellers.

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 2017	102.5	(90.5)	12.0
Income statement:			
Net interest income / (cost)[1]	2.7	(2.4)	0.3
Statement of comprehensive income:			
Actuarial gains arising from experience adjustments	1.0	1.5	2.5
Actuarial gains arising from changes in demographic assumptions	–	3.1	3.1
Actuarial losses arising from changes in financial assumptions	–	(3.5)	(3.5)
Benefits paid	(4.5)	4.5	–
At 31 December 2017	101.7	(87.3)	14.4
Income statement:			
Net interest income / (cost)[1]	2.4	(2.1)	0.3
Administration costs	(0.2)	–	(0.2)
Prior service costs[2]	–	(0.2)	(0.2)
Settlement[3]	(2.4)	2.4	–
Statement of comprehensive income:			
Actuarial losses arising from experience adjustments	(3.5)	–	(3.5)
Actuarial gains arising from changes in demographic assumptions	–	0.4	0.4
Actuarial gains arising from changes in financial assumptions	–	5.8	5.8
Benefits paid	(2.4)	2.4	–
At 31 December 2018	95.6	(78.6)	17.0

Notes:

1. The net interest income / (cost) in the income statement has been included under other operating expenses.
2. This results from the outcome of a court case ruling in October 2018 involving the Lloyds Bank pension schemes but leading to a one-off increase in liabilities for UK pension schemes more widely.
3. A number of historical annuity policies held by the scheme were transferred to individual members during the year.

The table below details the history of the scheme for the current and prior years.

	2018 £m	2017 £m	2016 £m	2015 £m	2014 £m
Present value of defined benefit scheme obligations	(78.6)	(87.3)	(90.5)	(72.0)	(79.6)
Fair value of defined benefit scheme assets	95.6	101.7	102.5	85.1	83.1
Net surplus	17.0	14.4	12.0	13.1	3.5
Experience adjustment gains on scheme liabilities	–	1.5	1.2	1.2	1.0
Experience adjustment (losses) / gains on scheme assets	(3.5)	1.0	13.7	(1.9)	12.9

Sensitivity analysis
The table below provides a sensitivity analysis of the potential impact 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. This sensitivity analysis has been selected to reflect the changes to discounted cash flows as a result of changes to the discount rate, inflation rate and mortality assumptions. The methodology adopted involves actuarial techniques.

	Impact on pension cost		Impact on present value of defined benefit scheme obligations	
	2018 £m	2017 £m	2018 £m	2017 £m
Discount rate				
0.25% increase in discount rate	(0.2)	(0.2)	(3.9)	(4.4)
0.25% decrease in discount rate	0.1	0.1	3.9	4.4
Inflation rate				
0.25% increase in inflation rate	–	–	2.0	2.2
0.25% decrease in inflation rate	–	–	(2.0)	(2.2)
Life expectancy				
1 year increase in life expectancy	0.1	0.1	2.7	3.1
1 year decrease in life expectancy	(0.1)	(0.1)	(2.7)	(3.1)

The most recent funding valuation of the Group's defined benefit scheme was carried out as at 1 October 2017. This showed an excess of assets over liabilities. The Group agreed with the trustees to make contributions of up to £1.5 million per annum in 2019, 2020 and 2021 in the event that a deficit subsequently emerges on the anniversary of the funding valuation date. As a result of the most recent funding update, no contributions are expected to be payable in 2019 (2018: £nil).

26. Financial investments

	2018 £m	2017 £m
AFS debt securities		
Corporate	3,916.0	4,170.5
Supranational	43.2	43.9
Local government	29.5	12.2
Sovereign	156.9	224.8
Total	4,145.6	4,451.4
HTM debt securities		
Corporate	101.0	103.6
Total debt securities	4,246.6	4,555.0
Total debt securities		
Fixed interest rate[1]	4,211.1	4,540.1
Floating interest rate	35.5	14.9
Total	4,246.6	4,555.0
Loans and receivables		
Infrastructure debt	289.6	316.4
Commercial real estate loans	201.6	169.0
Total	4,737.8	5,040.4

Note:
1. The Group swaps a fixed interest rate for a floating rate of interest on its US Dollar, Euro and a small amount of its sterling corporate debt securities by entering into interest rate derivatives. The hedged amount at 31 December 2018 was £1,206.1 million (2017: £1,591.5 million).

27. Cash and cash equivalents and borrowings

	2018 £m	2017 £m
Cash at bank and in hand	157.4	258.0
Short-term deposits with credit institutions[1]	997.0	1,100.6
Cash and cash equivalents	1,154.4	1,358.6
Bank overdrafts[2]	(62.0)	(54.1)
Cash and bank overdrafts[3]	1,092.4	1,304.5

Notes:

1. This represents money market funds with no notice period for withdrawal.
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 disclosure note 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 2018 was 0.58% (2017: 0.29%) and average maturity was 10 days (2017: 10 days).

28. Assets held for sale

	2018 £m	2017[1] £m
Freehold property held for sale	–	4.2

Note:

1. The freehold property held for sale at 31 December 2017 related to a property in Bristol which was sold in January 2018.

29. Share capital

	2018 Number millions	2017 Number millions	2018 £m	2017 £m
Issued and fully paid: equity shares				
Ordinary Shares of $10^{10}/_{11}$ pence each[1]	1,375	1,375	150.0	150.0

Note:

1. The shares have full voting dividend and capital distribution rights (including wind up) attached to them; these do not confer any rights of redemption.

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 2018, 10,432,376 Ordinary Shares (2017: 9,945,473 Ordinary Shares) were owned by the employee share trusts with a cost of £35.2 million (2017: £34.1 million). These Ordinary Shares are carried at cost and at 31 December 2018 had a market value of £33.2 million (2017: £38.0 million).

30. Other reserves

Movements in the AFS investments revaluation reserve

	2018 £m	2017 £m
At 1 January	80.2	92.1
Revaluation during the year – gross	(121.4)	8.8
Revaluation during the year – tax	20.6	(1.5)
Realised gains – gross	(19.5)	(23.2)
Realised gains – tax	3.3	4.0
At 31 December	(36.8)	80.2

Capital reserves

	2018 £m	2017 £m
Capital contribution reserve[1]	100.0	100.0
Capital redemption reserve[2]	1,350.0	1,350.0
Total	1,450.0	1,450.0

Notes:

1. Arose on the cancellation of a debt payable to a shareholder.
2. Arose on the reduction of nominal value of each share in issue with a corresponding transfer to capital redemption reserve.

31. Tier 1 notes

	2018 £m	2017 £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 which becomes mandatory upon breach of non-compliance with the Group SCR, a breach of the minimum capital requirement or where the Group has insufficient distributable reserves.

32. Subordinated liabilities

	2018 £m	2017 £m
Subordinated guaranteed dated notes	259.5	264.7

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%. On the same date, the Group also entered into a 10-year designated hedging instrument 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.

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 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 rate of interest will be reset at a rate of the 6-month LIBOR plus 7.91%.

The Group has the option, in certain circumstances, to defer interest payments on the notes but to date has not exercised this right.

The notes are unsecured, subordinated obligations of the Group, and rank pari passu without any preference among themselves. In the event of a winding-up or of bankruptcy, they are to be repaid only after the claims of all other senior creditors have been met.

33. Insurance liabilities

	2018 £m	2017 £m
Insurance liabilities	4,005.9	4,225.7

Gross insurance liabilities

Accident year	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	Total £m
Estimate of ultimate gross claims costs:											
At end of accident year	3,823.3	3,941.7	2,698.1	2,372.7	2,184.0	2,094.5	2,118.1	2,157.7	2,217.3	2,300.1	
One year later	121.6	(117.1)	(99.3)	(163.3)	(117.6)	20.7	(30.0)	(86.7)	(116.2)		
Two years later	(37.0)	(99.1)	(94.6)	(118.9)	(153.0)	(38.4)	(143.5)	(53.3)			
Three years later	(14.0)	(50.3)	(89.3)	(49.3)	(21.0)	(144.9)	(62.4)				
Four years later	(101.5)	(105.5)	(60.9)	(9.9)	(102.1)	(50.2)					
Five years later	(38.8)	(57.7)	(21.2)	(79.2)	(50.8)						
Six years later	(80.8)	(25.9)	(60.3)	(36.2)							
Seven years later	(27.3)	(50.0)	(25.1)								
Eight years later	(14.0)	(17.6)									
Nine years later	(36.4)										
Current estimate of cumulative claims	3,595.1	3,418.5	2,247.4	1,915.9	1,739.5	1,881.7	1,882.2	2,017.7	2,101.1	2,300.1	
Cumulative payments to date	(3,474.6)	(3,323.4)	(2,172.8)	(1,862.3)	(1,655.4)	(1,592.6)	(1,547.7)	(1,554.6)	(1,471.4)	(1,174.0)	
Gross liability recognised in balance sheet	**120.5**	**95.1**	**74.6**	**53.6**	**84.1**	**289.1**	**334.5**	**463.1**	**629.7**	**1,126.1**	**3,270.4**
2008 and prior											655.5
Claims handling provision											80.0
Total											4,005.9

Net insurance liabilities

Accident year	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	Total £m
Estimate of ultimate net claims costs:											
At end of accident year	3,790.6	3,902.0	2,644.4	2,271.8	2,093.9	1,971.0	1,926.7	1,922.2	2,016.9	2,125.9	
One year later	70.0	(125.2)	(131.5)	(146.7)	(123.6)	(29.7)	(67.0)	(18.9)	(79.7)		
Two years later	(17.4)	(120.4)	(82.1)	(107.8)	(134.4)	(42.0)	(77.8)	(38.2)			
Three years later	(54.1)	(44.0)	(76.5)	(35.6)	(27.8)	(100.7)	(30.4)				
Four years later	(67.0)	(93.6)	(48.7)	(11.6)	(64.3)	(41.3)					
Five years later	(29.6)	(52.3)	(37.3)	(54.2)	(38.9)						
Six years later	(74.6)	(43.9)	(37.0)	(30.4)							
Seven years later	(38.2)	(24.8)	(20.4)								
Eight years later	(0.4)	(17.4)									
Nine years later	(35.1)										
Current estimate of cumulative claims	3,544.2	3,380.4	2,210.9	1,885.5	1,704.9	1,757.3	1,751.5	1,865.1	1,937.2	2,125.9	
Cumulative payments to date	(3,441.4)	(3,308.2)	(2,149.3)	(1,845.4)	(1,637.1)	(1,585.0)	(1,544.1)	(1,548.8)	(1,470.3)	(1,173.7)	
Net liability recognised in balance sheet	**102.8**	**72.2**	**61.6**	**40.1**	**67.8**	**172.3**	**207.4**	**316.3**	**466.9**	**952.2**	**2,459.6**
2008 and prior											361.1
Claims handling provision											80.0
Total											2,900.7

Movements in gross and net insurance liabilities

	Gross[1] £m	Reinsurance £m	Net[1] £m
Claims reported	2,584.5	(388.3)	2,196.2
Incurred but not reported	2,002.8	(890.0)	1,112.8
Claims handling provision	79.3	–	79.3
At 1 January 2017	4,666.6	(1,278.3)	3,388.3
Cash paid for claims settled in the year	(2,012.0)	14.0	(1,998.0)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,389.9	(200.3)	2,189.6
Arising from prior-year claims	(818.8)	383.4	(435.4)
At 31 December 2017	4,225.7	(1,081.2)	3,144.5
Claims reported	3,003.7	(742.5)	2,261.2
Incurred but not reported	1,142.7	(338.7)	804.0
Claims handling provision	79.3	–	79.3
At 31 December 2017	4,225.7	(1,081.2)	3,144.5
Cash paid for claims settled in the year	**(2,186.7)**	**31.1**	**(2,155.6)**
Increase / (decrease) in liabilities:			
Arising from current-year claims	**2,490.4**	**(174.2)**	**2,316.2**
Arising from prior-year claims	**(523.5)**	**119.1**	**(404.4)**
At 31 December 2018	**4,005.9**	**(1,105.2)**	**2,900.7**
Claims reported	**3,001.0**	**(809.8)**	**2,191.2**
Incurred but not reported	**924.9**	**(295.4)**	**629.5**
Claims handling provision	**80.0**	**–**	**80.0**
At 31 December 2018	**4,005.9**	**(1,105.2)**	**2,900.7**

Note:

1. Included within the incurred but not reported claims provision is a £55 million net release (gross: £175 million release) relating to assumed changes to the Ogden discount rate which have not yet been reflected in claims reported (31 December 2017: gross and net £nil; 1 January 2017: £217 million net provision increase; £542 million gross provision increase).

Movement in prior-year net claims liabilities by operating segment

	2018 £m	2017 £m
Motor[1]	**(276.3)**	(318.6)
Home	**(32.6)**	(23.7)
Rescue and other personal lines	**(16.1)**	(6.8)
Commercial	**(79.4)**	(86.3)
Total	**(404.4)**	(435.4)

Note:

1. Results for the year ended 31 December 2018 are based on total Group operations including the Run-off segment. Comparative data has been re-presented accordingly to include Run-off segment prior-year claims movements within the Motor segment (2017: £43.1 million).

34. Unearned premium reserve

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2017	1,547.9	(93.5)	1,454.4
Net movement in the year	52.4	(3.8)	48.6
At 31 December 2017	1,600.3	(97.3)	1,503.0
Net movement in the year	**(94.8)**	**(6.2)**	**(101.0)**
At 31 December 2018	**1,505.5**	**(103.5)**	**1,402.0**

35. Share-based payments

The Group operates equity-settled, share-based compensation plans in the form of an LTIP, a Restricted Shares Plan, a 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 TSR and RoTE. For awards since August 2017, the Directors are subject to an additional two-year holding period following the three-year vesting period.

Awards were made in the year ended 31 December 2018 over 3.9 million Ordinary Shares with an estimated fair value of £10.5 million at the 2018 grant dates (2017: 4.2 million Ordinary Shares with an estimated fair value of £15.2 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.

	2018	2017
Weighted average assumptions during the year:		
Share price (pence)	355	359
Exercise price (pence)	0	0
Volatility of share price	21%	20%
Average comparator volatility	30%	30%
Expected life	3 years	3 years
Risk-free rate	0.9%	0.2%

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 to eligible employees. These awards can be granted at any time during the year, generally have no performance criteria, and vest over periods ranging between one and three years from the date of the grant, subject to continued employment. During the year awards were made over 0.5 million Ordinary Shares (2017: 1.1 million Ordinary Shares) with an estimated fair value of £1.6 million (2017: £3.9 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 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 1.3 million Ordinary Shares (2017: 0.9 million Ordinary Shares) under this plan with an estimated fair value of £4.9 million (2017: £2.9 million) using the market value at the date of grant.

The awards outstanding at 31 December 2018 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 2018, the Group offered all eligible employees a Free Share award granting 133 Ordinary Shares free of charge to celebrate the Group's fifth anniversary in October 2017 of its launch on the London Stock Exchange. 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 1.4 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 2018, matching share awards were granted over 0.4 million Ordinary Shares (2017: 0.4 million Ordinary Shares) with an estimated fair value of £1.5 million (2017: £1.3 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 the 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	
	2018 millions	2017 millions
At 1 January	**20.2**	18.1
Granted during the year[1]	**9.2**	9.6
Forfeited during the year	**(2.7)**	(1.3)
Exercised during the year	**(5.4)**	(6.2)
At 31 December	**21.3**	20.2
Exercisable at 31 December	**1.5**	1.9

Note:

1. In accordance with the rules of the LTIP and DAIP award plans, additional awards of 1.7 million shares were granted during the year ended 31 December 2018 (2017: 3.0 million) in respect of the equivalent dividend.

In respect of the outstanding options at 31 December 2018, the weighted average remaining contractual life is 1.58 years (2017: 1.39 years). No share awards expired during the year (2017: nil).

The weighted average share price for awards exercised during the year ended 31 December 2018 was £3.58 (2017: £3.61).

The Group recognised total expenses in the year ended 31 December 2018 of £21.0 million (2017: £14.8 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.

36. Trade and other payables, including insurance payables

	2018 £m	2017 £m
Trade creditors and accruals	**227.7**	282.8
Other taxes	**100.0**	103.9
Other creditors	**89.1**	95.9
Provisions	**72.8**	74.2
Due to reinsurers	**47.4**	74.2
Due to agents, brokers and intermediaries	**11.9**	18.2
Deferred income	**4.7**	4.8
Due to insurance companies	**0.5**	4.0
Total	**554.1**	658.0

Movement in provisions during the year

	Regulatory levies £m	Restructuring £m	Other £m	Total £m
At 1 January 2018	31.7	6.4	36.1	74.2
Additional provision	47.5	2.8	32.5	82.8
Utilisation of provision	(43.6)	(1.9)	(26.0)	(71.5)
Released to income statement	–	(3.9)	(8.8)	(12.7)
At 31 December 2018	35.6	3.4	33.8	72.8

37. Notes to the consolidated cash flow statement

	2018 £m	2017 £m
Profit for the year	473.7	434.0
Adjustments for:		
Investment return	(154.6)	(175.4)
Instalment income	(119.9)	(116.4)
Finance costs	19.1	103.8
Defined benefit pension scheme – net interest charge / (income)	0.1	(0.3)
Equity-settled share-based payment charge	21.0	14.8
Tax charge	108.9	105.0
Depreciation and amortisation charge	76.3	82.0
Impairment of property, plant and equipment, goodwill and intangible assets	1.5	56.9
Impairment provision movements on reinsurance contracts	(5.2)	9.2
Gain on sale / fair value adjustment on assets held for sale	(9.6)	(0.4)
Loss on sale of property, plant and equipment	0.3	0.7
Operating cash flows before movements in working capital	411.6	513.9
Movements in working capital:		
Net decrease in net insurance liabilities including reinsurance assets, unearned premium reserves and deferred acquisition costs	(325.2)	(186.7)
Net decrease / (increase) in prepayments and accrued income and other assets	18.2	(15.2)
Net decrease in insurance and other receivables	105.3	7.1
Net decrease in trade and other payables, including insurance payables	(103.9)	(41.2)
Cash generated from operations	106.0	277.9
Taxes paid	(102.6)	(76.5)
Cash flow hedges	0.8	2.6
Net cash generated from operating activities before investment of insurance assets	4.2	204.0
Interest received	303.6	316.6
Rental income received from investment property	15.9	16.2
Purchase of investment property	(0.1)	–
Proceeds on disposal of investment property	–	41.3
Proceeds on disposal / maturity of AFS debt securities	2,159.2	1,948.4
Proceeds from maturity of HTM debt securities	2.5	–
Advances made for infrastructure debt and commercial real estate loans	(59.3)	(108.5)
Repayments of infrastructure debt	49.2	31.8
Purchase of AFS debt securities	(2,002.9)	(1,885.4)
Purchase of HTM debt securities	–	(18.5)
Cash generated from investment of insurance assets	468.1	341.9

The table below details changes in liabilities arising from the Group's financing activities.

	Subordinated liabilities		Interest rate swaps[1]	
	2018 £m	2017 £m	2018 £m	2017 £m
At 1 January	(264.7)	(539.6)	16.3	38.4
Repayment of subordinated liabilities	–	326.8	–	–
Interest paid on subordinated liabilities[2]	23.1	51.6	–	–
Interest rate swap cash settlement	–	–	(5.8)	(19.9)
Financing cash flows	23.1	378.4	(5.8)	(19.9)
Premium paid to buy back of debt issued	–	(76.8)	–	–
Amortisation of arrangement costs and discount on issue of subordinated liabilities	(0.4)	(2.2)	–	–
Accrued interest expense on subordinated liabilities	(23.1)	(47.5)	–	–
Unrealised gain on associated interest rate risk on hedged item	5.6	11.7	–	–
Realised gain on associated interest rate risk on hedged item	–	11.3	–	10.7
Net accrued interest on interest rate swap	–	–	(0.2)	(1.2)
Fair value movement in interest rate swap	–	–	(1.3)	(11.7)
Non-cash changes	(17.9)	(103.5)	(1.5)	(2.2)
At 31 December	(259.5)	(264.7)	9.0	16.3

Notes:

1. The interest rate swaps relate to the Group's 10-year designated hedging instrument which exchanges 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.
2. This includes £2.7 million of accrued interest settled in relation to the £250 million of repayment of subordinated guaranteed notes in 2017.

38. Contingent liabilities

The Group did not have any material contingent liabilities at 31 December 2018 (2017: none).

39. Commitments

Operating lease commitments where the Group is the lessee

The Group has entered into non-cancellable operating lease agreements for properties, vehicles and other assets.

	2018 £m	2017 £m
Lease payments under operating leases recognised as an expense in the year	21.3	18.8

The following table analyses the outstanding commitments for future minimum lease payments under non-cancellable operating leases by the period in which they fall due.

	2018 £m	2017 £m
Within one year	19.2	19.2
In the second to fifth years inclusive	56.4	58.1
After five years	148.7	154.8
Total	224.3	232.1

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.

	2018 £m	2017 £m
Within one year	14.5	15.3
In the second to fifth years inclusive	42.9	46.1
After five years	70.4	73.1
Total	127.8	134.5

40. 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 are 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.
- level 3 fair value measurements used for investment properties, HTM debt securities, infrastructure debt and commercial real estate loans 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 carried at fair value

The following table compares the carrying value and the fair value of financial instruments and other assets where the Group discloses a fair value.

At 31 December 2018	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
Assets held at fair value:					
Investment property (note 19)	322.1	–	–	322.1	322.1
Derivative assets (note 24)	48.2	–	48.2	–	48.2
AFS debt securities (note 26)	4,145.6	156.9	3,988.7	–	4,145.6
Other financial assets:					
HTM debt securities (note 26)	101.0	–	13.9	87.4	101.3
Infrastructure debt (note 26)	289.6	–	–	286.3	286.3
Commercial real estate loans (note 26)	201.6	–	–	201.6	201.6
Total	5,108.1	156.9	4,050.8	897.4	5,105.1
Liabilities held at fair value:					
Derivative liabilities (note 24)	25.9	–	25.9	–	25.9
Other financial liabilities:					
Subordinated liabilities (note 32)	259.5	–	297.8	–	297.8
Total	285.4	–	323.7	–	323.7

At 31 December 2017	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
Assets held at fair value:					
Investment property (note 19)	309.3	–	–	309.3	309.3
Derivative assets (note 24)	84.4	–	84.4	–	84.4
AFS debt securities (note 26)	4,451.4	224.8	4,226.6	–	4,451.4
Other financial assets:					
HTM debt securities (note 26)	103.6	–	14.4	92.8	107.2
Infrastructure debt (note 26)	316.4	–	–	326.0	326.0
Commercial real estate loans (note 26)	169.0	–	–	169.0	169.0
Total	5,434.1	224.8	4,325.4	897.1	5,447.3
Liabilities held at fair value:					
Derivative liabilities (note 24)	12.0	–	12.0	–	12.0
Other financial liabilities:					
Subordinated liabilities (note 32)	264.7	–	328.7	–	328.7
Total	276.7	–	340.7	–	340.7

Differences arise between carrying value and fair value where the measurement basis of the asset or liability is not fair value (e.g. assets and liabilities carried at amortised cost). Fair values of the following assets and liabilities approximate their carrying values:

– insurance and other receivables;
– cash and cash equivalents;
– borrowings; and
– trade and other payables, including insurance payables (excluding provisions).

The movements in assets held at fair value and classified as level 3 in the fair value hierarchy are within investment property and are analysed in note 19. There were no changes in the categorisation of assets between levels 1, 2 and 3 for assets and liabilities held by the Group since 31 December 2017.

41. Related parties

Transactions between the Group's subsidiary undertakings, which are related parties, have been eliminated on consolidation and accordingly are not disclosed.

There were no sales and purchases of products and services to or from related parties in the year ended 31 December 2018 (2017: £nil).

Compensation of key management

	2018 £m	2017 £m
Short-term employee benefits	11.2	10.6
Share-based payments	8.9	5.5
Total	20.1	16.1

PARENT COMPANY BALANCE SHEET

As at 31 December 2018

	Notes	2018 £m	2017 £m
Assets			
Investment in subsidiary undertakings	2	3,119.0	3,099.1
Other receivables	3	548.3	613.5
Current tax assets	4	–	16.1
Derivative financial instruments	5	1.4	1.0
Financial investments	6	5.1	5.2
Cash and cash equivalents	7	236.1	209.3
Total assets		3,909.9	3,944.2
Equity			
Shareholders' equity		3,205.8	3,257.5
Tier 1 notes	9	346.5	346.5
Total equity		3,552.3	3,604.0
Liabilities			
Subordinated liabilities	10	253.0	252.7
Borrowings	11	100.7	84.5
Derivative financial instruments	5	1.4	1.0
Trade and other payables	12	1.7	1.4
Deferred tax liabilities	4	0.6	0.6
Current tax liabilities	4	0.2	–
Total liabilities		357.6	340.2
Total equity and liabilities		3,909.9	3,944.2

The attached notes on pages 184 to 188 form an integral part of these separate financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 4 March 2019. They were signed on its behalf by:

PENNY JAMES
CHIEF FINANCIAL OFFICER

Direct Line Insurance Group plc

Registration No. 02280426

PARENT COMPANY STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2018

	2018 £m	2017 £m
Profit for the year	449.6	50.6
Other comprehensive loss		
Items that may be reclassified subsequently to income statement:		
Fair value loss on fair value through other comprehensive income investments	(0.1)	(0.4)
Tax relating to items that may be reclassified	–	0.1
Other comprehensive loss for the year net of tax	(0.1)	(0.3)
Total comprehensive income for the year attributable to owners of the Company	449.5	50.3

PARENT COMPANY STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2018

	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 2017	150.0	1,450.0	1.8	0.4	1,835.3	3,437.5	–	3,437.5
Total comprehensive income for the year	–	–	–	(0.3)	50.6	50.3	–	50.3
Dividends paid	–	–	–	–	(225.3)	(225.3)	–	(225.3)
Credit to equity for equity-settled share-based payments	–	–	14.8	–	–	14.8	–	14.8
Shares distributed by employee trusts	–	–	(19.8)	–	–	(19.8)	–	(19.8)
Issue of Tier 1 notes (note 9)	–	–	–	–	–	–	346.5	346.5
Balance at 31 December 2017	150.0	1,450.0	(3.2)	0.1	1,660.6	3,257.5	346.5	3,604.0
Total comprehensive income for the year	–	–	–	(0.1)	449.6	449.5	–	449.5
Dividends and appropriations paid (note 13)	–	–	–	–	(503.8)	(503.8)	–	(503.8)
Credit to equity for equity-settled share-based payments	–	–	21.0	–	–	21.0	–	21.0
Shares distributed by employee trusts	–	–	(18.4)	–	–	(18.4)	–	(18.4)
Balance at 31 December 2018	150.0	1,450.0	(0.6)	–	1,606.4	3,205.8	346.5	3,552.3

The attached notes on pages 184 to 188 form an integral part of these separate 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.

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 Financial Reporting Standard FRS 101 'Reduced Disclosure Framework'. In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of IFRSs issued by the IASB as adopted by the EU but makes amendments where necessary to comply with the Companies Act 2006.

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 IFRS13 'Fair Value Measurement';
- FRS 101.8 (g): the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D, 111 and 134 – 136 of IAS 1 'Presentation of Financial Statements' to produce a cash flow statement, a third balance sheet 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.

1.2 Adoption of new and revised standards

The accounting policies used in the preparation of these separate financial statements are consistent with previous years, and the accounting policies applied in the consolidated financial statements of Direct Line Insurance Group plc, except for the adoption of IFRS 9 'Financial Instruments' and the additional accounting policies specific to the separate financial statements of the Company as set out below.

The Company has adopted IFRS 9 which became mandatory for the first time in 2018. IFRS 9 replaces IAS 39 'Financial Instruments: Recognition and Measurement', introducing new guidance on the classification and measurement of financial assets, an expected credit loss impairment model, and new hedge accounting requirements.

The Company completed an impact assessment on transition to IFRS 9, including an assessment of its financial assets under the new impairment model, and concluded there was no impact on the Company's equity at 1 January 2018. The Company will continue applying the hedge accounting requirements of IAS 39 as permitted under IFRS 9.

The Company assessed its business model for managing the financial assets held by the Company and classified its financial assets into the appropriate IFRS 9 categories. The impact of the reclassification was as follows:

	Measurement category		Carrying amount		Difference
Financial asset	IAS 39	IFRS 9	IAS 39 £m	IFRS 9 £m	£m
AFS debt securities	AFS	Fair value through other comprehensive income	5.1	5.1	–
Loan to subsidiary undertakings	Amortised cost	Amortised cost	531.8	531.8	–
Derivative financial instruments	Fair value through profit or loss	Fair value through profit or loss	1.4	1.4	–
Cash and cash equivalents	Amortised cost	Amortised cost	236.1	236.1	–

UK sovereign debt securities were reclassified from AFS to fair value through other comprehensive income as the AFS category has been removed under IFRS 9. This is appropriate as the Company's business model is achieved by collecting contractual cash flows and selling these investments, and contractual cash flows are solely payments of principal and interest. The treatment of changes in fair value remain consistent and as a result there is no impact on equity. There is no difference in the carrying amount of any financial assets under IAS 39 and IFRS 9. IFRS 9 accounting policies adopted in the period are presented in note 1.5.

1.3 Investment in subsidiaries

Investment in subsidiaries is stated at cost less any impairment.

1.4 Dividend income

Dividend income from investment in subsidiaries is recognised when the right to receive payment is established.

1.5 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. The Company initially measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs.

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 subsequently measured at amortised cost, unless designated as fair value through profit or loss. Financial assets at amortised cost are subsequently measured using the effective interest method 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. 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
On recognition of a financial asset measured at amortised cost or fair value through other comprehensive income, an expected credit loss allowance is recognised by multiplying the financial asset's gross carrying amount by the probability of default multiplied by the loss given default.

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. This assessment depends on whether there has been a deterioration in the instrument's credit quality since initial recognition. 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, 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. The expected loss allowance is based on assumptions about risk of default and expected loss rates. 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.

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.

Hedge accounting
The Company has utilised the transition for hedge accounting option in IFRS 9 to continue applying the hedge accounting requirements of IAS 39.

2. Investment in subsidiary undertakings

	2018 £m	2017 £m
At 1 January	3,099.1	3,084.3
Additional investment in subsidiary undertakings	20.9	14.8
Impairment of investment in subsidiary undertakings	(1.0)	–
At 31 December	3,119.0	3,099.1

The subsidiary undertakings of the Company are set out on page 186. 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.

2. Investment in subsidiary undertakings continued

Name of subsidiary	Place of incorporation and operation	Principal activity
Directly held by the Company:		
Direct Line Group Limited[1]	United Kingdom	Intermediate holding company
DL Insurance Services Limited[1]	United Kingdom	Management services
Finsure Premium Finance Limited[1]	United Kingdom	Non-trading company
Inter Group Insurance Services Limited[1]	United Kingdom	Non-trading company
UK Assistance Accident Repair Centres Limited[1]	United Kingdom	Motor vehicle repair services
UK Assistance Limited[1]	United Kingdom	Dormant[7]
U K Insurance Business Solutions Limited[1]	United Kingdom	Insurance intermediary services
U K Insurance Limited[2,3]	United Kingdom	General insurance
Indirectly held by the Company:		
10-15 Livery Street, Birmingham UK Limited[4]	Jersey	Dormant[7]
Churchill Insurance Company Limited[1]	United Kingdom	General insurance
Direct Line Insurance Limited[1]	United Kingdom	Dormant[7]
DL Support Services India Private Limited[5]	India	Support and operational services
DLG Legal Services Limited[6]	United Kingdom	Legal services
DLG Pension Trustee Limited[1]	United Kingdom	Dormant[7]
Farmweb Limited[1]	United Kingdom	Non-trading company
Green Flag Group Limited[2]	United Kingdom	Intermediate holding company
Green Flag Holdings Limited[1]	United Kingdom	Intermediate holding company
Green Flag Limited[2]	United Kingdom	Breakdown recovery services
Intergroup Assistance Services Limited[1]	United Kingdom	Non-trading company
National Breakdown Recovery Club Limited[1]	United Kingdom	Dormant[7]
Nationwide Breakdown Recovery Services Limited[1]	United Kingdom	Dormant[7]
The National Insurance and Guarantee Corporation Limited[1]	United Kingdom	Dormant[7]
UKI Life Assurance Services Limited[1]	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.
4. Registered office at: 22 Grenville Street, St Helier, JE4 8PX, Jersey.
5. Registered office at: 4 Aradhana Enclave, Sector 13, Rama Krishna Puram, New Delhi, South West Delhi, Delhi, 110066, India.
6. Registered office at: 42 The Headrow, Leeds, LS1 8HZ.
7. In accordance with the requirements under sections 394A and 448A of the Companies Act 2006, there is no requirement to audit a dormant company.

3. Other receivables

	2018 £m	2017 £m
Loans to subsidiary undertakings[1]	531.9	612.2
Trade receivables due from subsidiary undertakings	15.1	–
Other debtors	1.3	1.3
Total	548.3	613.5
Current	48.3	113.5
Non-current	500.0	500.0
Total	548.3	613.5

Note:
1. Included in loans to subsidiary undertakings is a £500 million unsecured subordinated loan to U K Insurance Limited. The loan was advanced on 27 April 2012 at a fixed rate of 9.5% with a repayment date of 27 April 2042. There is an option to repay the loan on specific dates from 27 April 2022. If the loan is not repaid on 27 April 2022, the rate of interest will be reset at 6-month LIBOR plus 8.16%. All loans are neither past due nor impaired.

4. Current and deferred tax

	2018 £m	2017 £m
Per balance sheet:		
Current tax assets	–	16.1
Current tax liabilities	(0.2)	–
Deferred tax liabilities	(0.6)	(0.6)

The table below analyses the major deferred tax liabilities recognised by the Company and movements thereon.

	Provisions and other temporary differences £m	Fair value through other comprehensive income revaluation reserve £m	Total £m
At 1 January 2017	(0.3)	(0.1)	(0.4)
Credit to the income statement	0.4	–	0.4
Credit to other comprehensive income	–	0.1	0.1
Other movements	(0.7)	–	(0.7)
At 31 December 2017 and 2018	(0.6)	–	(0.6)

5. Derivative financial instruments

	Notional amount 2018 £m	Fair value 2018 £m	Notional amount 2017 £m	Fair value 2017 £m
Derivative assets				
Designated as hedging instruments:				
Foreign exchange contracts[2]	18.5	1.4	17.3	1.0
Total	18.5	1.4	17.3	1.0
Derivative liabilities				
Designated as hedging instruments:				
Foreign exchange contracts[2]	18.5	1.4	17.3	1.0
Total	18.5	1.4	17.3	1.0

Notes:

1. The derivative assets and liabilities are both classified as level 2 within the Group's fair value hierarchy set out in note 40 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

	2018 £m	2017 £m
Fair value through other comprehensive income debt securities[1]	5.1	5.2

Note:

1. The fair value through other comprehensive income debt securities are fixed interest UK sovereign debt classified as level 1 within the Group's fair value hierarchy which is set out in note 40 of the consolidated financial statements.

7. Cash and cash equivalents

	2018 £m	2017 £m
Cash at bank and in hand	0.1	3.8
Short-term deposits with credit institutions[1]	236.0	205.5
Total	236.1	209.3

Note:

1. This represents money market funds with no notice period for withdrawal.

8. Share capital and capital reserves

Full details of the share capital and capital reserves of the Company are set out in notes 29 and 30 to the consolidated financial statements.

9. Tier 1 notes

Full details of the Tier 1 notes of the Company are set out in note 31 to the consolidated financial statements.

10. Subordinated liabilities

	2018 £m	2017 £m
Subordinated guaranteed dated notes	253.0	252.7

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. The Company has the option to repay the notes on specific dates from 27 April 2022. If the notes are not repaid on 27 April 2022, the rate of interest will be reset at a rate of 6-month LIBOR plus 7.91%.

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 Company has the option, in certain circumstances, to defer interest payments on the notes but to date has not exercised this right.

The notes are unsecured, subordinated obligations of the Company, and rank pari passu without any preference among themselves. In the event of a winding up or insolvency, they are to be repaid only after the claims of all other senior creditors have been met.

The notes are guaranteed by U K Insurance Limited, a principal subsidiary of the Company.

The aggregate fair value of subordinated guaranteed dated notes at 31 December 2018 was £297.8 million (2017: £328.7 million).

11. Borrowings

	2018 £m	2017 £m
Loans from fellow subsidiaries within the Group[1]	100.7	84.5

Note:

1. Included in the above is a loan of £73.0 million (2017: £61.5 million) from UK Assistance Accident Repair Centres Limited. Other loans of £23.7 million from fellow Group subsidiaries are repayable on demand and are subject to interest on outstanding balances based on the average 3-month LIBOR rate.

12. Trade and other payables

	2018 £m	2017 £m
Payables to subsidiary undertakings	–	0.1
Payables to third parties	1.7	1.3
Total	1.7	1.4

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 35 to the consolidated financial statements.

15. 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.

16. 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 41 to the consolidated financial statements and the remuneration and pension benefits payable in respect of the highest paid Director are included in the Directors' remuneration report in the Governance section of the Annual Report & Accounts.

17. Post balance sheet event

On 28 February 2019, the Board of U K Insurance Limited, a subsidiary undertaking of the Company, agreed to repay £250 million of its £500 million subordinated loan to the Company. This transaction is expected to occur in March 2019.