

Balance sheet management

Capital management and dividend policy

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

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

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

The Group expects that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend, and two-thirds will be paid as a final dividend in the second quarter of the following year. The Board may revise the dividend policy from time to time. The Company may consider a special dividend and/or a repurchase of its own shares to distribute surplus capital to shareholders.

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

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

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

Capital analysis

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

Capital position

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

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

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

Movement in capital surplus

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

Notes:

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