Contents

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of Direct Line Insurance Group plc (the "**Parent Company**") and its subsidiaries (together the "**Group**") give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2020 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006, International Financial Reporting Standards ("**IFRSs**") as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board ("**IASB**");
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 101 'Reduced Disclosure Framework'; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the Consolidated Income Statement;
- the Consolidated and Parent Company Statements of Comprehensive Income;
- the Consolidated and Parent Company Balance Sheets;
- the Consolidated and Parent Company Statements of Changes in Equity;
- the Consolidated Cash Flow Statement; and
- the related notes 1 to 44 on the Consolidated financial statements and related notes 1 to 17 on the Parent Company financial statements, excluding the capital adequacy disclosures in note 3 calculated in accordance with the Solvency II regime which are marked as unaudited.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law, international accounting standards in conformity with the requirements of the Companies Act 2006 and IFRSs as adopted by the European Union and as issued by the IASB. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 'Reduced Disclosure Framework' (United Kingdom Generally Accepted Accounting Practice).

2. Basis for opinion

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

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

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

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in 2020 were: – valuation of insurance liabilities: 1) The frequency and severity assumptions for large bodily injury claims; 2) The inflation and discount rate assumptions for valuing periodic payment orders ("**PPOs**"); and 3) The judgement applied in setting the margin above the actuarial best estimate. – valuation of illiquid investments: 1) Commercial real estate loans, infrastructure debt and private placement bonds; 2) Investment property; – general ledger migration. Within this report, key audit matters are identified as follows: Newly identified; Increased level of risk; Similar level of risk; and Decreased level of risk.
Materiality	The materiality that we used for the Group financial statements was £28 million, which approximates to 5.6% (2019: 5.3%) of the three year average profit before tax, excluding the impact of the Ogden discount rate change to 0% in the 2018 results and minus 0.25% in the 2019 results which we elected to exclude due to the non-recurring nature of these events.
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 95% of the Group's profit before tax. We performed analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to a full scope audit or an audit of specified balances.
Significant changes in our approach	During the year we have identified one new key audit matter relating to the migration of the general ledger, given the potential wide-reaching impact this one-off event has on the financial statements. We have also extended two existing key audit matters in relation to: a. the valuation of insurance liabilities, which now includes the judgement applied in setting the margin above the actuarial best estimate; and b. the valuation of illiquid investments, which now includes investment property. Lastly, we have no longer identified the valuation of intangible assets as a key audit matter due to the progress made in 2020 towards rolling out the new motor trading platform.

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the Directors' assessment of the Group's and Parent Company's ability to continue to adopt the going concern basis of accounting included:

- assessing the Group's process around the going concern assessment performed by management;
- evaluating the historical accuracy of forecasts prepared by management;
- challenging the reasonableness of the profit forecasts used by management; and
- evaluating the Group's current-year performance and year end liquidity and solvency capital position.

We considered as part of our risk assessment the nature of the Group, its business model and related risks including where relevant the impact of climate change, Brexit and Covid-19, the requirements of the applicable financial reporting framework and the system of internal control.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group and Parent Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In relation to the reporting on how the Group has applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the Directors' statement in the financial statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

5.1 Valuation of insurance liabilities

Refer to page 99 (Audit Committee Report), page 163 (Accounting policies) and page 205 (Financial statements).

The Group's insurance liabilities total £3.6 billion (2019: £3.8 billion) and represent the single largest liability on the balance sheet. Valuation of these liabilities requires management to select methods and assumptions that are subject to high levels of estimation uncertainty. Consequently, small changes in these methods or assumptions can materially impact the valuation of these liabilities. We have identified the following three key areas of focus for our audit given their significance to the Group's result and the high level of estimation uncertainty. We have also identified these as potential fraud risk areas.

5.1.1 The frequency and severity assumptions for bodily injury claims

Key audit matter description

The frequency and severity of bodily injury claims have a significant impact on the valuation of the insurance liabilities and the setting of these assumptions is driven by a variety of factors. These factors include the completeness and accuracy of source data, the transparency of any changes in the reporting of bodily injury claims, and actuarial assumptions being consistent with emerging data, market factors and the Group's reserving policy. As a result of these factors, there is a significant level of estimation uncertainty in the valuation of these claims, which increases the susceptibility of the balance to material misstatement due to error and fraud.

In addition, the impact of the UK government's various lockdown measures introduced first in March 2020, in response to Covid-19, has resulted in significantly reduced mobility and traffic volumes in March and April 2020 and reduced volumes for the rest of the year after further lockdown measures were introduced. The Group and the wider market have experienced reduced motor vehicle accident frequencies as a result. This further adds to the inherent uncertainty underlying the estimation of the ultimate number of bodily injury claims for the 2020 accident year.

How the scope of our audit responded to the key audit matter

We have gained a detailed understanding of the end-to-end claims and reserving process and obtained an understanding of relevant controls.

In order to gain assurance over the completeness and accuracy of source data used in the Group's actuarial calculations and by our in-house actuarial specialists in performing our work, we have tested the data reconciliation controls and performed reconciliations on the actuarial data back to the financial ledger.

Having done this, we worked with our actuarial specialists to:

- inspect and challenge the reserving process in relation to bodily injury claims undertaken by assessing relevant documentation and meeting with the Actuarial Director and his team; and
- inspect and challenge the Group's documented methodology and key assumptions in respect of the prior years as well as the current year, with particular reference to Covid-19 impacts. This included:
    - using our in-house reserving software to help us challenge the Group's response to emerging claims trends;
    - inspecting the Group's models and conducting sensitivity testing on model methodology and assumptions including prior-year changes to assumptions;
    - comparing the Group's burning cost and frequency diagnostics to market benchmarks and independent reserve review results; and
    - analysing the consistency in reserving strength and reserve releases in comparison with prior years.

Key observations

In the prior financial year we considered the frequency and severity assumptions for large bodily injury claims to be reasonable and prudent however less prudent than previous financial periods given that the Group's actuaries had given credit for favourable experience noted that year. In the current financial year we have concluded that the assumptions continue to be reasonable, albeit we have seen a continuation in the trend of reduced prudence compared to previous periods.

5.1.2 The inflation and discount rate assumptions for PPOs

Key audit matter description

The Group is required to settle a proportion of large bodily injury claims as PPOs rather than lump sum payments. The valuation of PPOs has a material impact on the financial statements, with liabilities totalling £814.8 million (2019: £800.1 million) on a discounted gross basis as detailed in note 34.

Given the ongoing uncertainty in the UK's inflation environment and investment markets, the selection of the inflation and discount rate assumptions is highly judgemental and has a material impact on the financial statements. The PPOs are sensitive to economic assumptions selected and as at 31 December 2020, the Group valued PPOs using an inflation rate of 3.5% (2019: 4%) and a discount rate of 3.5% (2019: 4%). These assumptions represent a key source of estimation uncertainty for the Group which increases the susceptibility of the balance to material misstatement due to error and fraud.

How the scope of our audit responded to the key audit matter

We have gained a detailed understanding over management's process for setting these assumptions and obtained an understanding of the relevant controls surrounding the setting of the PPO inflation rate and discount rate, which is the challenge and approval of these assumptions by the Loss Ratio Committee and Audit Committee. In addition, we tested the relevant direct and precise business control, performed weekly, over the completeness of the PPO listing. This is a key data input which has a material impact on the PPO assumptions and hence the valuation.

We have worked with our actuarial specialists to challenge:

- The PPO inflation assumption through inquiries with the Actuarial Director, reviewing relevant supporting documentation and benchmarking against market economic data with particular reference to Covid-19 uncertainty, and other market participants;
- The Group's sensitivity testing on the PPO inflation assumption;
- The selected discount rate with reference to current and future performance of the assets backing the PPO liabilities; and
- The methodology and rationale for deriving the discount rate.

Key observations

We have determined that the inflation and discount rate assumptions used in the calculation of the PPO claims reserve are in the middle of a reasonable range.

5.1.3 Judgement applied in setting the margin above the actuarial best estimate

Key audit matter description

Actual claims experience may differ from the historical pattern on which the actuarial best estimate is based and the cost of settling individual claims may exceed that reserved for. Consequently, management adds a margin to the actuarial best estimate to arrive at the booked insurance liabilities. This margin is determined by considering a range of adverse economic and non-economic scenarios and reflects the inherent uncertainty in estimating the ultimate losses on claims, over and above that which can be projected actuarially as a best estimate based on underlying claims development data.

The appropriate margin to recognise is an area of significant management judgement based on the perceived uncertainty and potential for volatility in the underlying claims. In light of the heightened uncertainties created by the Covid-19 pandemic, we have identified the margin as an area of key audit focus given its susceptibility to management bias.

How the scope of our audit responded to the key audit matter

We worked with our in-house actuarial specialists to challenge the appropriateness of the recommended margin to be applied to the actuarial best estimate. In doing so we performed the following procedures:

- Inspected and challenged the approach to, and analysis performed in, setting the margin by reviewing relevant documentation and meeting with the Chief Financial Officer and Actuarial Director;
- Leveraged third party economic studies to challenge the appropriateness of management's adverse scenarios, with a specific focus on care worker wage inflation given the sensitivity of the Group's bodily injury claims to this assumption, whilst looking back to outcomes from previous economic downturns; and
- Performed a 'stand back' test to challenge the level of prudence in the overall insurance liabilities between periods in light of the level of uncertainties that exist at each respective reporting date.

Key observations

We have determined that the margin remains appropriate and is on balance slightly more prudent than in previous periods. In combination with the conclusion drawn in relation to large bodily injury claims above, we have concluded in overall terms the total insurance liabilities show a consistent level of prudence with previous years.

5.2 Valuation of illiquid investments

Refer to page 99 (Audit Committee Report), pages 166 and 167 (Accounting policies) and pages 196 and 202 (Financial statements).

In the current year, we continue to identify the valuation of illiquid investments, specifically the commercial real estate, infrastructure and private placements investments as a key audit matter as described below. Additionally, we have identified the valuation of investment property as a key audit matter due to the greater level of estimation uncertainty in determining a fair value as a result of Covid-19.

5.2.1 Commercial real estate loans, infrastructure debt and private placement bonds

Key audit matter description

We have identified a key audit matter in relation to these credit portfolios totalling £575.1 million (2019: £587.8 million).

Given the Group continues to recognise and measure financial instruments under IAS 39, these instruments are measured at amortised cost and require the recognition of an impairment when an incurred loss event arises. Significant management judgement is required in determining if an incurred loss event has occurred and, in the instance an event has occurred, there is significant estimation uncertainty in determining the impairment charge.

We deem there to be an increasing risk of default or delinquency on these less liquid assets owing to high and sustained levels of uncertainty in the UK economy from Covid-19 restrictions coupled with the ongoing impact of the UK's exit from the European Union.

5.2.1 Commercial real estate loans, infrastructure debt and private placement bonds continued

How the scope of our audit responded to the key audit matter

We have obtained an understanding and tested the relevant controls that mitigate the risk over the valuation of illiquid investments. Our work included attendance at the year-end impairment review meeting in order to observe the operation of a key management review control.

In addition, we performed the following procedures:

- Tested a sample of interest payments to bank during the year to test for default or delinquency in interest payments;
- Utilised market indices to identify commercial real estate loans at risk and inspected the tenancy breakdowns for potential risks of store closure given the current economic issues facing the UK high street;
- Challenged management on loans of interest where indicators could point to issuer financial difficulty and obtained evidence to help assess whether the conclusion reached by management is reasonable; and
- Engaged our complex pricing specialists to determine an independent fair value of these assets to identify any significant decreases in value below book cost.

Key observations

We considered the accounting treatment applied to be reasonable. In performing our procedures, we did not note any indicators of material impairment.

5.2.2 Investment property

Key audit matter description

The investment properties held by the Group comprise retail, supermarkets and food stores, office, industrial and alternative properties. As noted in disclosure note 20, the total value as at 31 December 2020 is £292.1 million (2019: £291.7 million). Given the impact of Covid-19 and its potential to accelerate long-term trends in the use of various types of property, we have identified the methodology and assumptions used for valuing certain parts of the investment property portfolio as a key audit matter in the current year. The investment properties we have identified relate to the retail, office and alternative sector properties held, where tenants possessed an increased exposure to Government imposed Covid-19 lockdown restrictions which may accelerate the long-term downwards trend of property valuation in these sectors. These properties total £142.0 million (2019: £150.0 million).

We considered the valuation of the investment properties to be a key audit matter as the determination of fair value involves significant judgement by the external valuation experts in light of Covid-19 and long-term trends in the use of various types of property. Valuation methodology for investment properties is subjective in nature and involves various key assumptions. The use of different valuation methodology and assumptions could produce significantly different estimates of fair value. With the outbreak of Covid-19, the property valuers can attach less weight to previous market evidence in determining a fair value. This leads to greater levels of estimation uncertainty in determining the valuation.

How the scope of our audit responded to the key audit matter

We have obtained an understanding and tested the relevant control related to the annual meeting with management's external valuation expert where a review and challenge of the assumptions and methodologies used in determining the fair value is performed. This relevant control mitigates the risk over the valuation of investment properties.

In addition, we performed the following procedures:

- We have worked with our real estate specialists who challenged the estimated rental value, yield and capitalisation rate assumptions and methodologies used in the valuation of the properties;
- We have tested the completeness and accuracy of the data inputs used in the valuation process performed by management and their external valuer; and
- We tested the data inputs used in the valuation model for investment properties, by agreeing occupation rates, unit sizes, and contracted rent to the underlying signed agreements and property reports. We then re-performed the calculation of the yields applied using this data.

Key observations

We considered the accounting treatment applied to be reasonable. In performing our procedures, we did not note any indicators of material impairment.

5.3 General ledger migration !

Refer to page 99 (Audit Committee Report).

Key audit matter description

During May 2020, as part of the Group's ongoing Finance Transformation programme, the Group migrated their general ledger system. We have focused on this migration due to the inherent risk of error and the impact such an error may have on the control environment of the Group. The incomplete and inaccurate transfer of data to the new general ledger system could result in the incorrect presentation of balances in the Group's consolidated accounts and would affect the quality of management information that supports the decision-making for those charged with governance.

Given the increased data integrity risks inherent to the migration of financial information and the importance of maintaining complete and accurate accounting records throughout the reporting period, we consider the general ledger migration to be a key audit matter.

How the scope of our audit responded to the key audit matter

We have performed the following procedures in order to respond to this risk:

- Obtained an understanding of and tested the relevant controls in the data migration;
- Re-performed key reconciliations to verify the completeness and accuracy of the data transfer and substantively test material differences; and
- Worked with IT specialists to test the design and implementation of general IT controls around the governance of the data migration and system controls post-implementation.

Key observations

Based on the work performed, we did not identify any significant issues from our testing of the general ledger migration.

6. Our application of materiality

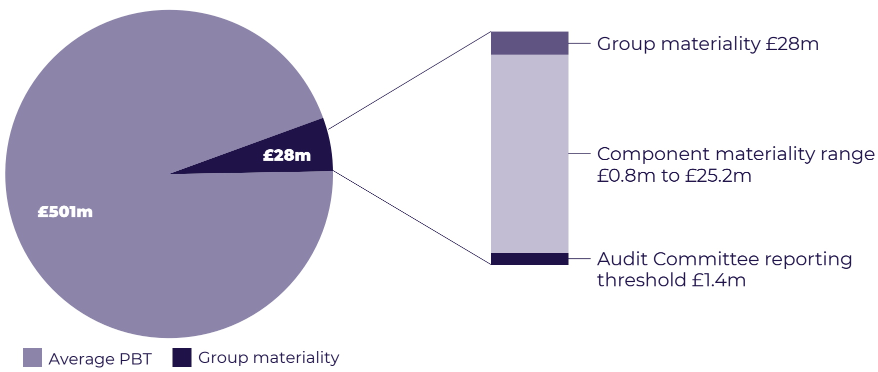
6.1 Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent Company financial statements
Materiality	£28.0 million (2019: £28.0 million)	£25.2 million (2019: £25.2 million)
Basis for determining materiality	The materiality approximates to 5.6% (2019: 5.3%) of the three year average profit before tax, excluding the impact of the Ogden discount rate change to 0% in the 2018 results and minus 0.25% in the 2019 results which we elected to exclude due to the non-recurring nature of these events.	Materiality equates to less than 1% of (2019: 1%) of shareholders' equity and is capped at 90% (2019: 90%) of Group materiality.
Rationale for the benchmark applied	We determined that the critical benchmark for the Group was average profit before tax. This measure uses a three-year average of profit before tax, which we deemed appropriate due to the inherent volatility of profits in the insurance industry. We also elected to exclude the impact of the Ogden discount rate change to 0% in the 2018 results and minus 0.25% in the 2019 results due to the non-recurring nature of these events. We also considered this measure to be suitable having compared to other benchmarks: our materiality equates to 6.2% (2019: 5.5%) of statutory profit before tax, 0.9% (2019: 0.9%) of gross earned premium and 0.9% (2019: 0.9%) of total equity.	We determined that the critical benchmark for the Parent Company was shareholder's equity. This is because the Parent Company is not a trading entity but rather received dividend income from its subsidiaries. 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 component's proportion of the chosen benchmark. This is capped at the lower of 90% of Group materiality and the component materiality determined for a standalone audit. The main UK insurance trading entity, U K Insurance Limited, which makes up 100% of Group gross earned premium and 86% of Group statutory profit before tax, is scoped to a component materiality of £25.2 million (2019: £25.2 million). Component materialities for other entities within the scope of our Group audit ranged from £0.8 million to £8.8 million (2019: £0.8 million to £9.0 million).



6. Our application of materiality continued

6.2 Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

	Group financial statements	Parent Company financial statements
Performance materiality	67.5% (2019: 70%) of Group materiality	67.5% (2019: 70%) of Parent Company materiality
Basis and rationale for determining performance materiality	In determining performance materiality, we considered the following factors: – We have audited the Group for a number of years and so have knowledge of both the Group and the environment it operates in; – Our ability to rely on controls over a number of significant business processes; – Our past experience of the audit, which has indicated a low number of corrected and uncorrected misstatements identified in prior periods; – Misstatements noted in prior periods have not been indicative of deficiencies in internal control and so there is a low likelihood they will occur in the current period; and – The potential impact of Covid-19.	For consistency within the Group, the same percentage of 67.5% of materiality has been applied to the Parent Company.

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £1.4 million (2019: £1.4 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. An overview of the scope of our audit

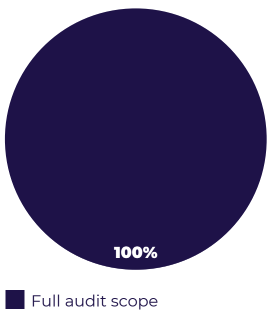
7.1 Identification and scoping of components

The scope of our Group audit was determined by obtaining an understanding of the Group and its environment, including group wide controls and assessing the risks of material misstatement at Group level.

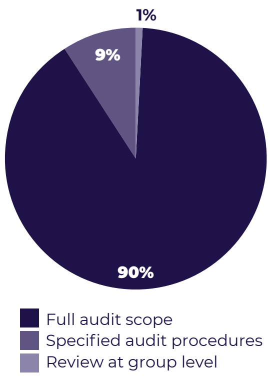
Consistent with the prior period, this resulted in two entities being subject to a full scope audit and a further two were subject to an audit of specified account balances where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the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

These four entities represent the principal trading and service operations of the Group and account for 99% (2019: 99%) of the Group's net assets, 100% (2019: 100%) of the Group's gross earned premium and 95% (2019: 98%) of the Group's profit before tax. They were also selected to provide an appropriate basis for undertaking audit work to address the risks of material misstatement identified above.

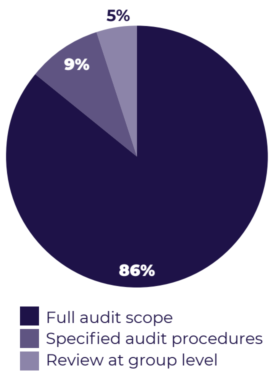
Gross Earned Premium



Net Assets



Profit before tax



At the Group level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

The Group audit team directly performed the audit work for all of the entities listed above, including the Parent Company.

7.2 Our consideration of the control environment

IT Controls

In planning our 2020 audit we identified 13 systems that were material to the Group's financial reporting processes. These systems handled data relating to premiums, claims, expenses and payroll and we intended to rely on the IT and business controls associated with these systems. Having worked with our in-house IT specialists to assess the operating effectiveness of the IT controls associated with these systems, as well as the wider general IT control environment across the Group, we were able to rely upon the IT controls associated with all 13 systems identified.

Business process and financial reporting controls

In planning our 2020 audit, we identified 20 business cycles that were material to the Group's financial reporting processes. These cycles spanned the Group's material transactions and account balances including the premiums, claims, reinsurance, expenses, payroll, investments and intangibles cycles and part of the reserving cycle relating to reconciliation of data, and we intended to rely on the business controls associated with all of these cycles. Having completed our testing over the operating effectiveness of business controls associated with these cycles, through a combination of current period testing and reliance on prior period testing, we concluded that we were able to rely upon the business controls associated with all 20 cycles.

8. Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information contained within the annual report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

9. Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

10. Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

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

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

11.1 Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the Group's remuneration policies, key drivers for Directors' remuneration, bonus levels and performance targets;
- the Group's own assessment of the risks that irregularities may occur either as a result of fraud or error that was approved by the Board Risk Committee on 11 February 2021;
- results of our enquiries of management, internal audit, and the Audit Committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the Group's documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations; and
- the matters discussed among the audit engagement team and involving relevant internal specialists, including tax, valuations, pensions, IT and industry specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas: the valuation of the insurance liabilities. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory framework that the Group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules and tax legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the Group's ability to operate or to avoid a material penalty. These included the Group's operating licence, regulatory solvency requirements such as those under the relevant Solvency II requirements and those required by the PRA and FCA and environmental regulations.

11.2 Audit response to risks identified

As a result of performing the above, we identified valuation of insurance liabilities and valuation of intangible assets as key audit matters related to the potential risk of fraud or non-compliance with laws and regulations. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

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

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

Report on other legal and regulatory requirements

12. Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and the Parent Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic report or the Directors' report.

13. Corporate governance statement

The Listing Rules require us to review the Directors' statement in relation to going concern, longer-term viability and that part of the Corporate Governance Statement relating to the Group's compliance with the provisions of the UK Corporate Governance Code specified for our review.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the corporate governance statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- the Directors' statement with regards to the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on page 143;
- the Directors' explanation as to its assessment of the Group's prospects, the period this assessment covers and why the period is appropriate set out on page 75;
- the Directors' statement on fair, balanced and understandable set out on page 95;
- the Board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 95;
- the section of the Annual Report and Accounts that describes the review of effectiveness of risk management and internal control systems set out on page 172; and
- the section describing the work of the Audit Committee set out on page 97.

14. Matters on which we are required to report by exception

14.1 Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

14.2 Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' remuneration report to be audited is not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

15. Other matters which we are required to address

15.1 Auditor tenure

Following the recommendation of the Audit Committee of Royal Bank of Scotland Group plc, ("**RBSG**"), which at the time owned Direct Line, we were appointed by the Board of Directors of RBSG on 21 March 2000 to audit the financial statements for the year ending 31 December 2000 and subsequent financial periods. When the Group became independent of RBSG the Group's Board reappointed us to audit the newly demerged Group. Taking into account our service to predecessor organisations, the period of total uninterrupted engagement including previous renewals and reappointments of the firm is 21 years, covering the years ending 31 December 2000 to 31 December 2020. Under the Companies Act 2006, the last financial year of our maximum engagement period is the year ending 31 December 2023.

15.2 Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

16. Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

COLIN RAWLINGS FCA (SENIOR STATUTORY AUDITOR)

FOR AND ON BEHALF OF DELOITTE LLP

SENIOR STATUTORY AUDITOR

LONDON, UNITED KINGDOM

5 MARCH 2021

Consolidated Income Statement
For the year ended 31 December 2020

	Notes	2020 £m	2019 £m
Gross earned premium		**3,189.3**	3,202.6
Reinsurance premium		**(228.8)**	(217.7)
Net earned premium	5	**2,960.5**	2,984.9
Investment return	6	**95.1**	134.6
Instalment income		**109.3**	114.0
Other operating income	7	**49.9**	66.2
Total income		**3,214.8**	3,299.7
Insurance claims		**(1,730.4)**	(1,917.3)
Insurance claims recoverable from reinsurers		**16.8**	69.7
Net insurance claims	8	**(1,713.6)**	(1,847.6)
Commission expenses	9	**(254.7)**	(211.5)
Operating expenses (including restructuring and one-off costs)	10	**(763.8)**	(704.9)
Total expenses		**(1,018.5)**	(916.4)
Finance costs	11	**(31.3)**	(26.0)
Profit before tax		**451.4**	509.7
Tax charge	12	**(84.2)**	(89.8)
Profit for the year attributable to the owners of the Company		**367.2**	419.9
Earnings per share:			
Basic (pence)	15	**25.8**	29.5
Diluted (pence)	15	**25.5**	29.2

The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2020

	Notes	2020 £m	2019 £m
Profit for the year attributable to the owners of the Company		**367.2**	419.9
Other comprehensive income			
Items that will not be reclassified subsequently to the income statement:			
Actuarial loss on defined benefit pension scheme	27	**(0.4)**	(7.3)
Tax relating to items that will not be reclassified	13	**0.3**	1.3
		(0.1)	(6.0)
Items that may be reclassified subsequently to the income statement:			
Cash flow hedges		**(0.1)**	(0.7)
Fair value gain on AFS investments	31	**47.4**	118.1
Less: net gains on AFS investments transferred to income statement on disposals	31	**(1.1)**	(16.5)
Tax relating to items that may be reclassified	31	**(9.9)**	(17.3)
		36.3	83.6
Other comprehensive income for the year net of tax		**36.2**	77.6
Total comprehensive income for the year attributable to the owners of the Company		**403.4**	497.5

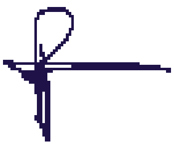
The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

Consolidated Balance Sheet
As at 31 December 2020

	Notes	2020 £m	2019 £m
Assets			
Goodwill and other intangible assets	17	**786.8**	702.5
Property, plant and equipment	18	**146.1**	143.4
Right-of-use assets	19	**137.8**	149.2
Investment property	20	**292.1**	291.7
Reinsurance assets	22	**1,129.2**	1,251.3
Deferred acquisition costs	23	**172.2**	176.2
Insurance and other receivables	24	**848.2**	846.5
Prepayments, accrued income and other assets	25	**126.0**	120.2
Derivative financial instruments	26	**73.4**	121.5
Retirement benefit asset	27	**9.0**	9.7
Financial investments	28	**4,681.4**	4,673.4
Cash and cash equivalents	29	**1,220.1**	948.6
Total assets		**9,622.3**	9,434.2
Equity			
Shareholders' equity		**2,699.7**	2,643.6
Tier 1 notes	32	**346.5**	346.5
Total equity		**3,046.2**	2,990.1
Liabilities			
Subordinated liabilities	33	**516.6**	259.0
Insurance liabilities	34	**3,617.0**	3,819.6
Unearned premium reserve	35	**1,497.1**	1,506.0
Borrowings	29	**51.9**	52.3
Derivative financial instruments	26	**57.2**	30.5
Provisions	37	**114.8**	74.3
Trade and other payables, including insurance payables	38	**549.9**	478.1
Lease liabilities		**152.4**	164.4
Deferred tax liabilities	13	**8.7**	9.6
Current tax liabilities	13	**10.5**	50.3
Total liabilities		**6,576.1**	6,444.1
Total equity and liabilities		**9,622.3**	9,434.2

The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 5 March 2021. They were signed on its behalf by:



PENNY JAMES
CHIEF EXECUTIVE OFFICER

Consolidated Statement of Changes in Equity
For the year ended 31 December 2020

	Share capital (note 30) £m	Employee trust shares £m	Capital reserves (note 31) £m	AFS revaluation reserve (note 31) £m	Foreign exchange translation reserve £m	Retained earnings £m	Share-holders' equity £m	Tier 1 notes (note 32) £m	Total equity £m
Balance at 1 January 2019	150.0	(35.2)	1,450.0	(36.8)	0.8	1,029.4	2,558.2	346.5	2,904.7
Profit for the year	–	–	–	–	–	419.9	419.9	–	419.9
Other comprehensive income	–	–	–	84.3	(0.7)	(6.0)	77.6	–	77.6
Dividends and appropriations paid (note 14)	–	–	–	–	–	(420.7)	(420.7)	–	(420.7)
Shares acquired by employee trusts	–	(10.4)	–	–	–	–	(10.4)	–	(10.4)
Credit to equity for equity-settled share-based payments (note 36)	–	–	–	–	–	18.4	18.4	–	18.4
Shares distributed by employee trusts	–	15.4	–	–	–	(15.4)	–	–	–
Tax on share-based payments	–	–	–	–	–	0.6	0.6	–	0.6
Balance at 31 December 2019	150.0	(30.2)	1,450.0	47.5	0.1	1,026.2	2,643.6	346.5	2,990.1
Profit for the year	**–**	**–**	**–**	**–**	**–**	**367.2**	**367.2**	**–**	**367.2**
Other comprehensive income	**–**	**–**	**–**	**36.4**	**(0.1)**	**(0.1)**	**36.2**	**–**	**36.2**
Dividends and appropriations paid (note 14)	**–**	**–**	**–**	**–**	**–**	**(312.5)**	**(312.5)**	**–**	**(312.5)**
Shares acquired by employee trusts	**–**	**(23.8)**	**–**	**–**	**–**	**–**	**(23.8)**	**–**	**(23.8)**
Shares cancelled following buyback (note 30)	**(1.1)**	**–**	**1.1**	**–**	**–**	**(30.0)**	**(30.0)**	**–**	**(30.0)**
Credit to equity for equity-settled share-based payments (note 36)	**–**	**–**	**–**	**–**	**–**	**18.5**	**18.5**	**–**	**18.5**
Shares distributed by employee trusts	**–**	**13.7**	**–**	**–**	**–**	**(13.7)**	**–**	**–**	**–**
Tax on share-based payments	**–**	**–**	**–**	**–**	**–**	**0.5**	**0.5**	**–**	**0.5**
Balance at 31 December 2020	**148.9**	**(40.3)**	**1,451.1**	**83.9**	**–**	**1,056.1**	**2,699.7**	**346.5**	**3,046.2**

The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

Consolidated Cash Flow Statement
For the year ended 31 December 2020

	Notes	2020 £m	2019 £m
Net cash generated from operating activities before investment of insurance assets	39	**268.8**	88.2
Cash generated from investment of insurance assets	39	**315.9**	373.9
Net cash generated from operating activities		**584.7**	462.1
Cash flows used in investing activities			
Purchases of goodwill and other intangible assets	17	**(140.7)**	(175.7)
Purchases of property, plant and equipment	18	**(20.1)**	(11.9)
Net cash flows from acquisition of subsidiaries		**(0.2)**	—
Net cash used in investing activities		**(161.0)**	(187.6)
Cash flows used in financing activities			
Dividends and appropriations paid	14	**(312.5)**	(420.7)
Finance costs (including lease interest)		**(30.2)**	(26.4)
Principal element of lease payments	39	**(12.5)**	(13.1)
Purchase of employee trust shares		**(23.8)**	(10.4)
Proceeds on issue of subordinated Tier 2 notes	39	**257.2**	—
Shares purchased in buyback	30	**(30.0)**	—
Net cash used in financing activities		**(151.8)**	(470.6)
Net increase / (decrease) in cash and cash equivalents		**271.9**	(196.1)
Cash and cash equivalents at the beginning of the year	29	**896.3**	1,092.4
Cash and cash equivalents at the end of the year	29	**1,168.2**	896.3

The attached notes on pages 162 to 214 form an integral part of these consolidated financial statements.

Corporate information

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

1. Accounting policies

Basis of preparation

As required by the Companies Act 2006 and Article 4 of the EU IAS Regulation, the Group's consolidated financial statements are prepared in accordance with IFRSs issued by the IASB as adopted by the EU on 31 December 2020 and by the UK's Department of Business, Energy & Industrial Strategy ("**BEIS**") in 2021. The BEIS has been given the power of endorsing and adopting international accounting standards while the UK Endorsement Board ("**UKEB**") is still being established. The Group has elected to prepare its parent entity financial statements in accordance with FRS 101 'Reduced Disclosure Framework'.

The consolidated financial statements are prepared on the historical cost basis except for available-for-sale ("**AFS**") financial assets, investment property and derivative financial instruments, which are measured at fair value (fair value is defined in note 42).

Where necessary, adjustments have been made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. The policies set out below have been applied consistently throughout the years ended 31 December 2020 and 31 December 2019 to items considered material to the consolidated financial statements.

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

Going concern

The Directors believe that the Group has sufficient financial resources to meet its financial needs, including managing a mature portfolio of insurance risk. The Directors believe the Group is well positioned to manage its business risks successfully in the current economic climate. The Finance review on pages 20 to 35 describes the Group's capital management strategy, including the capital actions taken in the year to ensure the continued strength of the balance sheet. The Group's financial position is also covered in that section, including a commentary on cash and investment levels, reserves, currency management, insurance liability management, liquidity and borrowings. Additionally, note 3 to the consolidated financial statements describes capital management needs and policies. The note also covers insurance, market, liquidity and credit risks which may affect the Group's financial position.

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

In addition, the Group's Risk Function has carried out an assessment of the risks to the Plan and the dependencies for the success of the Strategic Plan. This included running stress tests on the Plan to consider the 1 in 8 years and 1 in 25 years loss simulations based on the internal economic capital model.

A reverse stress test was also performed to identify the most probable combination of stresses that would result in capital loss and thus threaten the viability of the Group, i.e. a reduction of own funds to below the solvency capital requirement.

In all scenarios, it was concluded that the Group's solvency capital requirement would not be breached following the implementation of management actions.

Therefore, having made due enquiries, the Directors reasonably expect that the Group has adequate resources to continue in operational existence for at least 12 months from 5 March 2021 (the date of approval of the financial statements). Accordingly, the Directors have adopted the going concern basis in preparing the financial statements.

Adoption of new and revised standards

The Group has adopted the following new amendments to IFRSs and International Accounting Standards ("**IASs**") that became mandatorily effective for the Group for the first time during 2020.

None of these amendments require changes to existing accounting policies.

Amendment to IFRS 16 'Leases Covid-19-related Rent Concessions' permits lessees, as a practical expedient, not to assess whether particular rent concessions occurring as a direct consequence of the Covid-19 pandemic are lease modifications and instead to account for those rent concessions as if they are not lease modifications.

'Amendments to References to the Conceptual Framework in IFRS Standards' amends some references to previous versions of the Conceptual Framework in IFRS Standards and their accompanying documents and IFRS Practice Statements.

Amendments to IFRS 3 'Business Combinations', narrow and clarify the definition of a business. They also permit a simplified assessment of whether an acquired set of activities and assets is a group of assets rather than a business.

Amendments to IAS 1 and IAS 8: 'Definition of Material', clarify and align the definition of "material" and provide guidance to help improve consistency in the application of that concept whenever it is used in IFRS Standards.

1.1 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and the entities that are controlled by the Group at 31 December 2020 and 31 December 2019. Control exists when the Group is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In assessing whether the Group controls another entity, the existence and effect of the potential voting rights that are currently exercisable or convertible are considered.

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

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

1.2 Foreign currencies

The Group's consolidated financial statements are presented in sterling, which is the presentational currency of the Group.

Group entities record transactions in the currency of the primary economic environment in which they operate (their functional currency), translated at the foreign exchange rate ruling at the date of the transaction.

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

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

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

1.3 Contract classification

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

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

1.4 Revenue recognition

Premiums earned

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

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

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

Investment return

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

Rental income from investment property is recognised in the income statement on a straight-line basis over the period of the contract.

Dividend income is recognised when the right to receive payment is established.

Instalment income

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

Other operating income

Vehicle replacement referral income

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

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

Revenue from vehicle recovery and repair services

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

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

Legal services income

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

Other income

Commission fee income in respect of services is recognised at a point in time on satisfaction of related performance obligations. Where variable consideration is identified in a contract, this revenue is estimated and constrained to the extent that it is highly improbable that revenue recognised will be reversed. Income is stated excluding applicable sales taxes.

1.5 Insurance claims

Insurance claims are recognised in the accounting period in which the loss occurs. Provision is made for the full cost of settling outstanding claims at the balance sheet date, including claims incurred but not yet reported at that date, net of salvage and subrogation recoveries.

Outstanding claims provisions are not discounted for the time value of money except for claims to be settled by PPOs established under the Courts Act 2003.

1.5 Insurance claims continued

A court can award damages for future pecuniary loss in respect of personal injury or for other damages in respect of personal injury and may order that the damages are wholly or partly to take the form of PPOs. These are covered in more detail in note 2.4. Costs for both direct and indirect claims handling expenses are also included.

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

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

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

A liability adequacy provision is made for unexpired risks arising where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premium reserve in relation to such policies after the deduction of any acquisition costs deferred and other prepaid amounts. The expected value is determined by reference to recent experience and allowing for changes to the premium rates.

The provision for unexpired risks is calculated separately by reference to classes of business that are managed together after taking account of relevant investment returns.

1.6 Reinsurance

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

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

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

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

1.7 Deferred acquisition costs

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

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

1.8 Goodwill and other intangible assets

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

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the income statement over the assets' economic lives using methods that best reflect the pattern of economic benefits and is included in operating expenses. The estimated useful economic lives for software development costs is up to 10 years.

Expenditure on internally generated goodwill and indirect advertising costs is written off as incurred. Direct costs relating to the development of internal-use computer software and associated business processes are capitalised once technical feasibility and economic viability have been established. These costs include payroll costs, the costs of materials and services and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended.

During and after development, accumulated costs are reviewed for impairment against the projected benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred, as are all training costs and general overheads.

1.9 Property, plant and equipment

Items of property, plant and equipment (except investment property – see note 1.12) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

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

Freehold and leasehold buildings	50 years or the period of the lease if shorter
Vehicles	3 years
Computer equipment	Up to 5 years
Other equipment, including property adaptation costs	2 to 15 years

The gain or loss arising from the derecognition of an item of property, plant and equipment is determined as the difference between the disposal proceeds, if any, and the carrying amount of the item.

1.10 Impairment of intangible assets, goodwill and property, plant and equipment

At each reporting date, the Group assesses whether there is any indication that its intangible assets, goodwill or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss, if any. Goodwill is tested for impairment annually or more frequently, if events or changes in circumstances indicate that it might be impaired. If an asset does not generate cash flows that are independent of those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit ("**CGU**") to which the asset belongs. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use.

Value in use is the present value of future cash flows from the asset or CGU, discounted at a rate that reflects market interest rates, adjusted for risks specific to the asset or CGU that have not been reflected in the estimation of future cash flows.

If the recoverable amount of an intangible or a tangible asset is less than its carrying value, an impairment loss is recognised immediately in the income statement and the carrying value of the asset is reduced by the amount of the impairment loss.

A reversal of an impairment loss on intangible assets or property, plant and equipment is recognised as it arises provided the increased carrying value does not exceed the carrying amount that would have been determined had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

1.11 Right-of-use assets and lease liabilities

Where the Group is a lessee

At inception, the Group assesses whether a contract contains a lease arrangement, which involves assessing whether it obtains substantially all the economic benefits from the use of a specific asset, and it has the right to direct the use of that asset. The Group recognises a right-of-use asset and a lease liability at the commencement of the lease (when the underlying asset is available for use), except for short-term leases of 12 months or less and low value leases which are expensed on a straight-line basis in the income statement. The right-of-use asset is initially measured based on the present value of the lease payments, plus initial direct costs less any incentives received. Lease payments include fixed payments and variable payments. Variable payments relate to contractual rent increases linked to inflation indices. The right-of-use asset is depreciated over the lease term and is subject to impairment testing if there is an indicator of impairment. When leases contain an extension or purchase option which is reasonably expected to be exercised this is included in the measurement of the lease.

In calculating the present value of lease payments, the Group uses the incremental borrowing rate at the lease commencement date unless the interest rate implicit in the lease is readily determinable. The incremental borrowing rate is determined based on available risk-free market yield-to-maturity pricing linked to the lease amount and term, and includes a credit spread. The lease liability is subsequently measured at amortised cost using the effective interest rate method and remeasured, with a corresponding adjustment to the right-of-use asset, when there is a change in future lease payments, terms or reassessment of options.

The Group's leasehold property mainly relates to office space and vehicle repair centres. Leases in respect of motor vehicles relate to recovery and replacement vehicles, and management cars. The Group also leases certain IT equipment which is not a significant portion of the total leased asset portfolio.

Where the Group is a lessor

Leases where a significant proportion of the risks and rewards of ownership is retained by the lessor are classified as operating leases. Lease income from operating leases is recognised in the income statement on a straight-line basis over the lease term.

Where assets are subject to finance leases, the present value of the lease payments, together with any unguaranteed residual value, is recognised as a receivable.

1.12 Investment property

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

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

1.13 Financial assets

Financial assets are classified as available-for-sale, held-to-maturity, designated at fair value through profit or loss, or loans and receivables.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place are recognised on the date that the Group commits to purchase or sell the asset.

1.13 Financial assets continued

Available-for-sale ("**AFS**")

Financial assets can be designated as AFS on initial recognition. AFS financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Impairment losses and exchange differences, resulting from translating the amortised cost of foreign currency monetary AFS financial assets, are recognised in the income statement, together with interest calculated using the effective interest rate method. Other changes in the fair value of AFS financial assets are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in the income statement.

A financial asset is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's-length basis. The appropriate quoted market price for an asset held is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (for example, a change in the risk-free interest rate following the most recent price quote for a corporate bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate. The valuation methodology described above uses observable market data.

If the market for a financial asset is not active, the Group establishes the fair value by using a valuation technique. Valuation techniques include using recent arm's-length market transactions between knowledgeable and willing parties (if available), reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument, and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Group uses that technique.

AFS financial assets include equity investments.

Held-to-maturity ("**HTM**")

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

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

Loans and receivables

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

Impairment of financial assets

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

AFS

When a decline in the fair value of a financial asset classified as AFS has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in the income statement. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on AFS equity instruments are not reversed through profit or loss, but those on AFS debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

HTM or loans and receivables

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

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

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

Insurance receivables

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

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

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

Derivatives and hedging

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

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

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

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

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

Derecognition of financial assets

A financial asset is derecognised when the rights to receive the cash flows from that asset have expired or when the Group has transferred its rights to receive cash flows from the asset and has transferred substantially all the risk and rewards of ownership of the asset.

1.14 Cash and cash equivalents and borrowings

Cash and cash equivalents comprise cash in hand and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

Borrowings, comprising bank overdrafts, are measured at amortised cost using the effective interest rate method and are part of the Group's cash management approach and are repayable on demand.

1.15 Financial liabilities

Financial liabilities are initially recognised at fair value net of transaction costs incurred. Other than derivatives which are recognised and measured at fair value, all other financial liabilities are subsequently measured at amortised cost using the effective interest rate method.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

1.16 Subordinated liabilities

Subordinated liabilities comprise subordinated guaranteed dated notes which are initially measured at the consideration received less related transaction costs. Subsequently, subordinated liabilities are measured at amortised cost using the effective interest rate method.

1.17 Provisions

The Group recognises a provision for a present legal or constructive obligation from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount can be reliably estimated.

The Group makes provision for all insurance industry levies, such as the Financial Services Compensation Scheme and Motor Insurance Bureau.

When the Group has an onerous contract, it recognises the present obligation under the contract as a provision. A contract is onerous when the unavoidable costs of meeting the contractual obligations exceed the expected future economic benefit.

Restructuring provisions are made, including redundancy costs, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan and has communicated the plan to those affected.

1.18 Pensions and other post-retirement benefits

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

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

The Group's defined benefit pension scheme, as described in note 27, was closed in 2003. Scheme liabilities are measured on an actuarial basis, using the projected unit credit method, and discounted at a rate that reflects the current rate of return on a high-quality corporate bond of equivalent term and currency to the scheme liabilities.

Scheme assets are measured at their fair value. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). The current service cost and any past service costs, together with the net interest on the net pension liability or asset, is charged or credited to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside the income statement and presented in other comprehensive income under "Items that will not be reclassified subsequently to the income statement".

1.19 Taxation

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

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

Provision for taxation is calculated using tax rates that have been enacted, or substantively enacted, by the balance sheet date and is allocated over profits before taxation or amounts charged or credited to components of other comprehensive income and equity, as appropriate.

Deferred taxation is accounted for in full using the balance sheet liability method on all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes.

Deferred tax liabilities are generally recognised for all taxable temporary timing differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is probable that they will not be recovered.

1.19 Taxation continued

Deferred tax assets and liabilities are calculated at the tax rates expected to apply when the assets are realised or liabilities are settled based on laws and rates that have been enacted or substantively enacted at the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited to other comprehensive income or equity, in which case the deferred tax is also dealt with in other comprehensive income or directly in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current assets and liabilities on a net basis.

1.20 Share-based payment

The Group operates a number of share-based compensation plans under which it awards Ordinary Shares and share options to its employees. Such awards are generally subject to vesting conditions that can alter the amount of cash or shares to which an employee is entitled.

Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the Group to meet specified performance targets).

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

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

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

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

1.21 Capital instruments

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

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

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

1.22 Dividends

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

1.23 Accounting developments

New IFRS standards and amendments that are issued, but not yet effective for the 31 December 2020 reporting period and have not been early adopted by the Group, are disclosed below. The Group intends to adopt these standards, if applicable, when they become effective, except for amendments to IFRS 9 'Financial Instruments', as explained below.

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

In September 2016, the IASB issued Amendments to IFRS 4: 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' to address issues arising from the different effective dates of IFRS 9 and IFRS 17 'Insurance Contracts'. These amendments to IFRS 4 were endorsed by the EU in November 2017.

These amendments permitted insurers who satisfied certain criteria to defer the effective date of IFRS 9, to coincide with the expected effective date of IFRS 17. The Group conducted a high-level assessment of the three aspects of IFRS 9 and based on current information, the impact of applying the expected loss model for the first time is currently immaterial. The Group does not expect any other significant impact on its financial statements.

The amendments required insurance entities to evaluate whether their activities were predominantly connected to insurance as at their annual reporting date immediately preceding 1 April 2016, providing an option to defer adoption of IFRS 9 if liabilities connected to insurance comprised a predominant proportion of their total liabilities as at that date. The Group concluded that it satisfied the criteria and there have been no significant changes in the Group's activities since this assessment to require a reassessment of the criteria.

As a result, the Group has decided to defer the application of IFRS 9 and continues to do so. The amendments to IFRS 4 also require certain interim disclosures in relation to the fair value movements of financial assets as outlined below.

The fair value at the end of the reporting period for financial assets with contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount are disclosed in note 42. The amount of change in the fair value during the period for these financial assets was:

- AFS debt securities £96.7 million increase (2019: £118.6 million increase);
- HTM debt securities £0.2 million decrease (2019: £3.8 million increase);
- infrastructure debt £1.1 million increase (2019: £10.6 million increase); and
- commercial real estate loans £3.8 million decrease (2019: £2.5 million decrease).

Derivative assets do not have contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. The fair value of these financial assets is disclosed in note 42 and the amount of change in the fair value during the period was an increase of £64.5 million (2019: £111.8 million increase).

In note 3.3.3 the Group has disclosed the carrying amount of financial assets at the end of the reporting period by credit risk rating grade, as defined in IFRS 7 'Financial Instruments: Disclosures'. The fair value and the carrying amount of financial assets that meet the 'solely payments of principal and interest' criteria, and at the end of the reporting period do not have a low credit risk, was £377.2 million (2019: £390.8 million).

IFRS 9 information that relates to entities within the Group that is not provided in the Group's consolidated financial statements can be obtained from their individual financial statements, which are filed at Companies House.

As the effective date of IFRS 17 has since been delayed to 1 January 2023, 'Amendments to IFRS 4 – Deferral of IFRS 9' was issued in June 2020 which delays the effective date of IFRS 9 so as to remain in line with IFRS 17. The amendments were endorsed by the UK's Department of Business, Energy & Industrial Strategy ("**BEIS**") in January 2021.

'Amendments to IFRS 9: Prepayment Features with Negative Compensation' was issued in October 2017 and is endorsed by the EU to allow instruments with symmetric prepayment options to qualify for amortised cost or fair value through other comprehensive income measurement because they would otherwise fail the 'solely payments of principal and interest' test on the principal amount condition. The amendments are effective from the same period as IFRS 9.

IFRS 17 was issued by the IASB in May 2017 to replace IFRS 4 'Insurance Contracts' and is effective for reporting periods beginning on or after 1 January 2023, with comparative figures required. IFRS 17 is a comprehensive new accounting standard for all insurance contracts covering recognition and measurement, presentation and disclosure. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers and to replace the requirements of IFRS 4 that allowed insurers to apply grandfathering of previous local accounting policies.

The core of IFRS 17 is the general model, supplemented by an optional simplified premium allocation approach which is permitted for the liability for the remaining coverage for short-duration contracts. The general model measures insurance contracts using the building blocks of: discounted probability-weighted cash flows; an explicit risk adjustment; and a contractual service margin representing the unearned profit of the contract which is recognised as revenue over the coverage period.

An initial assessment of the impact of IFRS 17 on the Group's financial statements has been completed and work has now started on the design and build of the systems that will provide the foundation for reporting under IFRS 17 from 1 January 2023. The Group expects to be able to apply the simplified premium allocation approach to all material insurance and reinsurance contract groups. As the standard was not endorsed by the EU before 31 December 2020, it will instead require endorsement by the UKEB.

In September 2019, the IASB issued 'Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39 and IFRS 7' which the Group adopted in 2019. These Phase 1 amendments modify some specific hedge accounting requirements to provide relief from the potential effects of the uncertainty caused by the IBOR reform. In addition, it requires companies to disclose additional information about their hedging relationships which are directly affected by these uncertainties. The amendments allow the Group to continue applying hedge accounting to some of its benchmark interest rate exposure, as the amendments permit the continuation of hedge accounting where in future the hedged benchmark interest rate may no longer be separately available. The amendments do not alter the requirement for the designated interest rate risk component to be measurable. If the risk component is no longer reliably measurable, the hedging relationship is discontinued. The relief provided by the amendments ceases to apply prospectively when the uncertainties arising from the interest rate benchmark reform are no longer present.

The Group holds investments in US dollar and Euro fixed rate debt securities which it includes in a macro fair value hedge of the USD LIBOR and EURIBOR risk component of these investments respectively.

The Group will not discontinue hedge accounting should the retrospective assessment of hedge effectiveness fall outside the 80-125% range where the hedging relationship is subject to interest rate benchmark reforms. However, for those hedging relationships that are not subject to the interest rate benchmark reforms the entity continues to cease hedge accounting if retrospective effectiveness is outside the 80-125% range.

In August 2020, the IASB issued 'Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 'Interest Rate Benchmark Reform – Phase 2'.

The Phase 2 amendments provide additional temporary reliefs from applying specific IFRS 9 and IAS 39 hedge accounting requirements to hedging relationships directly affected by IBOR reform. They also require disclosure of: (i) how the entity is managing the transition to alternative benchmark rates, its progress and the risks arising from the transition; (ii) quantitative information about derivatives and non-derivatives that have yet to transition, disaggregated by significant interest rate benchmark; and (iii) a description of any changes to the risk management strategy as a result of IBOR reform.

The Phase 2 amendments are effective for annual periods starting on or after 1 January 2021 and were endorsed by the BEIS in January 2021.

In January 2020 the IASB issued 'Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)' which clarifies the requirements for classifying liabilities as current or non-current. More specifically:

- The amendments specify that the conditions which exist at the end of the reporting period are those which will be used to determine whether a right to defer settlement of a liability exists.
- Management expectations about events after the balance sheet date, for example on whether a covenant will be breached, or whether early settlement will take place, are not relevant.
- The amendments clarify the situations that are considered to determine settlement of a liability.

In July 2020 a further amendment was made: 'Classification of Liabilities as Current or Non-Current — Deferral of Effective Date (Amendment to IAS 1)' to defer the effective date of the January 2020 'Classification of Liabilities as Current or Non-Current (Amendments to IAS 1)' to annual reporting periods beginning on or after 1 January 2023.

1.23 Accounting developments continued

The new guidance is effective for annual periods starting on or after 1 January 2023 and will require endorsement by the UKEB.

In May 2020 the IASB issued narrow-scope amendments to three Standards:

- Amendments to IFRS 3 'Business Combinations' update a reference in IFRS 3 to the Conceptual Framework for Financial Reporting without changing the accounting requirements for business combinations.
- Amendments to IAS 16 'Property, Plant and Equipment' prohibit a company from deducting from the cost of property, plant and equipment amounts received from selling items produced while the company is preparing the asset for its intended use. Instead, a company will recognise such sales proceeds and related cost in profit or loss.
- Amendments to IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' specify which costs a company includes when assessing whether a contract will be loss-making.

These three amendments have an IASB effective date of 1 January 2022 and will require endorsement by the UKEB.

Also, in May 2020 the IASB issued 'Annual Improvements to IFRS Standards 2018-2020' which makes minor amendments to:

- IFRS 1 'First-time Adoption of International Financial Reporting Standards' which simplifies the application of IFRS 1 for a subsidiary that becomes a first-time adopter of IFRS Standards later than its parent;
- IFRS 9 'Financial Instruments' – this amendment clarifies that – for the purpose of performing the '10 per cent test' for derecognition of financial liabilities – in determining those fees paid net of fees received, a borrower includes only fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf; and
- IFRS 16 'Leases' which removes the illustration of payments from the lessor relating to leasehold improvements.

All amendments are effective 1 January 2022 and will require endorsement by the UKEB.

2. Critical accounting judgements and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial information. The Group's principal accounting policies are set out on pages 162 to 170. Company law and IFRSs require the Directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable.

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

2.1 Impairment provisions – financial assets

Accounting judgement

The Group makes a judgement that financial assets are impaired when there is objective evidence that an event or events have occurred since initial recognition that have adversely affected the amount or timing of future cash flows from the asset. The determination of which events could have adversely affected the amount or timing of future cash flows from the asset requires judgement. In making this judgement, the Group evaluates, among other factors: the normal price volatility of the financial asset; the financial health of the investee; industry and sector performance; changes in technology or operational and financing cash flow; and whether there has been a significant or prolonged decline in the fair value of the asset below its cost. Impairment may be appropriate when there is evidence of deterioration in these factors. There was a small impairment of £2.7 million within the loans and receivables portfolio in the year ended 31 December 2020 (2019: £nil).
On a quarterly basis, the Group reviews whether there is any objective evidence that a financial asset is impaired based on the following criteria:

- actual, or imminent, default on coupon interest or nominal;
- adverse movements in the credit rating for the investee/ borrower;
- price performance of a particular AFS debt security, or group of AFS debt securities, demonstrating an adverse trend compared to the market as a whole; and
- whether an event has occurred that could be reliably estimated and which had an impact on the financial asset or its future cash flows.

Had all the declines in AFS asset values met the criteria above at 31 December 2020, the Group would have suffered a loss of £3.0 million (2019: £4.0 million), being the transfer of the total AFS reserve for unrealised losses to the income statement. However, these movements represent mark-to-market movements and, as there was no objective evidence of any loss events that could affect future cash flows, no impairments have been recorded.

2.2 Fair value of investment properties

Sources of estimation uncertainty

The Group holds a portfolio of investment properties, with a value at 31 December 2020 of £292.1 million (2019: £291.7 million). Where quoted market prices are not available, valuation techniques are used to value these properties. The fair value was determined using a methodology based on recent market transactions for similar properties, which have been adjusted for the specific characteristics of each property within the portfolio. The valuation in the financial statements is based on valuations by independent registered valuers and the techniques used include some unobservable inputs. The valuations used for investment properties are classified in the level 3 category of the fair value hierarchy (see note 42).

2.3 Impairment provisions – intangible assets

Accounting judgement

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

Sources of estimation uncertainty

Sources of estimation uncertainty can arise where there are indicators of impairment of an intangible asset and an impairment provision is deemed appropriate. Factors, such as whether the carrying amount of the asset is expected to be greater than the recoverable amount are assessed, and in 2020 the Group recognised an impairment provision of £6.6 million (2019: £1.3 million) in relation to ongoing IT projects primarily relating to the development of new systems.

The sensitivities to the assumptions made by the Group in respect of the testing for impairment of goodwill and other intangible assets are shown in note 17.

2.4 General insurance: outstanding claims provisions and related reinsurance recoveries

Accounting judgement

Reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal actuarial best estimate. This margin is set by reference to various actuarial scenario assessments and reserve distribution percentiles. It also considers other long and short-term risks not reflected in the actuarial inputs, as well as management's view of the uncertainties in relation to the actuarial best estimate.

Source of estimation uncertainty

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and associated claims handling costs. Outstanding claims provisions net of related reinsurance recoveries at 31 December 2020 amounted to £2,591.7 million (2019: £2,670.0 million).

Claims reserves are assessed separately for large and attritional claims, typically using standard actuarial methods of projection. Key sources of estimation uncertainty include those arising from the selection of specific methods as well as assumptions for claims frequency and severity through the review of historical claims and emerging trends. The Group seeks to adopt a conservative approach to assessing claims liabilities, as evidenced by the favourable development of historical claims reserves.

The corresponding reinsurance recoveries are calculated on an equivalent basis, with similar estimation uncertainty, as discussed in note 1.6. The reinsurance bad debt provision is mainly held against expected recoveries on future PPO payments.

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

The Group reserves its large bodily injury claims at the relevant discount rate for each jurisdiction, with the overwhelming majority now reserved at minus 0.25% as most will be settled under the law in England and Wales. The Ogden discount rate will be reviewed again at the latest in 2024 but, following the most recent change in 2019, only small movements are expected in future. These will have a low impact on the Group's reserves. This is also a function of the ongoing reduction in large bodily injury exposures as a result of continued positive prior-year development of claims reserves, and a higher proportion of reserves being covered by reinsurance as a result of the decision to opt for a lower reinsurance attachment point from 2014 onwards.

The Group settles some large bodily injury claims as PPOs rather than lump sum payments. The Group has estimated the likelihood of large bodily injury claims settling as PPOs. Anticipated PPOs consist of both existing large loss case reserves including allowances for development and claims yet to be reported to the Group. Reinsurance is applied at claim level and the net cash flows are discounted for the time value of money. The discount rate is consistent with the long duration and the assumed future indexation of the claims payments.

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

The table in note 34 to the financial statements provides an analysis of outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2020 and 31 December 2019 and further details on sources of estimation uncertainty. Details of sensitivity analysis to the discount rate applied to PPO claims and the impact of changes in claims inflation are shown in note 3.3.1.

3. Risk management

3.1 Enterprise Risk Management Strategy and Framework

The Enterprise Risk Management Strategy and Framework sets out, at a high level, the Group's approach and processes for managing risks. Further information can be found in the Risk management section of the Strategic report on page 69.

3.2 Risk and capital management modelling

The Board has ultimate responsibility for ensuring that the Group has sufficient funds to meet its liabilities as they fall due. The Group carries out detailed modelling of its assets, liabilities and the key risks to which these are exposed. This modelling includes the Group's own assessment of its SCR, using its partial internal model approved by the PRA in 2016. The SCR quantifies the insurance, market, credit, operational and liquidity risks that the regulated entities are undertaking.

The Board is closely involved in the SCR process and reviews, challenges and approves its assumptions and results.

3.3 Principal risks from insurance activities and use of financial instruments

The Risk management section of the Strategic report also sets out all the risks assessed by the Group as principal risks. Detailed below is the Group's risk exposure arising from its insurance activities and use of financial instruments specifically in respect of insurance risk, market risk, credit risk, operational risk and liquidity risk.

Following the end of the transition period on 31 December 2020 and the trade and co-operation agreement between the UK and the EU, there still remains considerable uncertainty as to the effect of Brexit on the Group. The Group has proactively considered a variety of possible implications of a disruptive end to existing trading and other arrangements between the UK and the EU, including of a financial and operational nature. Additionally, the risk of a UK-wide recession and global financial instability as a result of the Covid-19 pandemic remains high and the Group continues to monitor the worst-case impact. The implications of both these risks are referred to in the Risk management section of the Strategic report.

3.3.1 Insurance risk

The Group is exposed to insurance risk as a primary consequence of its business. Key insurance risks focus on the risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting.

The Group is mainly exposed to the following insurance risks:

Reserve risk

Reserve risk relates to both premium and claims. This is the risk of understatement or overstatement of reserves arising from:

- the uncertain nature of claims;
- data issues and changes to the claims reporting process;
- operational failures;
- failure to recognise claims trends in the market; and
- changes in underwriting and business written so that past trends are not necessarily a predictor of the future.

Understatement of reserves may result in not being able to pay claims when they fall due. Alternatively, overstatement of reserves can lead to a surplus of funds being retained resulting in opportunity cost; for example, lost investment return or insufficient resource to pursue strategic projects and develop the business.

Reserve risk is controlled through a range of processes:

- regular reviews of the claims and premiums, along with an assessment of the requirement for a liability adequacy provision for the main classes of business by the internal actuarial team;
- the use of external actuaries to review periodically the actuarial best estimate reserves produced internally, either through peer review or through provision of independent reserve estimates;
- accompanying all reserve reviews with actuarial assessment of the uncertainties through a variety of techniques including bootstrapping and scenario analysis;
- oversight of the reserving process by relevant senior management and the Board;
- regular reconciliation of the data used in the actuarial reviews against general ledger data and reconciliation of the claims data history against the equivalent data from prior reviews; and
- regular assessment of the uncertainty in the reserves to help the Board set management best estimate reserves.

The Group's reserves are subject to the risk of retrospective changes in judicial conditions such as the recent changes in the Ogden discount rate. Detailed information on the Ogden discount rate is provided in note 2.4.

Uncertainty in claims reserves estimation is larger for claims such as PPOs for which annually indexed payments are made, typically over the lifetime of the injured party. Claims reserves for PPOs are held on a discounted basis and are sensitive to a change in the discount rate.

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

	Increase / (decrease) in profit before tax[1,2]	
	2020	2019
At 31 December	**£m**	£m
PPOs[3]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	**45.9**	48.5
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	**(62.7)**	(66.5)
Ogden discount rate[4]		
Impact of the Group reserving at a discount rate of 0.75% compared to minus 0.25% (2019: 0.75% compared to minus 0.25%)	**43.7**	53.3
Impact of the Group reserving at a discount rate of minus 1.25% compared to minus 0.25% (2019: minus 1.25% compared to minus 0.25%)	**(61.1)**	(75.0)
Claims inflation		
Impact of a decrease in claims inflation by 100 basis points for two consecutive years (new scenario in 2020)	**32.4**	–
Impact of an increase in claims inflation by 100 basis points for two consecutive years (new scenario in 2020)	**(32.2)**	–

Notes:

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

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

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

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

Underwriting risk

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

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

3. Risk management continued

3.3.1 Insurance risk continued

The key risks relating to climate change today are UK floods and major UK windstorms.

The Group recognises that climate change may impact its business over the longer term. In particular, there is a risk that climate change affects the frequency and severity of extreme weather events (physical risk), which will change the Group's view of underwriting risk, reinsurance and pricing. The Group will be developing its risk management systems and monitoring tools over 2021 for physical risk alongside participating in the Climate Biennial Exploratory Scenario ("**CBES**"). Low-frequency, high-severity weather losses are mitigated to a significant degree by the catastrophe reinsurance programme, the ceding of home high flood risks to Flood Re, and the commercial underwriting strategy which reduces high flood risk exposure. Furthermore, there is a risk that the Group's insurance products will not meet its customers' needs as a result of changes in market dynamics and customer behaviour in relation to climate change, for example a rapid shift towards electric vehicle usage. The Group expects these specific risks to materialise in the medium to longer-term (see page 63 for definition) and anticipates that its continued strategic and operational response to the transition to a lower-carbon economy will support mitigation of these risks and the associated impacts in the long term.

When underwriting policies, the Group is subject to concentration risk in a variety of forms, including:

- geographic concentration risk – the Group purchases a catastrophe reinsurance programme to protect against a modelled 1-in-200 year catastrophe loss. The programme renews annually on 1 July and has a retention of £130 million and an upper limit of £1,125 million;
- product concentration risk – the Group's business is heavily concentrated in the UK general insurance market. However, the Group offers a diversified portfolio of products and a variety of brands sold through a range of distribution channels to its customers; and
- sector concentration risk – the concentration of the Group to any given industry sector is monitored and analysed in respect of commercial customers.

It is important to note that none of these risk categories is independent of the others and that giving due consideration to the relationship between these risks is an important aspect of the effective management of insurance risk.

Distribution risk

The risk of a material reduction in profit compared to plan due to the Group not writing its planned policy volumes in each segment.

Pricing risk

The risk of economic loss arising from business being incorrectly priced or underwritten.

Reinsurance risk

This is the risk of inappropriate selection and/or placement of reinsurance arrangements, with either individual or multiple reinsurers, which renders the transfer of insurance risk to the reinsurer(s) inappropriate and/or ineffective.

Other risks include:

- reinsurance concentration risk – the concentration of credit exposure to any given counterparty;
- reinsurance capacity being reduced and/or withdrawn;
- underwriting risk appetite and reinsurance contract terms not being aligned;
- reinsurance contract terms being inappropriate or ineffective resulting in classes or types of business not being appropriately reinsured;
- non-adherence to the reinsurance policy terms and conditions, in terms of both policy management and claims not being handled within the reinsurance contract terms and conditions, or paid on an ex-gratia basis, resulting in reinsurance recoveries not being made in full;
- inappropriate or inaccurate management information and/or modelling being used to determine the value for money and purchasing of reinsurance (including aggregate modelling); and
- changes in the external legal, regulatory, social or economic environment (including changes resulting from climate change) altering the definition and application of reinsurance policy wordings or the effectiveness or value for money of reinsurance.

The Group uses reinsurance to:

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

3.3.2 Market risk

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

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

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

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

The Group monitors its market risk exposure on a daily basis and, in addition, has established an aggregate exposure limit consistent with its risk objective to maintain capital adequacy. Interdependencies across risk types have also been considered within the aggregate exposure limit. The allocation of the Group's investments across asset classes has been approved by the Investment Committee. The strategic asset allocation within the investment portfolio is reviewed by the Investment Committee, which makes recommendations to the Board for its investment strategy approval. The Investment Committee determines policy and controls, covering such areas as risk, liquidity and performance. The Investment Committee meets at least three times a year to evaluate risk exposure, the current strategy, associated policies and investment guidelines and to consider investment recommendations submitted to it. Oversight of the implementation of decisions taken by the Investment Committee is via the first and second lines of defence.

The investment management objectives are to:

- maintain the safety of the portfolio's principal both in economic terms and from a capital, accounting and reporting perspective;
- maintain sufficient liquidity to provide cash requirements for operations, including in the event of a catastrophe; and
- maximise the portfolio's total return within the constraints of the other objectives and the limits defined by the investment guidelines and capital allocation.

During the year, the Investment Committee agreed long-term targets for the investment portfolio in relation to supporting the Group's objectives on climate change. These are: ensuring the Group's entire investment portfolio is net carbon neutral by 2050 in line with the aims of the Paris Agreement; and an interim target of a 50% reduction in weighted average greenhouse gas emissions intensity by 2030 within the Group's corporate bonds portfolio, the largest part of its investment portfolio.

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

When setting the strategic asset allocation, the Group is subject to concentration risk in a variety of forms including:

- large exposures to individual assets (either bond issuers or deposit-taking institutions); and
- large exposures to different assets where movements in values and ratings are closely correlated.

Concentration risk on investments arises through excessive exposure to particular industry sectors, groups of business undertakings or similar activities. The Group may suffer significant losses in its investment portfolio as a result of over-exposure to particular sectors engaged in similar activities or having similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

3. Risk management continued

3.3.2 Market risk continued

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

At 31 December 2020	Corporate £m	Local government £m	Sovereign £m	Supranational £m	Debt securities total £m
Australia	205.7	–	–	–	**205.7**
Austria	17.1	–	–	–	**17.1**
Belgium	38.0	–	–	–	**38.0**
Canada	127.6	–	–	–	**127.6**
Cayman Islands	1.8	–	–	–	**1.8**
Czech Republic	1.1	–	–	–	**1.1**
Denmark	11.9	–	–	–	**11.9**
Finland	27.7	12.3	–	–	**40.0**
France	311.0	13.1	–	–	**324.1**
Germany	199.6	–	1.3	–	**200.9**
Ireland	7.1	–	–	–	**7.1**
Italy	27.1	–	–	–	**27.1**
Japan	48.2	–	–	–	**48.2**
Luxembourg	4.4	–	–	–	**4.4**
Mexico	14.0	–	–	–	**14.0**
Netherlands	155.3	–	–	–	**155.3**
New Zealand	8.1	–	–	–	**8.1**
Norway	15.0	10.2	–	–	**25.2**
Peru	1.9	–	–	–	**1.9**
South Africa	10.0	–	–	–	**10.0**
South Korea	3.1	–	–	–	**3.1**
Spain	75.8	–	–	–	**75.8**
Sweden	61.4	–	–	–	**61.4**
Switzerland	33.1	–	–	–	**33.1**
UAE	3.6	–	–	–	**3.6**
UK	1,201.1	–	15.1	–	**1,216.2**
USA	1,514.2	–	8.8	–	**1,523.0**
Supranational	–	–	–	21.3	**21.3**
Total	**4,124.9**	**35.6**	**25.2**	**21.3**	**4,207.0**

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

At 31 December 2019	Corporate £m	Local government £m	Sovereign £m	Supranational £m	Debt securities total £m
Australia	198.1	–	–	–	198.1
Austria	17.8	–	–	–	17.8
Belgium	35.6	–	–	–	35.6
Canada	89.7	–	–	–	89.7
Cayman Islands	14.1	–	–	–	14.1
Denmark	7.6	–	–	–	7.6
Finland	19.9	12.1	–	–	32.0
France	293.8	7.0	0.7	–	301.5
Germany	176.4	–	1.3	–	177.7
Ireland	12.9	–	–	–	12.9
Italy	30.2	–	–	–	30.2
Japan	33.6	–	–	–	33.6
Luxembourg	8.0	–	–	–	8.0
Mexico	17.2	–	–	–	17.2
Netherlands	133.4	–	0.3	–	133.7
New Zealand	34.7	–	–	–	34.7
Norway	23.2	10.1	–	–	33.3
South Africa	2.4	–	–	–	2.4
South Korea	3.0	–	–	–	3.0
Spain	67.1	–	–	–	67.1
Sweden	77.4	–	–	–	77.4
Switzerland	86.5	–	–	–	86.5
UK	1,105.5	–	91.8	–	1,197.3
USA	1,540.4	–	5.4	–	1,545.8
Zambia	1.1	–	–	–	1.1
Supranational	–	–	–	31.3	31.3
Total	4,029.6	29.2	99.5	31.3	4,189.6

3. Risk management continued

3.3.2 Market risk continued

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

At 31 December	2020 £m	2020 %	2019 £m	2019 %
Basic materials	**104.5**	**3%**	121.0	3%
Communications	**212.2**	**5%**	262.2	6%
Consumer, cyclical	**358.0**	**9%**	305.1	7%
Consumer, non-cyclical	**426.7**	**10%**	405.5	10%
Diversified	**20.8**	**0%**	6.4	0%
Energy	**184.2**	**4%**	181.7	4%
Financial	**1,897.0**	**45%**	1,861.7	44%
Industrial	**280.3**	**7%**	293.5	7%
Sovereign, supranational and local government	**82.1**	**2%**	160.1	4%
Technology	**103.9**	**3%**	145.3	4%
Transport	**13.4**	**0%**	13.4	0%
Utilities	**523.9**	**12%**	433.7	11%
Total	**4,207.0**	**100%**	4,189.6	100%

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

At 31 December	2020 £m	2020 %	2019 £m	2019 %
Social, of which:				
Education	**115.7**	**44%**	121.1	44%
Healthcare	**70.3**	**26%**	73.2	26%
Other	**50.7**	**19%**	53.5	19%
Transport	**27.8**	**11%**	30.3	11%
Total	**264.5**	**100%**	278.1	100%

The Group uses its internal economic capital model to determine its capital requirements and market risk limits and monitors its market risk exposure based on a 99.5% value-at-risk measure. The Group also applies market risk stress and scenario testing for the economic impact of specific severe market conditions. The results of this analysis are used to enhance the understanding of market risk. The market risk minimum standard explicitly prohibits the use of derivatives for speculative or gearing purposes. However, the Group is able to and does use derivatives for hedging its currency risk and interest rate risk exposures.

Spread risk

This is the risk of loss from the sensitivity of the value of assets and investments to changes in the level or in the volatility of credit spreads over the risk-free interest rate term structure. The level of spread is the difference between the risk-free rate and actual rate paid on the asset, with larger spreads being associated with higher risk assets. The Group is exposed to spread risk through its asset portfolio, most notably through its investment in corporate bonds.

Net interest rate risk

This is the risk of loss from changes in the term structure of interest rates or interest rate volatility which impact assets and liabilities. The Group's interest rate risk arises mainly from its debt, floating interest rate investments and assets and liabilities exposed to fixed interest rates.

The Group has subordinated guaranteed dated Tier 2 notes with fixed coupon rates which were issued on 27 April 2012 at a fixed rate of 9.25% and have a redemption date of 27 April 2042; at the time of issue, the Group entered into a 10-year interest rate swap, to exchange the fixed rate of interest on these notes to a floating rate, to hedge exposure to interest rates. This was treated as a designated hedging instrument.

Of the £500 million notes issued, the Group has bought back a total nominal value of £250 million.

The hedging relationship between the subordinated debt and the interest rate swap was redesignated to reflect this transaction and ensure continuing hedge effectiveness. However, on 31 July 2020 the Group identified that the hedge no longer met the criteria of hedge effectiveness under IAS 39 'Financial Instruments: Recognition and Measurement' and, under the rules of the standard, the accumulated hedging adjustment is being amortised to the income statement from the date of the last successful hedge effectiveness test over the remaining life of the subordinated debt using an effective interest rate calculation.

The Group also has subordinated Tier 2 notes with fixed coupon rates with a nominal value of £260 million that were issued on 5 June 2020 and perpetual Tier 1 notes with fixed coupon rates with a nominal value of £350 million that were issued on 7 December 2017.

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

The market value of the Group's financial investments with fixed coupons is affected by the movement of interest rates. For the majority of investments in US dollar and Euro corporate bonds, the Group hedges its exposure to US dollar and Euro interest rate risk using swaps, excluding £361.8 million of US dollar short duration high yield bonds (2019: £398.9 million), £99.9 million of US dollar subordinated financial debt and £71.4 million of Euro subordinated financial debt (2019: £111.4 million US dollar and £64.7 million Euro) and £58.7 million short duration Euro credit (2019: £194.3 million).

The Group is exposed to the following interest rate benchmarks within its hedging relationships: GBP LIBOR, USD LIBOR and EURIBOR. The first two are subject to interest rate benchmark reform. The hedged items include issued sterling fixed rate subordinated debt (which is no longer treated as designated under IAS 39) and holdings of US dollar and Euro denominated fixed rate debt securities.

The Group has in place an IBOR transition plan which is updated regularly. The most recent version of the plan was reviewed by the Investment Committee in November 2020. The plan identifies where the Group has IBOR exposures and the departments responsible for ensuring a suitable plan is in place to enable a smooth transition to alternative benchmark rates. Delivering the plan is under the governance of the Chief Financial Officer. The Group has also provided the plan and data in response to data submission requests from the PRA in 2020.

In the course of 2020 and early 2021 the following steps were undertaken as part of the transition process:

- amendments were made to the intra-company loan agreements to ensure that they contain LIBOR fall-back language;
- U K Insurance Limited adhered to the International Swaps and Derivative Association fall-back protocol which covers the interest rate swap held to hedge issued subordinated debt which references GBP LIBOR; the external asset managers too have to adhere to the protocol, thus covering the interest rate swaps in the managed portfolios;
- the Loan Market Association published the exposure drafts of facility agreements which in the first half of 2021 will be used to add LIBOR fall-back clauses to the existing loan agreements in the infrastructure debt and commercial real estate loan portfolios; and
- these fall-back clauses will be added to any new agreements.

The designated hedging instruments and hedged items in scope of the IFRS 9/IAS 39 amendments due to benchmark interest rate reform are set out in the table below by hedge type.

Hedge type	Instrument type	Maturing in	Nominal	Hedged item
Fair value hedges	Pay USD fixed, receive 3-month USD LIBOR interest rate swaps	2023 - 2051	US$131 million	Portfolio fair value hedge of the 3-month USD LIBOR component of US dollar denominated fixed rate debt securities
	Pay USD fixed, receive 1-month USD LIBOR interest rate swaps	2021 - 2031	US$1,016 million	Portfolio fair value hedge of the 1-month USD LIBOR component of US dollar denominated fixed rate debt securities
	Pay Euro fixed, receive 6-month EURIBOR interest rate swaps	2023 - 2041	€107 million	Portfolio fair value hedge of the 6-month EURIBOR component of Euro denominated fixed rate debt securities

The Group will continue to apply the amendments to IFRS 9/IAS 39 until the uncertainty arising from the interest rate benchmark reforms with respect to the timing and the amount of the underlying cash flows to which the Group is exposed ends. The Group has assumed that this uncertainty will not end until the Group's contracts that reference IBORs are amended to specify the date the interest rate benchmark will be replaced, the cash flows of the alternative benchmark rate and any resulting spread adjustments. This will, in part, be dependent on the introduction of fall-back clauses which have yet to be added to some of the Group's contracts and the negotiation with borrowers.

Property risk

This is the risk of loss arising from sensitivity of assets and financial investments to the level or volatility of market prices, rental yields, or occupancy rates of properties. At 31 December 2020, the value of these property investments was £292.1 million (2019: £291.7 million). The property investments are located in the UK.

Currency risk

This is the risk of loss from changes in the level or volatility of currency exchange rates.

Exposure to currency risk is generated by the Group's investments in US dollar and Euro denominated debt bonds.

The Group maintains exposure to US dollar securities through £1,331.9 million (2019: £1,366.1 million) of investments in US dollar bonds and Euro securities through £231.1 million (2019: £359.1 million) of Euro bonds. The foreign currency exposure of these investments is hedged by foreign currency forward contracts, maintaining a minimal unhedged currency exposure on these portfolios, as well as a low basis risk on the hedging contracts.

A limited exposure to currency risk also arises through the Group's insurance and other contractual liabilities.

Currency risk is not material at Group level.

3. Risk management continued

3.3.2 Market risk continued

Use of derivatives

The Group uses derivatives to hedge against interest rate and currency risk.

The tables below analyse the maturity of the Group's derivative assets and liabilities.

	Notional amounts	Maturity and fair value			
		Less than 1 year	1 – 5 years	Over 5 years	**Total**
At 31 December 2020	**£m**	£m	£m	£m	**£m**
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	**2,182.8**	63.5	–	–	**63.5**
Interest rate swaps[1]	**250.0**	1.0	7.2	–	**8.2**
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	**4.1**	0.1	–	–	**0.1**
Interest rate swaps	**150.3**	–	–	1.6	**1.6**
Total	**2,587.2**	**64.6**	**7.2**	**1.6**	**73.4**

	Notional amounts	Maturity and fair value			
		Less than 1 year	1 – 5 years	Over 5 years	**Total**
At 31 December 2020	**£m**	£m	£m	£m	**£m**
Derivative liabilities					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	**696.4**	12.3	–	–	**12.3**
Designated as hedging instruments:					
Interest rate swaps	**785.1**	2.4	17.7	24.8	**44.9**
Total	**1,481.5**	**14.7**	**17.7**	**24.8**	**57.2**

1. The 2012 interest rate swap which was entered into at at the same time as the issue of the 9.25% subordinated Tier 2 notes due 2042 was treated as a designated hedging instrument in 2019 and as fair value through the income statement in 2020.

	Notional amounts	Maturity and fair value			
		Less than 1 year	1 – 5 years	Over 5 years	Total
At 31 December 2019	£m	£m	£m	£m	£m
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	2,310.3	112.1	–	–	112.1
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	7.8	0.4	–	–	0.4
Interest rate swaps	277.7	0.7	8.3	–	9.0
Total	2,595.8	113.2	8.3	–	121.5

	Notional amounts	Maturity and fair value			
		Less than 1 year	1 – 5 years	Over 5 years	Total
At 31 December 2019	£m	£m	£m	£m	£m
Derivative liabilities					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	652.6	10.1	–	–	10.1
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	10.4	0.2	–	–	0.2
Interest rate swaps	853.2	2.6	2.8	14.8	20.2
Total	1,516.2	12.9	2.8	14.8	30.5

Sensitivity analysis

The table below provides a sensitivity analysis of the potential impact on financial investments and derivatives of a change in a single factor with all other assumptions left unchanged. Other potential risks beyond the ones described in the table could have an additional financial impact on the Group.

	Increase / (decrease) in profit before tax[1]		Decrease in total equity[1] at 31 December	
	2020	2019	**2020**	2019
	£m	£m	**£m**	£m
Spread				
Impact of a 100 basis points increase in spreads on financial investments[2,3]	**–**	–	**(151.2)**	(146.4)
Interest rate				
Impact of a 100 basis points increase in interest rates on financial investments and derivatives[2,3,4]	**12.5**	12.0	**(114.1)**	(103.7)
Investment property				
Impact of a 15% decrease in property markets	**(43.8)**	(43.8)	**(43.8)**	(43.8)

Notes:

1. These sensitivities exclude the impact of taxation and have not considered the impact of the general market changes on the value of the Group's insurance liabilities or retirement benefit obligations. They reflect one-off impacts at 31 December and should not be interpreted as predictions.
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 £15.1 million (2019: £16.7 million) and a 100 basis points increase in interest rates would have been £4.4 million (2019: £4.9 million).
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.

The Group has a number of open interest rate and foreign exchange derivative positions. Collateral management arrangements are in place for significant counterparty exposures. At 31 December 2020, the Group has pledged £65.8 million in cash (2019: £37.8 million) to cover initial margins and out-of-the-money derivative positions. At 31 December 2020, counterparties have pledged £12.0 million in cash and £8.1 million in UK Gilts (2019: £0.3 million in cash and £9.2 million in UK Gilts) to the Group to cover in-the-money derivative positions.

The terms and conditions of collateral pledged for both assets and liabilities are market-standard. When securities are pledged they are required to be readily convertible to cash, and as such no policy has been established for the disposal of assets not readily convertible into cash.

3.3.3 Credit risk

This is the risk of loss resulting from defaults in obligations due and/or changes in credit standing of either issuers of securities, counterparties or any debtors to which the Group is exposed. The Group is mainly exposed to counterparty default risk.

Counterparty default risk

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

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

- investments – this arises from the investment of funds in a range of investment vehicles permitted by the investment policy;
- reinsurance recoveries – this arises in respect of reinsurance claims against which a reinsurance bad debt provision is assessed. PPOs have the potential to increase the ultimate value of a claim and, by their very nature, to increase significantly the length of time to reach final payment. This can increase reinsurance counterparty default risk in terms of both amount and longevity;
- commercial credit – this arises as brokers collect premiums on behalf of the Group; and
- consumer credit – exposure from offering monthly instalments on annual insurance contracts.

3. Risk management continued

3.3.3 Credit risk continued

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

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

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

At 31 December 2020	Neither past due nor impaired £m	Past due 1 – 90 days £m	Past due more than 90 days £m	Carrying value in the balance sheet £m
Reinsurance assets	**1,129.1**	–	0.1	**1,129.2**
Insurance and other receivables	**802.6**	45.0	0.6	**848.2**
Derivative assets	**73.4**	–	–	**73.4**
Debt securities	**4,207.0**	–	–	**4,207.0**
Infrastructure debt	**264.5**	–	–	**264.5**
Commercial real estate loans	**206.7**	–	–	**206.7**
Cash and cash equivalents[1]	**1,220.1**	–	–	**1,220.1**
Total	**7,903.4**	**45.0**	**0.7**	**7,949.1**

At 31 December 2019	Neither past due nor impaired £m	Past due 1 – 90 days £m	Past due more than 90 days £m	Carrying value in the balance sheet £m
Reinsurance assets	1,251.2	–	0.1	1,251.3
Insurance and other receivables	805.9	40.5	0.1	846.5
Derivative assets	121.5	–	–	121.5
Debt securities	4,189.6	–	–	4,189.6
Infrastructure debt	278.1	–	–	278.1
Commercial real estate loans	205.7	–	–	205.7
Cash and cash equivalents[1]	948.6	–	–	948.6
Total	7,800.6	40.5	0.2	7,841.3

Note:

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

Within the analysis of debt securities above are bank debt securities at 31 December 2020 of £1,282.8 million (2019: £1,292.2 million) that can be further analysed as: secured £16.2 million (2019: £20.9 million); unsecured £1,125.2 million (2019: £1,105.5 million); and subordinated £141.4 million (2019: £165.8 million).

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

At 31 December 2020	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB– £m	BB+ and below £m	Total £m
Corporate	68.1	400.9	1,842.3	1,447.1	366.5	**4,124.9**
Supranational	21.3	–	–	–	–	**21.3**
Local government	10.2	25.4	–	–	–	**35.6**
Sovereign	10.1	15.1	–	–	–	**25.2**
Total	**109.7**	**441.4**	**1,842.3**	**1,447.1**	**366.5**	**4,207.0**

At 31 December 2019	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB– £m	BB+ and below £m	Total £m
Corporate	70.9	498.8	1,809.2	1,259.9	390.8	4,029.6
Supranational	31.3	—	—	—	—	31.3
Local government	10.1	19.1	—	—	—	29.2
Sovereign	6.7	92.8	—	—	—	99.5
Total	119.0	610.7	1,809.2	1,259.9	390.8	4,189.6

The tables below analyse the credit quality of financial and insurance assets that are neither past due nor impaired (excluding debt securities analysed above). The tables include reinsurance exposure, after provision. The Group's approach to reinsurance counterparty default risk is detailed on page 181.

At 31 December 2020	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB– £m	BB+ and below £m	Not rated £m	**Total £m**
Reinsurance assets	—	766.9	359.7	1.9	—	0.6	**1,129.1**
Insurance and other receivables[1]	—	17.3	40.2	16.4	—	728.7	**802.6**
Derivative assets	—	8.5	64.9	—	—	—	**73.4**
Infrastructure debt	—	—	71.7	192.8	—	—	**264.5**
Commercial real estate loans	1.2	44.7	117.8	32.3	10.7	—	**206.7**
Cash and cash equivalents[2]	995.2	55.7	169.2	—	—	—	**1,220.1**
Total	**996.4**	**893.1**	**823.5**	**243.4**	**10.7**	**729.3**	**3,696.4**

At 31 December 2019	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	—	842.0	406.3	2.3	—	0.6	1,251.2
Insurance and other receivables[1]	—	2.8	30.3	11.3	—	761.5	805.9
Derivative assets	—	111.5	10.0	—	—	—	121.5
Infrastructure debt	—	—	75.8	202.3	—	—	278.1
Commercial real estate loans	—	46.6	118.9	26.7	13.5	—	205.7
Cash and cash equivalents[2]	725.5	123.7	98.8	0.6	—	—	948.6
Total	725.5	1,126.6	740.1	243.2	13.5	762.1	3,611.0

Notes:
1. Includes receivables due from policyholders, agents, brokers and intermediaries which generally do not have a credit rating.
2. This represents money market funds with no notice period for withdrawal and cash at bank and in hand.

3.3.4 Operational risk

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

Change risk

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

Technology and infrastructure risk

This is the risk that information or services are unavailable because of compromised, unstable or inadequately performing systems, all of which impact customers.

Outsourcing risk

This is the risk of failing to implement a robust framework for the sourcing, appointment and ongoing contract management of third-party suppliers, outsourced service providers and intra-group relationships. This includes both domestic and offshore outsourcing activities.

Information security risk

This is the risk of loss or corruption to Group or customer data, intellectual property or failure of business-critical systems resulting in reputational damage, regulatory censure, supervision, fines and/or loss of competitive advantage.

Partnership contractual obligations

This is the risk of contractual obligations not being delivered for business partners resulting in damaged reputation, the loss of contract at renewal, significant liability payments and/or the early termination of a partnership scheme.

The Group has in place agreed policies and standards to establish and monitor key controls relating to operational risk.

3. Risk management continued

3.3.5 Liquidity risk

This is the risk of being unable to access cash from the sale of investments or other assets in order to settle financial obligations as they fall due.

The measurement and management of the Group's liquidity risk is undertaken within the limits and other policy parameters of the Group's liquidity risk appetite and is detailed in the liquidity risk minimum standard. As part of this process the Investment and Treasury team are required to put in place a liquidity plan which must consider expected and stressed scenarios for cash inflows and outflows that is reviewed at least annually by the Investment Committee. Compliance is monitored in respect of both the minimum standard and the regulatory requirements of the PRA.

The following table analyses the carrying value of financial investments and cash and cash equivalents, by contractual maturity, which can fund the repayment of liabilities as they crystallise.

At 31 December 2020	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	**Total £m**
Debt securities	407.7	1,053.8	1,133.6	1,492.8	119.1	**4,207.0**
Infrastructure debt	14.0	31.4	34.9	98.1	86.1	**264.5**
Commercial real estate loans	35.0	106.3	65.4	—	—	**206.7**
Cash and cash equivalents[1]	1,220.1	—	—	—	—	**1,220.1**
Total	**1,676.8**	**1,191.5**	**1,233.9**	**1,590.9**	**205.2**	**5,898.3**

At 31 December 2019	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	Total £m
Debt securities	506.1	1,054.8	1,089.7	1,391.3	147.7	4,189.6
Infrastructure debt	13.8	29.2	34.2	95.1	105.8	278.1
Commercial real estate loans	45.8	122.9	37.0	—	—	205.7
Cash and cash equivalents[1]	948.6	—	—	—	—	948.6
Total	1,514.3	1,206.9	1,160.9	1,486.4	253.5	5,622.0

Note:

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

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

At 31 December 2020	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	33.5	282.4	20.8	52.0	280.8	**669.5**	516.6
Insurance liabilities[1]	1,053.5	953.8	456.8	371.6	1,817.6	**4,653.3**	3,617.0
Borrowings	51.9	—	—	—	—	**51.9**	51.9
Lease liabilities	17.6	29.6	25.9	57.1	75.4	**205.6**	152.4
Provisions	108.2	6.5	0.1	—	—	**114.8**	114.8
Trade and other payables, including insurance payables	543.6	6.1	0.2	—	—	**549.9**	549.9
Total	**1,808.3**	**1,278.4**	**503.8**	**480.7**	**2,173.8**	**6,245.0**	**5,002.6**

At 31 December 2019	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	284.7	—	—	—	307.8	259.0
Insurance liabilities[1]	1,120.0	1,000.1	514.9	428.0	2,096.7	5,159.7	3,819.6
Borrowings	52.3	—	—	—	—	52.3	52.3
Lease liabilities	18.3	32.8	29.1	48.8	95.7	224.7	164.4
Provisions	74.3	—	—	—	—	74.3	74.3
Trade and other payables, including insurance payables	473.7	4.2	0.2	—	—	478.1	478.1
Total	1,761.7	1,321.8	544.2	476.8	2,192.4	6,296.9	4,847.7

Note:

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

The following table analyses the undiscounted cash flows of derivative financial instruments, by contractual maturity.

At 31 December 2020	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
Derivatives assets	69.2	2.3	0.1	1.9	—	**73.5**	73.4
Derivatives liabilities	(24.6)	(18.2)	(10.8)	(3.6)	(0.1)	**(57.3)**	(57.2)
Total	**44.6**	**(15.9)**	**(10.7)**	**(1.7)**	**(0.1)**	**16.2**	**16.2**

At 31 December 2019	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
Derivatives assets	116.1	5.5	—	—	—	121.6	121.5
Derivatives liabilities	(15.4)	(6.8)	(5.3)	(3.7)	—	(31.2)	(30.5)
Total	100.7	(1.3)	(5.3)	(3.7)	—	90.4	91.0

3.4 Capital management

At 31 December 2020, the Group's capital position was comprised of shareholders' equity of £2,699.7 million (31 December 2019: £2,643.6 million) and Tier 1 notes of £346.5 million (31 December 2019: £346.5 million). In addition, the Group's balance sheet also included £516.6 million of subordinated loan capital (31 December 2019: £259.0 million) which is classified as Tier 2 for Solvency II purposes.

The Group manages capital in accordance with the Group's capital management minimum standard, the aims of which are to manage capital efficiently and generate long-term sustainable value for shareholders, while balancing operational, regulatory, credit rating agency and policyholder requirements. The Group seeks to hold capital resources such that, in normal circumstances, the solvency capital ratio is around the middle of the target range of 140% to 180%.

The Group's regulatory capital position is assessed against the Solvency II framework. From 1 July 2016, the Group gained approval to assess its SCR using a partial internal model, including a full internal economic capital model for the U K Insurance Limited underwriting entity. The model is calibrated to a 99.5% confidence interval and considers business written to date and one year of future written business over a one-year time horizon, in line with Solvency II requirements.

3.5 Capital adequacy (unaudited)

Using the Group's partial internal model, there is a capital surplus of approximately £1.22 billion above an estimated SCR of £1.34 billion as at 31 December 2020 (31 December 2019: £0.85 billion and £1.32 billion respectively). The Group's capital requirements and solvency position are produced and presented to the Board on a regular basis.

4. Segmental analysis

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

Motor

This segment consists of personal motor insurance together with the associated legal protection cover. The Group sells motor insurance direct to customers through its own brands Direct Line, Churchill, Privilege and Darwin, and through partnership brands such as vehicle manufacturers and through price comparison websites ("**PCWs**").

Home

This segment consists of home insurance together with associated legal protection cover. The Group sells home insurance products through its brands Direct Line, Churchill and Privilege, and its partnership brands (Royal Bank of Scotland and NatWest), as well as through PCWs.

Rescue and other personal lines

This segment consists of rescue products which are sold direct through the Group's own brand, Green Flag, and other personal lines insurance, including travel, pet and creditor sold through its own brands Direct Line, Churchill and Privilege, and through partnership brands and through PCWs.

Commercial

This segment consists of commercial insurance for small and medium-sized enterprises sold through the Group's brands NIG, Direct Line for Business and Churchill. NIG sells its products exclusively through brokers operating across the UK. Direct Line for Business sells its products directly to customers, and Churchill sells its products directly to customers and through PCWs.

Restructuring and one-off costs

Restructuring costs are costs incurred in respect of those business activities which have a material effect on the nature and focus of the Group's operations. One-off costs are costs that are non-recurring in nature.

No inter-segment transactions occurred in the year ended 31 December 2020 (2019: £nil). If any transaction were to occur, transfer prices between operating segments would be set on an arm's-length basis in a manner similar to transactions with third parties. Segment income, expenses and results will include those transfers between business segments which will then be eliminated on consolidation.

4. Segmental analysis continued

For each operating segment, there is no individual policyholder or customer that represents 10% or more of the Group's total revenue.

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2020.

	Motor	Home	Rescue and other personal lines	Commercial	**Total Group**
	£m	£m	£m	£m	**£m**
Gross written premium	1,616.9	577.9	417.8	567.8	**3,180.4**
Gross earned premium	1,635.3	581.9	425.6	546.5	**3,189.3**
Reinsurance premium	(150.5)	(26.1)	(2.7)	(49.5)	**(228.8)**
Net earned premium	1,484.8	555.8	422.9	497.0	**2,960.5**
Investment return	62.8	10.3	3.4	18.6	**95.1**
Instalment income	80.1	19.2	3.0	7.0	**109.3**
Other operating income	38.4	0.2	8.9	2.4	**49.9**
Total income	1,666.1	585.5	438.2	525.0	**3,214.8**
Insurance claims	(889.2)	(316.5)	(279.1)	(245.6)	**(1,730.4)**
Insurance claims recoverable from / (payable to) reinsurers	1.1	7.4	18.0	(9.7)	**16.8**
Net insurance claims	(888.1)	(309.1)	(261.1)	(255.3)	**(1,713.6)**
Commission expenses	(47.4)	(45.0)	(69.4)	(92.9)	**(254.7)**
Operating expenses before restructuring and one-off costs	(367.1)	(130.0)	(100.9)	(126.4)	**(724.4)**
Total expenses	(414.5)	(175.0)	(170.3)	(219.3)	**(979.1)**
Operating profit	**363.5**	**101.4**	**6.8**	**50.4**	**522.1**
Restructuring and one-off costs					**(39.4)**
Finance costs					**(31.3)**
Profit before tax					**451.4**
Underwriting profit / (loss)	**182.2**	**71.7**	**(8.5)**	**22.4**	**267.8**
Loss ratio	59.8%	55.6%	61.7%	51.4%	**57.9%**
Commission ratio	3.2%	8.1%	16.4%	18.7%	**8.6%**
Expense ratio	24.7%	23.4%	23.9%	25.4%	**24.5%**
Combined operating ratio	**87.7%**	**87.1%**	**102.0%**	**95.5%**	**91.0%**

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2020.

	Motor	Home	Rescue and other personal lines	Commercial	**Total**
	£m	£m	£m	£m	**£m**
Goodwill	129.6	45.8	28.7	10.1	**214.2**
Other segment assets	6,874.0	765.5	304.2	1,464.4	**9,408.1**
Segment liabilities	(4,771.6)	(558.7)	(196.2)	(1,049.6)	**(6,576.1)**
Segment net assets	**2,232.0**	**252.6**	**136.7**	**424.9**	**3,046.2**

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

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2019.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
Gross written premium	1,651.6	586.6	436.0	528.9	3,203.1
Gross earned premium	1,653.2	598.8	427.4	523.2	3,202.6
Reinsurance premium	(145.5)	(25.2)	(2.2)	(44.8)	(217.7)
Net earned premium	1,507.7	573.6	425.2	478.4	2,984.9
Investment return	88.6	16.7	5.6	23.7	134.6
Instalment income	83.8	20.5	2.8	6.9	114.0
Other operating income	51.3	0.6	11.1	3.2	66.2
Total income	1,731.4	611.4	444.7	512.2	3,299.7
Insurance claims	(1,086.8)	(276.2)	(285.2)	(269.1)	(1,917.3)
Insurance claims recoverable from reinsurers	43.5	7.8	0.8	17.6	69.7
Net insurance claims	(1,043.3)	(268.4)	(284.4)	(251.5)	(1,847.6)
Commission expenses	(39.9)	(55.7)	(27.2)	(88.7)	(211.5)
Operating expenses before restructuring and one-off costs	(345.6)	(136.7)	(94.0)	(117.4)	(693.7)
Total expenses	(385.5)	(192.4)	(121.2)	(206.1)	(905.2)
Operating profit	302.6	150.6	39.1	54.6	546.9
Restructuring and one-off costs					(11.2)
Finance costs					(26.0)
Profit before tax					509.7
Underwriting profit	78.9	112.8	19.6	20.8	232.1
Loss ratio	69.3%	46.8%	66.9%	52.7%	61.9%
Commission ratio	2.6%	9.7%	6.4%	18.5%	7.1%
Expense ratio	22.9%	23.8%	22.1%	24.5%	23.2%
Combined operating ratio	94.8%	80.3%	95.4%	95.7%	92.2%

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2019.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total £m
Goodwill	129.6	45.8	28.7	10.1	214.2
Other segment assets	6,839.9	682.6	230.3	1,467.2	9,220.0
Segment liabilities	(4,770.4)	(489.1)	(154.6)	(1,030.0)	(6,444.1)
Segment net assets	2,199.1	239.3	104.4	447.3	2,990.1

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

5. Net earned premium

	2020 £m	2019 £m
Gross earned premium:		
Gross written premium	**3,180.4**	3,203.1
Movement in unearned premium reserve	**8.9**	(0.5)
	3,189.3	3,202.6
Reinsurance premium paid and payable:		
Premium payable	**(231.0)**	(215.9)
Movement in reinsurance unearned premium reserve	**2.2**	(1.8)
	(228.8)	(217.7)
Total	**2,960.5**	2,984.9

6. Investment return

	2020 £m	2019 £m
Investment income:		
Interest income from debt securities	**98.6**	108.4
Interest income from cash and cash equivalents	**2.5**	7.9
Interest income from infrastructure debt	**5.8**	7.0
Interest income from commercial real estate loans	**6.5**	6.9
Interest income	**113.4**	130.2
Rental income from investment property	**13.7**	16.2
	127.1	146.4
Net realised gains / (losses):		
AFS debt securities	**1.1**	16.5
Derivatives	**69.9**	(9.5)
Investment property (note 20)	**—**	(0.7)
	71.0	6.3
Net unrealised losses:		
Impairment of loans and receivables	**(2.7)**	—
Derivatives	**(90.2)**	(12.6)
Investment property (note 20)	**(10.1)**	(5.5)
	(103.0)	(18.1)
Total	**95.1**	134.6

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

	Realised 2020 £m	Unrealised 2020 £m	Realised 2019 £m	Unrealised 2019 £m
Derivative gains / (losses):				
Foreign exchange forward contracts[1]	**57.4**	**(50.8)**	(56.8)	103.4
Associated foreign exchange risk	**28.1**	**(45.7)**	53.4	(123.8)
Net gains / (losses) on foreign exchange forward contracts	**85.5**	**(96.5)**	(3.4)	(20.4)
Interest rate swaps[1]	**(26.2)**	**(23.0)**	(16.8)	(33.6)
Associated interest rate risk on hedged items	**10.6**	**29.3**	10.7	41.4
Net (losses) / gains on interest rate derivatives	**(15.6)**	**6.3**	(6.1)	7.8
Total	**69.9**	**(90.2)**	(9.5)	(12.6)

Note:

1. All foreign exchange forward contracts and certain interest rate swaps are measured at fair value through profit and loss. There are also interest rate swaps designated as hedging instruments.

7. Other operating income

	2020 £m	2019 £m
Revenue from vehicle recovery and repair services	**24.0**	28.3
Vehicle replacement referral income	**12.2**	19.1
Legal services income	**8.8**	11.3
Other income[1]	**4.9**	7.5
Total	**49.9**	66.2

Note:

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

8. Net insurance claims

	Gross 2020 £m	Reinsurance 2020 £m	Net 2020 £m	Gross 2019 £m	Reinsurance 2019 £m	Net 2019 £m
Current accident year claims paid	**1,056.4**	**(18.1)**	**1,038.3**	1,232.9	(0.2)	1,232.7
Prior accident year claims paid	**876.6**	**(123.0)**	**753.6**	870.7	(25.1)	845.6
Decrease in insurance liabilities	**(202.6)**	**124.3**	**(78.3)**	(186.3)	(44.4)	(230.7)
Total	**1,730.4**	**(16.8)**	**1,713.6**	1,917.3	(69.7)	1,847.6

Claims handling expenses[1] for the year ended 31 December 2020 of £208.2 million (2019: £202.9 million) have been included in the claims figures above.

Note:

1. Includes costs in respect of low value leases of £0.8 million (2019: £0.3 million).

9. Commission expenses

	2020 £m	2019 £m
Commission expenses	**180.9**	171.2
Expenses incurred under profit participations	**73.8**	40.3
Total	**254.7**	211.5

10. Operating expenses

	2020 £m	2019 £m
Staff costs[1,2]	**270.3**	267.3
IT and other operating expenses[1,2,3]	**220.2**	163.4
Marketing	**106.6**	113.9
Insurance levies	**80.4**	81.5
Depreciation and amortisation[1,4,5]	**86.3**	78.8
Total operating expenses (including restructuring and one-off costs)	**763.8**	704.9
Of which restructuring and one-off costs	**39.4**	11.2
Total excluding restructuring and one-off costs	**724.4**	693.7

Notes:

1. Restructuring and one-off costs of £39.4 million (2019: £11.2 million) are included as follows: staff costs of £14.7 million (2019: £5.8 million), other operating expenses of £24.2 million (2019: £5.4 million) and depreciation of £0.5 million (2019: £nil).
2. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
3. IT and other operating expenses include professional fees and property costs.
4. For year ended 31 December 2020, depreciation and amortisation include a £6.6 million impairment charge (2019: £1.3 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.
5. Includes depreciation on right-of-use assets of £14.8 million (2019: £14.2 million).

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

	At 31 December		Average for the year	
	2020	2019	2020	2019
Insurance operations	**8,022**	7,963	**8,010**	8,388
Repair centre operations	**1,441**	1,444	**1,454**	1,384
Support	**1,344**	1,355	**1,388**	1,350
Total	**10,807**	10,762	**10,852**	11,122

10. Operating expenses continued

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

	2020 £m	2019 £m
Wages and salaries	**393.5**	387.2
Social security costs	**43.6**	41.9
Pension costs	**26.2**	25.5
Share-based payments	**18.5**	18.4
Total	**481.8**	473.0

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

	2020 £m	2019 £m
Fees payable for the audit of:		
The Company's annual accounts	**0.2**	0.2
The Company's subsidiaries	**1.9**	1.8
Total audit fees	**2.1**	2.0
Audit-related assurance services	**0.2**	0.2
Non-audit services	**0.6**	0.1
Total	**2.9**	2.3

Aggregate Directors' emoluments

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

	2020 £m	2019 £m
Salaries, fees, bonuses and benefits in kind	**3.8**	4.4
Gains on exercise of share options	**—**	5.3
Total	**3.8**	9.7

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

At 31 December 2020, no Directors (2019: one Director) had retirement benefits accruing under the defined contribution pension scheme in respect of qualifying service. During the year ended 31 December 2020, one Director exercised share options (2019: three Directors).

11. Finance costs

	2020 £m	2019 £m
Interest expense on subordinated liabilities[1]	**29.1**	23.1
Net interest received on interest rate swap[2]	**(4.1)**	(3.4)
Unrealised losses on interest rate swap[2]	**1.9**	—
Unrealised (gain) / loss on designated hedging instrument[2]	**(1.2)**	0.1
Unrealised loss / (gains) on associated interest rate risk on hedged item[2]	**0.9**	(0.8)
Amortisation of arrangement costs, discount on issue and fair value hedging adjustment of subordinated liabilities	**(1.3)**	0.3
Interest expense on lease liabilities	**6.0**	6.7
Total	**31.3**	26.0

Notes:

1. On 5 June 2020, the Group issued subordinated Tier 2 notes at a fixed rate of 4.0%. See note 33.
2. As described in note 33, on 27 April 2012 the Group issued subordinated guaranteed dated Tier 2 notes with a nominal value of £500 million at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year interest rate swap to exchange the fixed rate of interest on the notes for a floating rate. This was treated as a hedging instrument. On 8 December 2017, the Group redeemed £250 million nominal value of the notes and the hedging agreement was redesignated accordingly. On 31 July 2020, the Group identified that the hedge no longer met the criteria of hedge effectiveness under IAS 39 and, under the rules of the standard, the accumulated hedging adjustment has begun to be amortised to the income statement from the date of the last successful hedge effectiveness test over the remaining life of the subordinated debt using an effective interest rate calculation.

12. Tax charge

	2020 £m	2019 £m
Current taxation:		
Charge for the year	**95.2**	101.9
Over provision in respect of prior year	**(0.5)**	(1.1)
	94.7	100.8
Deferred taxation (note 13):		
Credit for the year	**(11.1)**	(5.4)
Under / (over) provision in respect of prior year	**0.6**	(5.6)
	(10.5)	(11.0)
Current taxation	**94.7**	100.8
Deferred taxation (note 13)	**(10.5)**	(11.0)
Tax charge for the year	**84.2**	89.8

The following table analyses the difference between the actual income tax charge and the expected income tax charge computed by applying the standard rate of corporation tax of 19.0%[1] (2019: 19.0%).

	2020 £m	2019 £m
Profit before tax	**451.4**	509.7
Expected tax charge	**85.8**	96.8
Effects of:		
Disallowable expenses	**1.3**	2.9
Effect of change in corporation taxation rate[1]	**0.1**	—
Under / (over) provision in respect of prior year	**0.1**	(6.7)
Revaluation of property	**0.1**	—
Deductible Tier 1 notes coupon payment in equity	**(3.2)**	(3.2)
Tax charge for the year	**84.2**	89.8
Effective income tax rate	**18.7%**	17.6%

Note:

1. In the Finance Act 2020 the UK Government cancelled the previously enacted reduction in the UK corporation tax rate from 19% to 17% which had been due to take effect from 1 April 2020. The impact of this change on the tax charge for the year is set out in the table above.

13. Current and deferred tax

	2020 £m	2019 £m
Per balance sheet:		
Current tax liabilities	**10.5**	50.3
Deferred tax liabilities	**8.7**	9.6

13. Current and deferred tax continued

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

	Provisions and other temporary differences £m	Retirement benefit obligations £m	Depreciation in excess of capital allowances £m	Non-distributable reserve[1] £m	Share-based payments £m	AFS revaluation reserve £m	Total £m
At 1 January 2019	5.4	(3.0)	(3.4)	(13.7)	2.2	8.0	(4.5)
(Charge) / credit to the income statement	(1.1)	(0.1)	7.4	4.9	(0.1)	—	11.0
Credit / (charge) to other comprehensive income	—	1.3	—	—	—	(17.4)	(16.1)
At 31 December 2019	4.3	(1.8)	4.0	(8.8)	2.1	(9.4)	(9.6)
Credit / (charge) to the income statement	**5.9**	**(0.3)**	**0.2**	**3.9**	**0.8**	**–**	**10.5**
Credit / (charge) to other comprehensive income	**–**	**0.3**	**–**	**–**	**–**	**(10.1)**	**(9.8)**
Credit direct to equity	**–**	**–**	**–**	**–**	**0.2**	**–**	**0.2**
At 31 December 2020	**10.2**	**(1.8)**	**4.2**	**(4.9)**	**3.1**	**(19.5)**	**(8.7)**

Note:

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 2020 of £5.0 million (2019: £4.5 million) in relation to capital losses of which £5.0 million (2019: £4.5 million) relates to realised losses and £nil (2019: £nil) relates to unrealised losses.

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

14. Dividends and appropriations

	2020 £m	2019 £m
Amounts recognised as distributions to equity holders in the period:		
2020 interim dividend of 7.4 pence per share paid on 4 September 2020	**100.4**	—
2020 special interim dividend of 14.4 pence per share paid on 4 September 2020	**195.5**	—
2019 first interim dividend of 7.2 pence per share paid on 6 September 2019	**–**	98.6
2018 final dividend of 14.0 pence per share paid on 16 May 2019	**–**	191.8
2018 special dividend of 8.3 pence per share paid on 16 May 2019	**–**	113.7
	295.9	404.1
Coupon payments in respect of Tier 1 notes[1]	**16.6**	16.6
	312.5	420.7
Proposed dividends:		
2020 final dividend of 14.7 pence per share	**199.3**	—
2019 final dividend of 14.4 pence per share	**–**	198.0

Note:

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 dividends for 2020 have not been included as a liability in these financial statements.

The Board has also approved a share buyback of up to £100 million, with an initial tranche of up to £50 million expected to be completed by the time of the half-year results.

On 3 March 2020, the Group announced that the Board had approved a share buyback of up to £150 million. On 19 March 2020, the Board cancelled that share buyback programme given the uncertainty in the capital markets at the time, driven by the rapidly emerging Covid-19 pandemic.

Following the cancellation of the dividend as announced on 8 April 2020, the final dividend for 2019 was not paid. A special interim dividend of 14.4 pence per share reflecting a full catch-up of the cancelled 2019 final dividend was paid on 4 September 2020.

The trustees of the employee share trusts waived their entitlement to dividends on shares held to meet obligations arising on the Long-Term Incentive Plan, Deferred Annual Incentive Plan and Restricted Share Plan awards, which reduced the total dividends paid for the year ended 31 December 2020 by £1.6 million (2019: £1.5 million).

15. Earnings per share

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

Basic

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

	2020 £m	2019 £m
Earnings attributable to owners of the Company	367.2	419.9
Coupon payments in respect of Tier 1 notes	(16.6)	(16.6)
Profit for the calculation of earnings per share	350.6	403.3
Weighted average number of Ordinary Shares (millions)	1,356.5	1,367.2
Basic earnings per share (pence)	25.8	29.5

As noted in note 30, the Group cancelled the share buyback programme on 19 March 2020. At the time of cancellation, the Group had repurchased 10.4 million Ordinary Shares.

Diluted

Diluted earnings per share is calculated by dividing the earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the period, excluding Ordinary Shares held as employee trust shares, adjusted for the dilutive potential Ordinary Shares. The Company has share options and contingently issuable shares as categories of dilutive potential Ordinary Shares.

	2020 £m	2019 £m
Earnings attributable to owners of the Company	367.2	419.9
Coupon payments in respect of Tier 1 notes	(16.6)	(16.6)
Profit for the calculation of earnings per share	350.6	403.3
Weighted average number of Ordinary Shares (millions)	1,356.5	1,367.2
Effect of dilutive potential of share options and contingently issuable shares (millions)	18.6	15.3
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	1,375.1	1,382.5
Diluted earnings per share (pence)	25.5	29.2

16. Net asset value per share and return on equity

Net asset value per share is calculated as total shareholders' equity (which excludes Tier 1 notes) divided by the number of Ordinary Shares at the end of the period excluding shares held by employee share trusts.

Tangible net asset value per share is calculated as total shareholders' equity less goodwill and other intangible assets divided by the number of Ordinary Shares at the end of the period, excluding shares held by employee share trusts.

The table below analyses net asset and tangible net asset value per share.

At 31 December	2020 £m	2019 £m
Net assets	2,699.7	2,643.6
Goodwill and other intangible assets[1]	(786.8)	(702.5)
Tangible net assets	1,912.9	1,941.1
Number of Ordinary Shares (millions)	1,364.6	1,375.0
Shares held by employee share trusts (millions)	(12.8)	(8.4)
Closing number of Ordinary Shares (millions)	1,351.8	1,366.6
Net asset value per share (pence)	199.7	193.4
Tangible net asset value per share (pence)	141.5	142.0

Note:

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

16. Net asset value per share and return on equity continued

Return on equity

The table below details the calculation of return on equity.

	2020 £m	2019 £m
Earnings attributable to owners of the Company	**367.2**	419.9
Coupon payments in respect of Tier 1 notes	**(16.6)**	(16.6)
Profit for the calculation of return on equity	**350.6**	403.3
Opening shareholders' equity	**2,643.6**	2,558.2
Closing shareholders' equity	**2,699.7**	2,643.6
Average shareholders' equity	**2,671.7**	2,600.9
Return on equity	**13.1%**	15.5%

17. Goodwill and other intangible assets

	Goodwill £m	Other intangible assets £m	Total £m
Cost			
At 1 January 2019	212.7	779.4	992.1
Acquisitions and additions	1.5	174.2	175.7
Disposals and write-off[1]	—	(8.8)	(8.8)
At 31 December 2019	214.2	944.8	1,159.0
Acquisitions and additions	**—**	**140.7**	**140.7**
At 31 December 2020	**214.2**	**1,085.5**	**1,299.7**
Accumulated amortisation and impairment			
At 1 January 2019	—	425.3	425.3
Charge for the year	—	38.7	38.7
Disposals and write-off[1]	—	(8.8)	(8.8)
Impairment losses[2]	—	1.3	1.3
At 31 December 2019	—	456.5	456.5
Charge for the year	**—**	**49.8**	**49.8**
Impairment losses[2]	**—**	**6.6**	**6.6**
At 31 December 2020	**—**	**512.9**	**512.9**

Carrying amount			
At 31 December 2020	**214.2**	**572.6**	**786.8**
At 31 December 2019	214.2	488.3	702.5

Notes:
1. Disposals and write-off include fully amortised intangible assets no longer utilised by the Group in its operating activities.
2. Impairment losses relate to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.

Included within other intangible assets are assets still in development of £370.7 million (2019: £343.5 million). These assets are tested for impairment during the Group's annual impairment review at each reporting date.

Goodwill arose on the acquisition of U K Insurance Limited (£141.0 million), Churchill Insurance Company Limited (£70.0 million) and accident repair networks (£3.2 million) and is allocated to reportable segments.

The Group's testing for impairment of goodwill and intangible assets includes the comparison of the recoverable amount of each CGU to which goodwill and other intangible assets have been allocated with its carrying value and is updated at each reporting date and whenever there are indications of impairment.

The table below analyses the carrying amount of goodwill allocated to each CGU.

	2020 £m	2019 £m
Motor	**129.6**	129.6
Home	**45.8**	45.8
Rescue and other personal lines	**28.7**	28.7
Commercial	**10.1**	10.1
Total	**214.2**	214.2

There is no goodwill impairment for the year ended 31 December 2020 (2019: £nil).

The recoverable amount is the higher of the CGU fair value less the costs to sell and its value-in-use. Value-in-use is the present value of expected future cash flows from the CGU. Fair value is the estimated amount that could be obtained from the sale of the CGU in an arm's-length transaction between knowledgeable and willing parties.

The recoverable amounts of all CGUs were based on the value-in-use test, using the Group's strategic plan. The long-term growth rates have been based on gross domestic product rates adjusted for inflation. The risk discount rates incorporate observable market long-term government bond yields and average industry betas adjusted for an appropriate risk premium based on independent analysis.

The table below details the recoverable amounts in excess of carrying value for the CGUs where goodwill and other intangible assets are held. Sensitivity information is included to enhance user understanding of the influence of key assumptions. Following the annual impairment review, no reasonable possible change in these key assumptions would have resulted in an impairment of goodwill and other intangible assets.

	Assumptions			Sensitivity: impact on recoverable amount of a:		
	Terminal growth rate	Pre-tax discount rate	Recoverable amount in excess of carrying value	1% decrease in terminal growth rate	1% increase in pre-tax discount rate	1% decrease in forecast pre-tax profit[1]
CGU	%	%	£m	£m	£m	£m
Motor	1.5	10.7	759.2	(211.7)	(298.1)	(293.6)
Home	1.5	10.7	540.9	(59.0)	(83.0)	(83.1)
Rescue and other personal lines	1.5	10.7	640.1	(56.9)	(79.1)	(74.2)
Commercial	1.5	10.7	323.4	(57.2)	(79.6)	(73.9)

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

18. Property, plant and equipment

	Land and buildings	Other equipment	Total
	£m	£m	£m
Cost			
At 1 January 2019	79.8	185.0	264.8
Additions	—	11.9	11.9
Disposals	—	(7.7)	(7.7)
At 31 December 2019	79.8	189.2	269.0
Additions	**–**	**20.1**	**20.1**
Disposals	**–**	**(13.4)**	**(13.4)**
At 31 December 2020	**79.8**	**195.9**	**275.7**
Accumulated depreciation and impairment			
At 1 January 2019	5.3	103.3	108.6
Depreciation charge for the year	1.1	23.5	24.6
Disposals	—	(7.6)	(7.6)
At 31 December 2019	6.4	119.2	125.6
Depreciation charge for the year	**1.1**	**14.0**	**15.1**
Disposals	**–**	**(11.1)**	**(11.1)**
At 31 December 2020	**7.5**	**122.1**	**129.6**
Carrying amount			
At 31 December 2020	**72.3**	**73.8**	**146.1**
At 31 December 2019	73.4	70.0	143.4

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

19. Right-of-use assets

	Property £m	Motor vehicles £m	IT equipment £m	Total £m
Cost				
At 1 January 2019	204.0	14.0	1.2	219.2
Additions	5.9	4.3	–	10.2
Disposals	–	(4.3)	–	(4.3)
At 31 December 2019	209.9	14.0	1.2	225.1
Additions	**4.2**	**1.8**	**–**	**6.0**
Disposals	**(18.7)**	**(3.2)**	**–**	**(21.9)**
At 31 December 2020	**195.4**	**12.6**	**1.2**	**209.2**
Accumulated depreciation and impairment				
At 1 January 2019	58.5	7.0	0.3	65.8
Depreciation charge for the year	10.2	3.8	0.2	14.2
Disposals	–	(4.1)	–	(4.1)
At 31 December 2019	68.7	6.7	0.5	75.9
Depreciation charge for the year	**11.0**	**3.6**	**0.2**	**14.8**
Disposals	**(16.1)**	**(3.2)**	**–**	**(19.3)**
At 31 December 2020	**63.6**	**7.1**	**0.7**	**71.4**

Carrying amount				
At 31 December 2020	**131.8**	**5.5**	**0.5**	**137.8**
At 31 December 2019	141.2	7.3	0.7	149.2

20. Investment property

	2020 £m	2019 £m
At 1 January	**291.7**	322.1
Additions at cost	**10.5**	–
Decrease in fair value during the year	**(10.1)**	(6.2)
Disposals	**–**	(24.2)
At 31 December[1]	**292.1**	291.7

Note:

1. The cost included in the carrying value at 31 December 2020 is £233.4 million (2019: £222.9 million).

The investment properties are measured at fair value derived from valuation work carried out at the balance sheet date by independent property valuers.

The valuation conforms to international valuation standards. The fair value was determined using a methodology based on recent market transactions for similar properties, which have been adjusted for the specific characteristics of each property within the portfolio. This approach to valuation is consistent with the methodology used in the year ended 31 December 2019.

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

21. Subsidiaries

The principal subsidiary undertakings of the Group, over which it exercises 100% voting power, are shown below. Their capital consists of Ordinary Shares which are unlisted. All subsidiaries (a full list of which is included in note 2 of the Parent Company's financial statements) are included in the Group's consolidated financial statements.

Name of subsidiary	Company registration number	Place of incorporation and operation	Principal activity
DL Insurance Services Limited	03001989	United Kingdom	Management services
U K Insurance Limited	01179980	United Kingdom	General insurance

On 15 September 2020, the Group acquired 100% of the issued share capital of Brolly UK Technology Limited. The Group did not dispose of any subsidiaries in the year ended 31 December 2020 (31 December 2019: no acquisitions or disposals).

For the period ended 31 December 2020, it is expected that Brolly UK Technology Limited will be exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of section 479 A(2)(d).

22. Reinsurance assets

	Notes	2020 £m	2019 £m
Reinsurers' share of general insurance liabilities		**1,071.6**	1,190.1
Impairment provision[1]		**(46.3)**	(40.5)
Total excluding reinsurers' unearned premium reserves	34	**1,025.3**	1,149.6
Reinsurers' unearned premium reserve	35	**103.9**	101.7
Total		**1,129.2**	1,251.3

Note:

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

Movements in reinsurance asset impairment provision

	2020 £m	2019 £m
At 1 January	**(40.5)**	(54.7)
Additional provision	**(13.7)**	(4.2)
Release to income statement	**7.9**	18.4
At 31 December	**(46.3)**	(40.5)

23. Deferred acquisition costs

	2020 £m	2019 £m
At 1 January	**176.2**	170.4
Additions	**361.6**	366.8
Recognised in the income statement	**(365.6)**	(361.0)
At 31 December	**172.2**	176.2

24. Insurance and other receivables

	2020 £m	2019 £m
Receivables arising from insurance contracts:		
Due from policyholders	**614.6**	684.8
Impairment provision of policyholder receivables	**(2.2)**	(1.0)
Due from agents, brokers and intermediaries	**136.0**	111.5
Impairment provision of agent, broker and intermediary receivables	**(0.3)**	(0.2)
Amounts due from reinsurers	**51.8**	10.1
Other debtors	**48.3**	41.3
Total	**848.2**	846.5

Movement in impairment provisions during the year

	Policyholders £m	Agents, brokers and intermediaries £m	Total £m
At 1 January 2020	**1.0**	**0.2**	**1.2**
Additional provision	**25.2**	**0.3**	**25.5**
Released to income statement	**(24.0)**	**(0.2)**	**(24.2)**
At 31 December 2020	**2.2**	**0.3**	**2.5**

25. Prepayments, accrued income and other assets

	2020 £m	2019 £m
Prepayments	**95.1**	99.2
Accrued income and other assets	**30.9**	21.0
Total	**126.0**	120.2

26. Derivative financial instruments

	2020 £m	2019 £m
Derivative assets		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	**63.5**	112.1
Interest rate swaps[1]	**8.2**	–
Designated as hedging instruments:		
Foreign exchange contracts (forwards)[2]	**0.1**	0.4
Interest rate swaps[1]	**1.6**	9.0
Total	**73.4**	121.5
Derivative liabilities		
At fair value through the income statement:		
Foreign exchange contracts (forwards)	**12.3**	10.1
Designated as hedging instruments:		
Foreign exchange contracts (forwards)[2]	**–**	0.2
Interest rate swaps	**44.9**	20.2
Total	**57.2**	30.5

Notes:

1. As described in note 33, the 2012 interest rate swap, which was entered into at the same time as the issue of the 9.25% subordinated Tier 2 notes due 2042, was treated as a designated hedging instrument in 2019 and as fair value through the income statement in 2020.
2. Foreign exchange contracts (forwards) are designated as cash flow hedges in relation to supplier payments.

27. Retirement benefit obligations

Defined contribution scheme

The pension charge in respect of the defined contribution scheme for the year ended 31 December 2020 was £26.2 million (2019: £25.5 million).

Defined benefit scheme

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

The trustee invests the scheme's assets in an appropriate mix of return-seeking assets and liability matching assets to better match the assets to future pension obligations. The main risks impacting funding levels are interest rates, changes in inflation expectations and the performance of the dynamic bond fund. The split of scheme assets is shown below. The matching assets are invested in liability-driven investment strategies, primarily UK gilts and index-linked gilt funds, but also including some leveraged gilt funds and interest rate and inflation swap funds. These are used to reduce the scheme's inflation and duration risks against its liabilities.

The weighted average duration of the defined benefit obligations at 31 December 2020 is 20 years (2019: 20 years) using accounting assumptions.

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

	2020 %	2019 %
Rate of increase in pension payment	**2.2**	2.1
Rate of increase of deferred pensions	**2.2**	2.1
Discount rate	**1.4**	2.0
Inflation rate	**2.9**	3.0

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

Post-retirement mortality assumptions

	2020	2019
Life expectancy at age 60 now:		
Males	**87.5**	87.1
Females	**89.3**	88.8
Life expectancy at age 60 in 20 years' time:		
Males	**89.3**	88.9
Females	**91.1**	90.7

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

	2020 £m	2019 £m
Index-linked bonds	**30.0**	28.1
Government bonds	**33.6**	29.1
Liquidity fund[1]	**1.5**	2.5
Absolute return bond fund[2]	**–**	40.2
Dynamic bond fund[3]	**42.3**	–
Other	**0.3**	0.1
Total	**107.7**	100.0

Notes:

1. The liquidity fund is an investment in an open-ended fund incorporated in the Republic of Ireland which targets capital stability and income in the UK. It is invested in short-term fixed income and variable rate securities (such as treasury bills) listed or traded on one or more recognised exchanges.
2. The absolute return bond fund is an investment in an open-ended fund incorporated in Luxembourg which targets positive returns in all market conditions. It is invested in short-term fixed income asset classes and seeks additional returns via a range of additional investments including certificates of deposit, rates and global currencies.
3. In the third quarter of 2020, the scheme transferred the absolute return bond mandate to a new dynamic bond fund which targets positive returns over a three-year rolling basis. It is invested to maximise the total return from a globally diversified portfolio, predominantly comprising high-yield corporate and government bonds.

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

27. Retirement benefit obligations continued

Movement in net pension surplus

	Fair value of defined benefit scheme assets £m	Present value of defined benefit scheme obligations £m	Net pension surplus £m
At 1 January 2019	95.6	(78.6)	17.0
Income statement:			
Net interest income / (cost)[1]	2.7	(2.2)	0.5
Administration costs	(0.5)	–	(0.5)
Statement of comprehensive income:			
Remeasurement losses			
Return on plan assets excluding amounts included in the net interest on the defined benefit asset	4.4	–	4.4
Actuarial gains of defined benefit scheme			
Experience gains	–	0.4	0.4
Gains from change in demographic assumptions	–	0.8	0.8
Loss from change in financial assumptions	–	(12.9)	(12.9)
Benefits paid	(2.2)	2.2	–
At 31 December 2019	100.0	(90.3)	9.7
Income statement:			
Net interest income / (cost)[1]	**1.9**	**(1.8)**	**0.1**
Administration costs	**(0.4)**	**–**	**(0.4)**
Statement of comprehensive income:			
Remeasurement losses			
Return on plan assets excluding amounts included in the net interest on the defined benefit asset	**9.0**	**–**	**9.0**
Actuarial gains of defined benefit scheme			
Experience gains	**–**	**2.4**	**2.4**
Loss from change in demographic assumptions	**–**	**(1.7)**	**(1.7)**
Loss from change in financial assumptions	**–**	**(10.1)**	**(10.1)**
Benefits paid	**(2.8)**	**2.8**	**–**
At 31 December 2020	**107.7**	**(98.7)**	**9.0**

Note:

1. The net interest income / (cost) in the income statement has been included under other operating expenses.

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

	2020 £m	2019 £m	2018 £m	2017 £m	2016 £m
Present value of defined benefit scheme obligations	**(98.7)**	(90.3)	(78.6)	(87.3)	(90.5)
Fair value of defined benefit scheme assets	**107.7**	100.0	95.6	101.7	102.5
Net surplus	**9.0**	9.7	17.0	14.4	12.0
Experience gains on scheme liabilities	**2.4**	0.4	–	1.5	1.2
Return on plan assets excluding amounts included in the net interest on the defined benefit asset	**9.0**	4.4	(3.5)	1.0	13.7

Sensitivity analysis

The sensitivity analysis has been calculated by valuing the pension scheme liabilities using the amended assumptions shown in the table below and keeping the remaining assumptions the same as disclosed in the table above, except in the case of the inflation sensitivity where other assumptions that depend on assumed inflation have also been amended correspondingly. The pension cost has been determined allowing for the estimated impact on the scheme's assets. The sensitivity to discount rates is based on movements in credit spreads, rather than gilt yields, which are hedged in the scheme's assets. The selection of these movements to illustrate the sensitivity of the defined benefit obligation to key assumptions should be viewed as illustrative, rather than providing a view on the likely size of any change.

	Impact on pension cost		Impact on present value of defined benefit scheme obligations	
	2020 £m	2019 £m	2020 £m	2019 £m
Discount rate				
0.25% increase in discount rate	**(0.1)**	(0.1)	**(4.9)**	(4.5)
0.25% decrease in discount rate	**0.1**	0.1	**4.9**	4.5
Inflation rate				
0.25% increase in inflation rate	**–**	–	**2.5**	2.3
0.25% decrease in inflation rate	**–**	–	**(2.5)**	(2.3)
Life expectancy				
1-year increase in life expectancy	**0.1**	0.1	**3.6**	3.2
1-year decrease in life expectancy	**(0.1)**	(0.1)	**(3.6)**	(3.2)

The most recent funding valuation of the Group's defined benefit scheme was carried out as at 1 October 2017. This showed an excess of assets over liabilities. The Group agreed with the trustees to make contributions of up to £1.5 million per annum in 2019, 2020 and 2021, in the event that a deficit subsequently emerges, on the anniversary of the funding valuation date.

At the date of signing these financial statements, no contributions are expected to be payable in 2021 (2020: £nil). The Group is currently undertaking a funding valuation of the defined benefit scheme at 1 October 2020, the results of which are due to be agreed with the trustees in 2021.

28. Financial investments

	2020 £m	2019 £m
AFS debt securities		
Corporate	**4,021.0**	3,925.6
Supranational	**21.3**	31.3
Local government	**35.6**	29.2
Sovereign	**25.2**	99.5
Total	**4,103.1**	4,085.6
HTM debt securities		
Corporate	**103.9**	104.0
Total debt securities	**4,207.0**	4,189.6
Total debt securities		
Fixed interest rate[1]	**4,184.5**	4,166.5
Floating interest rate	**22.5**	23.1
Total	**4,207.0**	4,189.6
Loans and receivables		
Infrastructure debt	**264.5**	278.1
Commercial real estate loans	**206.7**	205.7
Total loans and receivables	**471.2**	483.8
Equity investments[2]	**3.2**	—
Total	**4,681.4**	4,673.4

Notes:

1. The Group swaps a fixed interest rate for a floating rate of interest on its US dollar and Euro corporate debt securities by entering into interest rate derivatives. The hedged amount at 31 December 2020 was £971.1 million (2019: £955.8 million).
2. An equity fund which is valued based on external valuation reports received from a third-party fund manager.

29. Cash and cash equivalents and borrowings

	2020 £m	2019 £m
Cash at bank and in hand	**224.9**	223.1
Short-term deposits with credit institutions[1]	**995.2**	725.5
Cash and cash equivalents	**1,220.1**	948.6
Bank overdrafts[2]	**(51.9)**	(52.3)
Cash and bank overdrafts[3]	**1,168.2**	896.3

Notes:

1. This represents money market funds.
2. Bank overdrafts represent short-term timing differences between transactions posted in the records of the Group and transactions flowing through the accounts at the bank.
3. Cash and bank overdrafts total is included for the purposes of the consolidated cash flow statement.

The effective interest rate on short-term deposits with credit institutions for the year ended 31 December 2020 was 0.25% (2019: 0.79%) and average maturity was 10 days (2019: 10 days).

30. Share capital

Issued and fully paid: equity shares	**2020**			2019	
	Number of shares	**Share capital**	**Transfer to capital redemption reserve**	Number of shares	Share capital
Ordinary Shares of 10 10/11 pence each[1]	**millions**	**£m**	**£m**	millions	£m
At 1 January	**1,375.0**	**150.0**	**–**	1,375.0	150.0
Shares cancelled following share buyback[2]	**(10.4)**	**(1.1)**	**1.1**	—	—
At 31 December	**1,364.6**	**148.9**	**1.1**	1,375.0	150.0

Notes:

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.
2. On 3 March 2020, the Group announced a share buyback of Ordinary Shares for an aggregate purchase price of £150 million. On 19 March 2020 the buyback programme was cancelled, given the uncertainty in the capital markets at the time driven by the rapidly emerging Covid-19 pandemic. At the time of cancellation, the Group had repurchased 10,448,395 Ordinary Shares for an aggregate consideration of £30,014,567 as reflected in retained earnings. The shares were subsequently cancelled giving rise to a capital redemption reserve of an equivalent amount as required by the Companies Act 2006.

Employee trust shares

The Group satisfies share-based payments under the Group's share plans primarily through shares purchased in the market and held by employee share trusts.

At 31 December 2020, 12,753,755 Ordinary Shares (2019: 8,445,670 Ordinary Shares) were owned by the employee share trusts at a cost of £40.3 million (2019: £30.2 million). These Ordinary Shares are carried at cost and at 31 December 2020 had a market value of £40.7 million (2019: £26.4 million).

31. Other reserves

Movements in the AFS investments revaluation reserve

	2020 £m	2019 £m
At 1 January	**47.5**	(36.8)
Revaluation during the year – gross	**47.4**	118.1
Revaluation during the year – tax	**(10.1)**	(20.1)
Net gains transferred to income statement on disposals – gross	**(1.1)**	(16.5)
Net gains transferred to income statement on disposals – tax	**0.2**	2.8
At 31 December	**83.9**	47.5

Capital reserves

	2020 £m	2019 £m
Capital contribution reserve[1]	**100.0**	100.0
Capital redemption reserve[2]	**1,351.1**	1,350.0
Total	**1,451.1**	1,450.0

Notes:

1. Arose on the cancellation of a debt payable to a shareholder.
2. Arose on the reduction of nominal value of each share in issue with a corresponding transfer to capital redemption reserve. An additional £1.1 million arose in 2020 when shares repurchased through buyback were cancelled.

32. Tier 1 notes

	2020 £m	2019 £m
Tier 1 notes	**346.5**	346.5

On 7 December 2017, the Group issued £350 million of fixed rate perpetual Tier 1 notes with a coupon rate of 4.75% per annum.

The Group has an optional redemption date of 7 December 2027. If the notes are not repaid on that date, a fixed rate of interest per annum will be reset. The notes are direct, unsecured and subordinated obligations of the issuer ranking pari passu and without any preference amongst themselves.

The Tier 1 notes are treated as a separate category within equity and the coupon payments are recognised outside of the profit after tax result and directly in shareholders' equity.

The Group has the option to cancel the coupon payment. Cancellation becomes mandatory if: the Solvency condition[1] is not met at the time of, or following, coupon payment; there is non-compliance with the SCR or the minimum capital requirement; the Group has insufficient distributable reserves; or the relevant regulator requires the coupon payment to be cancelled.

Note:

1. All payments shall be conditional upon the Group being solvent at the time of payment and immediately after payment. The Issuer will be solvent if (i) it is able to pay its debts owed to senior creditors as they fall due and (ii) its assets exceed its liabilities.

33. Subordinated liabilities

	2020 £m	2019 £m
Subordinated Tier 2 notes	**516.6**	259.0

£250 million 9.25% subordinated Tier 2 notes due 2042

Subordinated guaranteed dated notes with a nominal value of £500 million were issued on 27 April 2012 at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year interest rate swap to exchange the fixed rate of interest for a floating rate of 3-month LIBOR plus a spread of 706 basis points which was credit value adjusted to 707 basis points with effect from 29 July 2013. This was treated as a designated hedging instrument.

On 8 December 2017, the Group repurchased £250 million nominal value of the subordinated guaranteed dated notes for a purchase price of £330.1 million including accrued interest of £2.7 million and associated transaction costs of £0.6 million. The designated hedging agreement was adjusted accordingly.

The remaining notes, with a nominal value of £250 million, have a redemption date of 27 April 2042 with the option to repay the notes on 27 April 2022. If the notes are not repaid on that date, the terms of the notes provide that the rate of interest will be reset at a rate of 6-month LIBOR plus 7.91%. If LIBOR has been discontinued by this time, the terms of the notes provide for an ultimate fall back rate of interest of 9.25% for subsequent interest periods. The terms of the notes do not automatically provide for the transition of LIBOR to SONIA, which would require a separate agreement between the Group and the noteholders.

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

During 2020 the Group identified that the hedge no longer met the criteria of hedge effectiveness under IAS 39 'Financial Instruments: Recognition and Measurement' and, under the rules of the standard, the accumulated hedging adjustment has begun to be amortised to the income statement from the date of the last successful hedge effectiveness test over the remaining life of the subordinated debt using an effective interest rate calculation.

£260 million 4.0% subordinated Tier 2 notes due 2032

On 5 June 2020, the Group issued subordinated Tier 2 notes at a fixed rate of 4.0%. The notes have a redemption date of 5 June 2032 and may be redeemed at the option of the Group commencing on 5 December 2031 until the maturity date.

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

The 2032 and 2042 notes are unsecured and subordinated obligations of the Group and rank pari passu and without any preference among themselves. In the event of a winding-up or of bankruptcy they are to be repaid only after the claims of all other senior creditors have been met and will rank at least pari passu with the claims of holders of other Tier 2 capital.

34. Insurance liabilities

	2020 £m	2019 £m
Insurance liabilities	**3,617.0**	3,819.6

Gross insurance liabilities

Accident year	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m	Total £m
Estimate of ultimate gross claims costs:											
At end of accident year	2,698.1	2,372.7	2,184.0	2,094.5	2,118.1	2,157.7	2,217.3	2,300.1	2,110.4	1,847.3	
One year later	(99.3)	(163.3)	(117.6)	20.7	(30.0)	(86.7)	(116.2)	(62.3)	(67.2)		
Two years later	(94.6)	(118.9)	(153.0)	(38.4)	(143.5)	(53.3)	(103.1)	(52.0)			
Three years later	(89.3)	(49.3)	(21.0)	(144.9)	(62.4)	(82.8)	(42.4)				
Four years later	(60.9)	(9.9)	(102.1)	(50.2)	(22.9)	(46.1)					
Five years later	(21.2)	(79.2)	(50.8)	(51.6)	(22.0)						
Six years later	(60.3)	(36.2)	(27.4)	(33.6)							
Seven years later	(25.1)	(23.8)	(14.0)								
Eight years later	(27.9)	(1.6)									
Nine years later	(11.0)										
Current estimate of cumulative claims	2,208.5	1,890.5	1,698.1	1,796.5	1,837.3	1,888.8	1,955.6	2,185.8	2,043.2	1,847.3	
Cumulative payments to date	(2,183.0)	(1,873.8)	(1,683.5)	(1,682.6)	(1,688.8)	(1,693.8)	(1,665.8)	(1,740.8)	(1,467.3)	(895.7)	
Gross liability recognised in balance sheet	**25.5**	**16.7**	**14.6**	**113.9**	**148.5**	**195.0**	**289.8**	**445.0**	**575.9**	**951.6**	**2,776.5**
2010 and prior											**762.5**
Claims handling provision											**78.0**
Total											**3,617.0**

34. Insurance liabilities continued

Net insurance liabilities

Accident year	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m	Total £m
Estimate of ultimate net claims costs:											
At end of accident year	2,644.4	2,271.8	2,093.9	1,971.0	1,926.7	1,922.2	2,016.9	2,125.9	1,941.2	1,674.5	
One year later	(131.5)	(146.7)	(123.6)	(29.7)	(67.0)	(18.9)	(79.7)	(41.4)	(34.5)		
Two years later	(82.1)	(107.8)	(134.4)	(42.0)	(77.8)	(38.2)	(65.3)	(27.1)			
Three years later	(76.5)	(35.6)	(27.8)	(100.7)	(30.4)	(43.7)	(14.0)				
Four years later	(48.7)	(11.6)	(64.3)	(41.3)	(24.1)	(16.9)					
Five years later	(37.3)	(54.2)	(38.9)	(52.5)	(20.7)						
Six years later	(37.0)	(30.4)	(17.7)	(8.3)							
Seven years later	(20.4)	(14.6)	(10.6)								
Eight years later	(23.0)	(1.2)									
Nine years later	(6.6)										
Current estimate of cumulative claims	2,181.3	1,869.7	1,676.6	1,696.5	1,706.7	1,804.5	1,857.9	2,057.4	1,906.7	1,674.5	
Cumulative payments to date	(2,159.5)	(1,856.3)	(1,664.4)	(1,653.8)	(1,638.5)	(1,678.8)	(1,637.6)	(1,731.4)	(1,459.3)	(878.0)	
Net liability recognised in balance sheet	**21.8**	**13.4**	**12.2**	**42.7**	**68.2**	**125.7**	**220.3**	**326.0**	**447.4**	**796.5**	**2,074.2**
2010 and prior											**439.5**
Claims handling provision											**78.0**
Total											**2,591.7**

Movements in gross and net insurance liabilities

	Gross £m	Reinsurance £m	Net £m
Claims reported	3,001.0	(809.8)	2,191.2
Incurred but not reported	924.9	(295.4)	629.5
Claims handling provision	80.0	—	80.0
At 1 January 2019	4,005.9	(1,105.2)	2,900.7
Cash paid for claims settled in the year	(2,103.6)	25.3	(2,078.3)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,311.3	(169.2)	2,142.1
Arising from prior-year claims	(394.0)	99.5	(294.5)
At 31 December 2019	3,819.6	(1,149.6)	2,670.0
Claims reported	2,916.0	(829.3)	2,086.7
Incurred but not reported	825.4	(320.3)	505.1
Claims handling provision	78.2	—	78.2
At 31 December 2019	3,819.6	(1,149.6)	2,670.0
Cash paid for claims settled in the year	**(1,933.0)**	**141.1**	**(1,791.9)**
Increase / (decrease) in liabilities:			
Arising from current-year claims	**2,057.3**	**(169.9)**	**1,887.4**
Arising from prior-year claims	**(326.9)**	**153.1**	**(173.8)**
At 31 December 2020	**3,617.0**	**(1,025.3)**	**2,591.7**
Claims reported	**2,762.0**	**(842.8)**	**1,919.2**
Incurred but not reported	**777.0**	**(182.5)**	**594.5**
Claims handling provision	**78.0**	**—**	**78.0**
At 31 December 2020	**3,617.0**	**(1,025.3)**	**2,591.7**

Movement in prior-year net claims liabilities by operating segment

	2020 £m	2019 £m
Motor	**(100.6)**	(180.5)
Home	**(10.8)**	(41.4)
Rescue and other personal lines	**(5.6)**	(7.6)
Commercial	**(56.8)**	(65.0)
Total	**(173.8)**	(294.5)

34. Insurance liabilities continued

Analysis of outstanding PPO claims provisions on a discounted and an undiscounted basis

The Group settles some large bodily injury claims as PPOs rather than lump sum payments.

The table below analyses the outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2020 and 31 December 2019. These represent the total cost of PPOs rather than any costs in excess of purely Ogden-based settlements.

At 31 December	Discounted 2020 £m	Undiscounted 2020 £m	Discounted 2019 £m	Undiscounted 2019 £m
Gross claims				
Approved PPO claims provisions	**561.1**	**1,289.5**	529.7	1,425.5
Anticipated PPOs	**253.7**	**561.6**	270.4	716.8
Total	**814.8**	**1,851.1**	800.1	2,142.3
Reinsurance				
Approved PPO claims provisions	**(309.3)**	**(743.6)**	(277.2)	(786.9)
Anticipated PPOs	**(186.9)**	**(435.8)**	(185.6)	(529.1)
Total	**(496.2)**	**(1,179.4)**	(462.8)	(1,316.0)
Net of reinsurance				
Approved PPO claims provisions	**251.8**	**545.9**	252.5	638.6
Anticipated PPOs	**66.8**	**125.8**	84.8	187.7
Total	**318.6**	**671.7**	337.3	826.3

The provisions for PPOs have been categorised as either claims which have already been determined by the courts as PPOs (approved PPO claims provisions) or those expected to settle as PPOs in the future (anticipated PPOs). The Group has estimated the likelihood of large bodily injury claims settling as PPOs. The anticipated PPOs in the table above are based on historically-observed propensities adjusted for the assumed Ogden discount rate.

In the majority of cases, the inflation agreed in the settlement is the Annual Survey of Hours and Earnings SOC 6115 inflation published by the Office for National Statistics, for which the long-term rate is assumed to be 3.5% (2019: 4%). The Group has estimated a rate of interest used for the calculation of present values as 3.5% (2019: 4%), which results in a real discount rate of 0% (2019: 0%). The Group will continue to review the inflation and discount rates used to calculate these insurance reserves.

35. Unearned premium reserve

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2019	1,505.5	(103.5)	1,402.0
Written in the period	3,203.1	(215.9)	2,987.2
Earned in the period	(3,202.6)	217.7	(2,984.9)
At 31 December 2019	1,506.0	(101.7)	1,404.3
Written in the period	**3,180.4**	**(231.0)**	**2,949.4**
Earned in the period	**(3,189.3)**	**228.8**	**(2,960.5)**
At 31 December 2020	**1,497.1**	**(103.9)**	**1,393.2**

36. Share-based payments

The Group operates equity-settled, share-based compensation plans in the form of a Long-Term Incentive Plan ("**LTIP**"), a Restricted Shares Plan, a Deferred Annual Incentive Plan ("**DAIP**") and Direct Line Group Share Incentive Plans, including both the Free Share awards and a Buy-As-You-Earn Plan, details of which are set out below. All awards are to be satisfied using market-purchased shares.

Long-Term Incentive Plan

Executive Directors and certain members of senior management are eligible to participate in the LTIP with awards granted in the form of nil-cost options. Under the plan, the shares vest at the end of a three-year period dependent upon the continued employment by the Group and also the Group achieving predefined performance conditions associated with Total Shareholder Return ("**TSR**") and return on tangible equity ("**RoTE**"). For awards since August 2017, the Directors are subject to an additional two-year holding period following the three-year vesting period.

Awards were made in the year ended 31 December 2020 over 4.7 million Ordinary Shares with an estimated fair value of £13.2 million at the 2020 grant dates (2019: 4.5 million Ordinary Shares with an estimated fair value of £14.4 million).

The estimated fair value of the LTIP share awards with market-based performance conditions was calculated using a Monte-Carlo simulation model.

The table below details the inputs into the model.

	2020	2019
Weighted average assumptions during the year:		
Share price (pence)	**290**	318
Exercise price (pence)	**0**	0
Volatility of share price	**34%**	19%
Average comparator volatility	**48%**	29%
Expected life	**3 years**	3 years
Risk-free rate	**0.02%**	0.50%

Expected volatility was determined by considering the actual volatility of the Group's share price since its initial public offering and that of a group of listed UK insurance companies.

Plan participants are entitled to receive additional shares in respect of dividends paid to shareholders over the vesting period. Therefore, no deduction has been made from the fair value of awards in respect of dividends.

Expected life was based on the contractual life of the awards and adjusted based on management's best estimate, for the effects of exercise restrictions and behavioural considerations.

Restricted Shares Plan

The purpose of the Restricted Shares Plan is to facilitate the wider participation in Group share-based awards of eligible employees. These awards can be granted in the form of a nil-cost option at any time during the year, generally have no performance criteria, and vest over periods ranging up to seven years from the date of the grant, subject to continued employment. During the year awards were made over 1.0 million Ordinary Shares (2019: 0.2 million Ordinary Shares) with an estimated fair value of £2.9 million (2019: £0.7 million) using the market value at the date of grant.

Deferred Annual Incentive Plan

To incentivise delivery of performance over a one-year operating cycle, Executive Directors and certain members of senior management are eligible for awards under the Annual Incentive Plan ("**AIP**"), of which at least 40% is granted in the form of a nil-cost option under the DAIP with the remainder being settled in cash following year end. During the year awards were made over 1.8 million Ordinary Shares (2019: 1.3 million Ordinary Shares) under this plan with an estimated fair value of £4.6 million (2019: £4.5 million) using the market value at the date of grant.

The awards outstanding at 31 December 2020 have no performance criteria attached; there is a requirement that the employee remains in employment with the Group for three years from the date of grant.

Direct Line Group Share Incentive Plans: Free Share awards

In early 2020, the Group offered all eligible employees a Free Share award granting 180 Ordinary Shares free of charge as a measure of thanks to the employees for the part they played in the good results that the Group reported for 2019. These awards have no performance criteria attached and vest on the third anniversary of the award grant date, subject to completion of three years continuing employment. The Group initially granted 1.9 million Ordinary Shares with an estimated fair value of £5.4 million using the market value at the date of grant. No free shares were awarded in the year ended 31 December 2019.

Direct Line Group Share Incentive Plans: Buy-As-You-Earn Plan

The Buy-As-You-Earn Plan entitles employees to purchase shares from pre-tax pay for between £10 and £150 per month and receive one matching share for every two shares purchased.

In the year ended 31 December 2020, matching share awards were granted over 0.6 million Ordinary Shares (2019: 0.5 million Ordinary Shares) with an estimated fair value of £1.6 million (2019: £1.6 million). The fair value of each matching share award is estimated using the market value at the date of grant.

Under the plan, the shares vest at the end of a three-year period dependent upon continued employment with the Group together with continued ownership of the associated purchased shares up to the point of vesting.

36. Share-based payments continued

Movement in total share awards

	Number of share awards 2020 millions	2019 millions
At 1 January	**21.6**	21.3
Granted during the year[1]	**11.3**	8.0
Forfeited during the year	**(1.9)**	(3.0)
Exercised during the year	**(4.1)**	(4.7)
At 31 December	**26.9**	21.6
Exercisable at 31 December	**1.5**	1.6

Note:

1. In accordance with the rules of the LTIP, Restricted Shares Plan and DAIP, additional awards of 1.3 million shares were granted during the year ended 31 December 2020 (2019: 1.5 million) in respect of the equivalent dividend.

In respect of the outstanding options at 31 December 2020, the weighted average remaining contractual life is 1.61 years (2019: 1.57 years). No share awards expired during the year (2019: nil).

The weighted average share price for awards exercised during the year ended 31 December 2020 was £2.86 (2019: £3.29).

The Group recognised total expenses in the year ended 31 December 2020 of £18.5 million (2019: £18.4 million) relating to equity-settled share-based compensation plans. An equivalent credit was recognised in retained earnings.

Further information on share-based payments, in respect of Executive Directors, is provided in the Directors' Remuneration Report.

37. Provisions

Movement in provisions during the year

	Regulatory levies £m	Restructuring £m	Other £m	Total £m
At 1 January 2020	**40.0**	**2.5**	**31.8**	**74.3**
Additional provision	**59.3**	**26.5**	**45.6**	**131.4**
Utilisation of provision	**(57.7)**	**(1.8)**	**(23.9)**	**(83.4)**
Released to income statement	**–**	**(1.3)**	**(6.2)**	**(7.5)**
At 31 December 2020	**41.6**	**25.9**	**47.3**	**114.8**

Of the above, £6.0 million (2019: £nil) is due to be settled outside of 12 months.

Regulatory levies provisions include undiscounted balances held for MIB, FSCS and other insurance levies where the Group is charged in the following year.

Restructuring provisions include balances held in respect of various property dilapidations and a number of restructuring programmes within the Group, including office site closures and staff restructuring.

Other provisions primarily include balances held in respect of staff bonuses and reward.

38. Trade and other payables, including insurance payables

	2020 £m	2019 £m
Trade creditors and accruals	**293.5**	224.2
Other taxes	**100.4**	101.3
Other creditors	**89.1**	95.3
Due to reinsurers	**60.2**	43.7
Due to agents, brokers and intermediaries	**2.5**	9.7
Deferred income	**3.3**	2.9
Due to insurance companies	**0.9**	1.0
Total	**549.9**	478.1

39. Notes to the consolidated cash flow statement

	2020 £m	2019 £m
Profit for the year	**367.2**	419.9
Adjustments for:		
Investment return	**(95.1)**	(134.6)
Instalment income	**(109.3)**	(114.0)
Finance costs	**31.3**	26.0
Defined benefit pension scheme – net interest charge	**0.7**	–
Equity-settled share-based payment charge	**18.5**	18.4
Tax charge	**84.2**	89.8
Depreciation and amortisation charge	**79.7**	77.5
Impairment of property, plant and equipment, goodwill and intangible assets	**6.6**	1.3
Impairment provision movements on reinsurance contracts	**5.8**	(14.1)
Loss on sale of property, plant and equipment and right of use assets	**4.9**	0.3
Movement in prepayments	**4.1**	(0.2)
Operating cash flows before movements in working capital	**398.6**	370.3
Movements in working capital:		
Net decrease in net insurance liabilities including reinsurance assets, unearned premium reserves and deferred acquisition costs	**(91.3)**	(220.1)
Net (increase) / decrease in insurance and other receivables	**(1.6)**	29.4
Net (increase) / decrease in accrued income and other assets	**(9.9)**	4.5
Net increase / (decrease) in trade and other payables, including insurance payables and provisions	**106.8**	(1.7)
Cash generated from operations	**402.6**	182.4
Taxes paid	**(134.0)**	(95.8)
Cash flow hedges	**0.2**	1.6
Net cash generated from operating activities before investment of insurance assets	**268.8**	88.2

	2020 £m	2019 £m
Interest received	**260.0**	280.7
Rental income received from investment property	**13.7**	16.2
Purchase of investment property	**(10.5)**	–
Proceeds on disposal of investment property	**–**	24.2
Proceeds on disposal / maturity of AFS debt securities	**1,614.0**	1,886.4
Advances made for commercial real estate loans	**(46.3)**	(32.3)
Repayments of infrastructure debt and commercial real estate loans	**56.7**	40.6
Purchase of AFS debt securities	**(1,568.5)**	(1,838.8)
Purchase of equity investments	**(3.2)**	–
Purchase of HTM debt securities	**–**	(3.1)
Cash generated from investment of insurance assets	**315.9**	373.9

39. Notes to the consolidated cash flow statement continued

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

	Leases		Subordinated liabilities		Interest rate swap associated with subordinated debt[1]	
	2020 £m	2019 £m	**2020 £m**	2019 £m	**2020 £m**	2019 £m
At 1 January	**164.4**	167.3	**(259.0)**	(259.5)	**9.0**	9.0
Proceeds on issue of subordinated liabilities[2]	**–**	–	**(257.2)**	–	**–**	–
Interest paid on subordinated liabilities	**–**	–	**28.3**	23.1	**–**	–
Interest rate swap cash settlement	**–**	–	**–**	–	**(4.1)**	(3.4)
Lease cash flows	**(18.5)**	(19.8)	**–**	–	**–**	–
Interest on lease payments	**6.0**	6.7	**–**	–	**–**	–
Financing cash flows	**(12.5)**	(13.1)	**(228.9)**	23.1	**(4.1)**	(3.4)
Net lease additions	**0.5**	10.2	**–**	–	**–**	–
Amortisation of arrangement costs and discount on issue of subordinated liabilities	**–**	–	**(0.5)**	(0.3)	**–**	–
Amortisation of fair value hedging	**–**	–	**1.8**	–	**–**	–
Accrued interest expense on subordinated liabilities	**–**	–	**(29.1)**	(23.1)	**–**	–
Unrealised (loss) / gain on associated interest rate risk on hedged item	**–**	–	**(0.9)**	0.8	**–**	–
Net accrued interest on interest rate swap	**–**	–	**–**	–	**0.3**	–
Fair value movement in interest rate swap	**–**	–	**–**	–	**3.0**	3.4
Non-cash changes	**0.5**	10.2	**(28.7)**	(22.6)	**3.3**	3.4
At 31 December	**152.4**	164.4	**(516.6)**	(259.0)	**8.2**	9.0

Notes:

1. As described in note 33, the Group entered into a 10-year interest rate swap on the same date as issuing the £250 million 9.25% subordinated Tier 2 notes due 2042.
2. As described in note 33, on 5 June 2020 the Group issued £260.0 million of subordinated Tier 2 notes at a fixed rate of 4.0%. The notes have a redemption date of 5 June 2032 and may be redeemed at the option of the Group commencing on 5 December 2031 until the maturity date. Proceeds are net of issue costs of £2.8 million.

40. Commitments and contingent liabilities

The Group did not have any material commitments and contingent liabilities at 31 December 2020 (2019: none).

41. Leases

Operating lease commitments where the Group is the lessor

The following table analyses future aggregate minimum lease payments receivable under non-cancellable operating leases in respect of property leased to third-party tenants.

	2020 £m	2019 £m
Within one year	**13.7**	13.8
In the second to fifth years inclusive	**38.6**	39.2
After five years	**66.5**	69.1
Total[1]	**118.8**	122.1

Note:

1. At year ended 31 December 2020, £116.6 million of the total operating lease commitments where the Group is the lessor relates to the lease of investment properties detailed in note 20 (2019: £119.6 million).

Other leases disclosures

Sublease income in respect of property right-of-use assets was £0.2 million during the year (2019: £0.3 million). Expenses relating to short-term and variable lease payments were not included in the measurement of lease liabilities as they were not significant. Total cash outflow in respect of leases for the year ended 31 December 2020 was £18.7 million (2019: £20.1 million).

42. Fair value

Fair value hierarchy

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique.

For disclosure purposes, fair value measurements are classified as level 1, 2 or 3 based on the degree to which fair value is observable:

- Level 1 financial assets are measured in whole or in part by reference to published quotes in an active market. In an active market quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's-length basis.
- Level 2 financial assets and liabilities are measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. These include AFS debt security assets for which pricing is obtained via pricing services, but where prices have not been determined in an active market, or financial assets with fair values based on broker quotes or assets that are valued using the Group's own models whereby the majority of assumptions are market-observable. Derivatives are valued using broker quotes or appropriate valuation models. Model inputs include a range of factors which are deemed to be observable, including current market and contractual prices for underlying instruments, period to maturity, correlations, yield curves and volatility of underlying instruments.
- Level 3 fair value measurements used for investment properties, HTM debt securities, infrastructure debt, commercial real estate loans and equity investments are those derived from a valuation technique that includes inputs for the asset that are unobservable.

Comparison of carrying value to fair value of financial instruments and assets where fair value is disclosed

At 31 December 2020	**Carrying value £m**	Level 1 £m	Level 2 £m	Level 3 £m	**Fair value £m**
Assets held at fair value:					
Investment property (note 20)	**292.1**	—	—	292.1	**292.1**
Derivative assets (note 26)	**73.4**	—	73.4	—	**73.4**
AFS debt securities (note 28)	**4,103.1**	25.2	4,077.9	—	**4,103.1**
Equity investments (note 28)	**3.2**	—	—	3.2	**3.2**
Other financial assets:					
HTM debt securities (note 28)	**103.9**	—	14.2	93.7	**107.9**
Infrastructure debt (note 28)	**264.5**	—	—	273.6	**273.6**
Commercial real estate loans (note 28)	**206.7**	—	—	202.9	**202.9**
Total	**5,046.9**	**25.2**	**4,165.5**	**865.5**	**5,056.2**
Liabilities held at fair value:					
Derivative liabilities (note 26)	**57.2**	—	57.2	—	**57.2**
Other financial liabilities:					
Subordinated liabilities (note 33)	**516.6**	—	589.0	—	**589.0**
Total	**573.8**	**—**	**646.2**	**—**	**646.2**

At 31 December 2019	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
Assets held at fair value:					
Investment property (note 20)	291.7	—	—	291.7	291.7
Derivative assets (note 26)	121.5	—	121.5	—	121.5
AFS debt securities (note 28)	4,085.6	99.5	3,986.1	—	4,085.6
Other financial assets:					
HTM debt securities (note 28)	104.0	—	14.1	94.0	108.1
Infrastructure debt (note 28)	278.1	—	—	285.6	285.6
Commercial real estate loans (note 28)	205.7	—	—	203.0	203.0
Total	5,086.6	99.5	4,121.7	874.3	5,095.5
Liabilities held at fair value:					
Derivative liabilities (note 26)	30.5	—	30.5	—	30.5
Other financial liabilities:					
Subordinated liabilities (note 33)	259.0	—	297.8	—	297.8
Total	289.5	—	328.3	—	328.3

42. Fair value continued

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

- insurance and other receivables;
- cash and cash equivalents;
- borrowings; and
- trade and other payables, including insurance payables.

The movements in assets held at fair value and classified as level 3 in the fair value hierarchy relate to investment property and equity investments. Investment property is analysed in note 20 along with further details on the Group's valuation approach. A summary of realised and unrealised gains or losses in relation to investment property at fair value are presented in note 6. Sensitivity analysis in respect of investment property has been provided in note 3. There were no changes in the categorisation of assets between levels 1, 2 and 3 for assets and liabilities held by the Group since 31 December 2019.

The table below shows the unobservable inputs used by the Group in the fair value measurement of its investment property.

31 December 2020	Fair value £m	Valuation technique	Unobservable input	Range (weighted average)
Investment property	288.8[1]	Income capitalisation	Equivalent yield	3.88% - 7.97% (average 5%)
			Estimated rental value per square foot	£1.81 - £35.00 (average £12.34)

Note:

1. The methodology of valuation reflects commercial property held within U K Insurance Limited.

The table below analyses the movement in assets carried at fair value classified as level 3 in the fair value hierarchy.

	Investment property (note 20) £m	Equity investment £m
At 1 January 2020	**291.7**	**–**
Additions at cost	**10.5**	**3.2**
Decrease in fair value in the period through profit or loss (note 6)	**(10.1)**	**–**
At 31 December 2020	**292.1**	**3.2**

43. Related parties

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

There were no sales or purchases of products and services to or from related parties in the year ended 31 December 2020 (2019: £nil).

Compensation of key management

	2020 £m	2019 £m
Short-term employee benefits	**11.9**	11.6
Post-employment benefits	**0.1**	–
Share-based payments	**7.6**	7.9
Total	**19.6**	19.5

44. Post balance sheet event

On 10 February 2021, U K Insurance Limited signed a contract in relation to its Bromley site to surrender the current lease and DL Insurance Services Limited signed a contract to purchase the head lease. The cost of surrendering the lease was £91 million and the value of the fixed asset capitalised will be in the region of £17 million. This will reduce the Group's Solvency II own funds by around £85 million.

Parent Company Balance Sheet
As at 31 December 2020

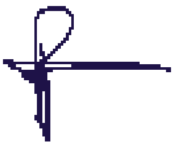
	Notes	2020 £m	2019 £m
Assets			
Investment in subsidiary undertakings	2	**3,305.9**	3,137.4
Other receivables	3	**335.7**	299.1
Current tax assets	4	**5.5**	3.5
Derivative financial instruments	5	**0.1**	0.6
Financial investments	6	**–**	85.0
Cash and cash equivalents	7	**266.1**	124.2
Total assets		**3,913.3**	3,649.8
Equity			
Shareholders' equity		**2,936.6**	2,931.4
Tier 1 notes	9	**346.5**	346.5
Total equity		**3,283.1**	3,277.9
Liabilities			
Subordinated liabilities	10	**511.9**	253.4
Borrowings	11	**116.4**	116.3
Derivative financial instruments	5	**0.1**	0.6
Trade and other payables	12	**1.1**	1.0
Deferred tax liabilities	4	**0.7**	0.6
Total liabilities		**630.2**	371.9
Total equity and liabilities		**3,913.3**	3,649.8

The attached notes on pages 217 to 221 form an integral part of these separate financial statements.

The profit for the year net of tax was £343.0 million (2019: £143.3 million).

The financial statements were approved by the Board of Directors and authorised for issue on 5 March 2021.

They were signed on its behalf by:



PENNY JAMES
CHIEF EXECUTIVE OFFICER
Direct Line Insurance Group plc
Registration No. 02280426

Parent Company Statement of Comprehensive Income
For the year ended 31 December 2020

	2020 £m	2019 £m
Profit for the year attributable to the owners of the Company	**343.0**	143.3
Other comprehensive loss		
Items that may be reclassified subsequently to income statement:		
Loss on fair value through other comprehensive income investments	**(0.1)**	–
Other comprehensive loss for the year net of tax	**(0.1)**	–
Total comprehensive income for the year attributable to the owners of the Company	**342.9**	143.3

Parent Company Statement of Changes in Equity
For the year ended 31 December 2020

	Share capital £m	Capital reserves £m	Share-based payment reserve £m	Fair value through other comprehensive income revaluation reserve £m	Retained earnings £m	Shareholders' equity £m	Tier 1 notes £m	Total equity £m
Balance at 1 January 2019	150.0	1,450.0	(0.6)	–	1,606.4	3,205.8	346.5	3,552.3
Total comprehensive income for the year	–	–	–	–	143.3	143.3	–	143.3
Dividends and appropriations paid (note 13)	–	–	–	–	(420.7)	(420.7)	–	(420.7)
Credit to equity for equity-settled share-based payments	–	–	18.4	–	–	18.4	–	18.4
Shares distributed by employee trusts	–	–	(15.4)	–	–	(15.4)	–	(15.4)
Balance at 31 December 2019	150.0	1,450.0	2.4	–	1,329.0	2,931.4	346.5	3,277.9
Total comprehensive income for the year	**–**	**–**	**–**	**(0.1)**	**343.0**	**342.9**	**–**	**342.9**
Dividends and appropriations paid (note 13)	**–**	**–**	**–**	**–**	**(312.5)**	**(312.5)**	**–**	**(312.5)**
Shares cancelled following buyback	**(1.1)**	**1.1**	**–**	**–**	**(30.0)**	**(30.0)**	**–**	**(30.0)**
Credit to equity for equity-settled share-based payments	**–**	**–**	**18.5**	**–**	**–**	**18.5**	**–**	**18.5**
Shares distributed by employee trusts	**–**	**–**	**(13.7)**	**–**	**–**	**(13.7)**	**–**	**(13.7)**
Balance at 31 December 2020	**148.9**	**1,451.1**	**7.2**	**(0.1)**	**1,329.5**	**2,936.6**	**346.5**	**3,283.1**

The attached notes on pages 217 to 221 form an integral part of these separate financial statements.

1. Accounting policies

1.1 Basis of preparation

Direct Line Insurance Group plc, registered in England and Wales (company number 02280426), is the ultimate parent company of the Group. The principal activity of the Company is managing its investments in subsidiaries, providing loans to those subsidiaries, raising funds for the Group and the receipt and payment of dividends.

The address of the Company's registered office is Churchill Court, Westmoreland Road, Bromley, BR1 1DP.

The Company's financial statements are prepared on the historical cost basis except for financial investments and derivative financial investments, which are measured at fair value.

In accordance with the exemption permitted under section 408 of the Companies Act 2006, the Company's income statement and related notes have not been presented in these separate financial statements.

The Company's financial statements are prepared in accordance with FRS 101 'Reduced Disclosure Framework'.

The Company has taken advantage of the following FRS 101 disclosure exemptions:

- FRS 101.8 (d): the requirements of IFRS 7 'Financial Instruments: Disclosures' to make disclosures about financial instruments;
- FRS 101.8 (e): the disclosure requirements of IFRS 13 'Fair Value Measurement';
- FRS 101.8 (g): the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 111 and 134 – 136 of IAS 1 'Presentation of Financial Statements' to produce a cash flow statement and to make an explicit and unreserved statement of compliance with IFRSs;
- FRS 101.8 (h): the requirements of IAS 7 'Statements of Cash Flows' to produce a cash flow statement and related notes;
- FRS 101.8 (i): the requirements of paragraphs 30 and 31 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' to include a list of new IFRSs that have been issued but that have yet to be applied; and
- FRS 101.8 (k): the requirements of IAS 24 'Related Party Disclosures' to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is party to a transaction is wholly owned by such a member.

Adoption of new and revised standards

Full details of the new and revised standards adopted by the Company are set out in note 1 to the consolidated financial statements.

1.2 Investment in subsidiaries

Investment in subsidiaries is stated at cost less any impairment.

1.3 Financial assets

Financial assets are classified at initial recognition and subsequently measured at amortised cost or fair value through other comprehensive income. The classification of financial assets at initial recognition depends on the financial asset's contractual cash flow characteristics and the Company's business model for managing them.

Amortised cost

Assets which are held to collect contractual cash flows, and with contractual terms which give rise to cash flows which are solely payments of principal and interest on the principal amount outstanding, are classified as financial assets held at amortised cost. The Company initially measures financial assets held at amortised cost at fair value plus transaction costs. They are subsequently measured using the effective interest method where applicable and are subject to impairment. Gains and losses are recognised in the income statement when the asset is derecognised, modified or impaired.

Fair value through other comprehensive income

Assets which are held both to collect contractual cash flows and to sell the financial asset, where the contractual terms of the asset give rise to cash flows which are solely payments of principal and interest on the principal amount outstanding, are measured at fair value through other comprehensive income, unless designated as fair value through profit or loss. The Company's financial assets at fair value through other comprehensive income relate to UK sovereign debt securities. Movements in the carrying amount are taken through other comprehensive income, except for gains or losses recognised in the income statement when the asset is derecognised, modified or impaired.

Impairment

At initial recognition of a financial asset measured at amortised cost or fair value through other comprehensive income an expected credit loss assessment is conducted with an impairment loss booked if material. The Company uses judgement in making these assumptions and selecting the inputs to the impairment calculation based on the credit quality and history of the financial asset or group of financial assets, as well as existing market conditions and forward-looking expectations.

At each balance sheet date, the Company assesses on a forward-looking basis whether there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as held at amortised cost or fair value through other comprehensive income is expected. The Company measures the expected loss as the difference between the carrying amount of the asset or group of assets, including the allowance for expected losses at initial recognition, and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition.

The Company applies the simplified impairment approach to trade receivables due from subsidiary undertakings.

Impairment losses, including the expected credit allowance, are recognised in the income statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for the impairment losses. If in a subsequent period the amount of the expected impairment allowance reduces, and this can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. A financial asset is written off when there is no reasonable expectation of recovery.

Hedge accounting

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

2. Investment in subsidiary undertakings

	2020 £m	2019 £m
At 1 January	**3,137.4**	3,119.0
Additional investment in subsidiary undertakings	**168.5**	18.4
At 31 December	**3,305.9**	3,137.4

On 27 March 2020, the Company provided additional funding to its subsidiary, U K Insurance Limited. It purchased one Ordinary Share of £1 nominal value for a consideration of £150 million.

The subsidiary undertakings of the Company are set out in the table below. Their capital consists of Ordinary Shares which are unlisted. In all cases, the Company owns 100% of the Ordinary Shares, either directly or through its ownership of other subsidiaries, and exercises full control over their decision-making.

Name of subsidiary	Company registration number	Place of incorporation and operation	Principal activity
Directly held by the Company:			
Direct Line Group Limited[1]	02811437	United Kingdom	Intermediate holding company
DL Insurance Services Limited[1]	03001989	United Kingdom	Management services
Finsure Premium Finance Limited[1]	01670887	United Kingdom	Non-trading company
Inter Group Insurance Services Limited[1]	02762848	United Kingdom	Dormant[8]
UK Assistance Accident Repair Centres Limited[1]	02568507	United Kingdom	Motor vehicle repair services
UK Assistance Limited[1]	02857232	United Kingdom	Dormant[8]
U K Insurance Business Solutions Limited[1]	05196274	United Kingdom	Insurance intermediary services
U K Insurance Limited[2,3]	01179980	United Kingdom	General insurance
Indirectly held by the Company:			
10-15 Livery Street, Birmingham UK Limited[4]	JE109119	Jersey	Dormant[9]
Brolly UK Technology Limited[1,5]	10134039	United Kingdom	Insurance intermediary services
Churchill Insurance Company Limited[1]	02258947	United Kingdom	General insurance
Direct Line Insurance Limited[1]	01810801	United Kingdom	Dormant[8]
DL Support Services India Private Limited[6]	See footnote 6	India	Support and operational services
DLG Legal Services Limited[7]	08302561	United Kingdom	Legal services
DLG Pension Trustee Limited[1]	08911044	United Kingdom	Dormant[8]
Farmweb Limited[1]	03207393	United Kingdom	Dormant[8]
Green Flag Group Limited[2]	02622895	United Kingdom	Intermediate holding company
Green Flag Holdings Limited[1]	03577191	United Kingdom	Intermediate holding company
Green Flag Limited[2]	01003081	United Kingdom	Breakdown recovery services
Intergroup Assistance Services Limited[1]	03315786	United Kingdom	Dormant[8]
National Breakdown Recovery Club Limited[1]	02479300	United Kingdom	Dormant[8]
Nationwide Breakdown Recovery Services Limited[1]	01316805	United Kingdom	Dormant[8]
The National Insurance and Guarantee Corporation Limited[1]	00042133	United Kingdom	Dormant[8]
UKI Life Assurance Services Limited[1]	03034263	United Kingdom	Dormant[8]

Notes:

1. Registered office at: Churchill Court, Westmoreland Road, Bromley, BR1 1DP.
2. Registered office at: The Wharf, Neville Street, Leeds, LS1 4AZ.
3. U K Insurance Limited has a branch in the Republic of South Africa and a branch in the Republic of Ireland.
4. Registered office at: 22 Grenville Street, St Helier, JE4 8PX, Jersey.
5. On 15 September 2020, DL Insurance Services Limited acquired 100% of the issued share capital of Brolly UK Technology Limited. For the period ended 31 December 2020, it is expected that Brolly UK Technology Limited will be exempt from the requirements of the Companies Act 2006 relating to the audit of individual accounts by virtue of section 479 A(2)(d).
6. Registered office at: ESC House, 155, 1st & 2nd Floor, Okhla Industrial Area Phase-3, New Delhi, 110020, India. Company registration number: U74140DL2014FTC265567.
7. Registered office at: 42 The Headrow, Leeds, LS1 8HZ.
8. These entities have not been audited, in accordance with the exemptions available for dormant entities under section 480 of the Companies Act 2006.
9. Under the Companies (Jersey) Law 1991, there is no requirement to file individual accounts and audit a private limited company.

3. Other receivables

	2020 £m	2019 £m
Loans to subsidiary undertakings[1]	**322.2**	298.6
Trade receivables due from subsidiary undertakings	**13.5**	–
Other debtors	**–**	0.5
Total	**335.7**	299.1
Current	**85.7**	49.1
Non-current	**250.0**	250.0
Total	**335.7**	299.1

Note:

1. Included in loans to subsidiary undertakings is a £250 million unsecured subordinated loan to U K Insurance Limited. A loan of £500 million was advanced on 27 April 2012 at a fixed rate of 9.5% with a repayment date of 27 April 2042. On 7 March 2019, £250 million was repaid. All loans are neither past due nor impaired.

4. Current and deferred tax

	2020 £m	2019 £m
Per balance sheet:		
Current tax assets	**5.5**	3.5
Deferred tax liabilities	**(0.7)**	(0.6)

The deferred tax liability is in respect of provisions and other temporary differences.

5. Derivative financial instruments[1]

	Notional amount 2020 £m	Fair value 2020 £m	Notional amount 2019 £m	Fair value 2019 £m
Derivative assets				
Designated as hedging instruments:				
Foreign exchange contracts[2]	**4.1**	**0.1**	18.2	0.6
Total	**4.1**	**0.1**	18.2	0.6
Derivative liabilities				
Designated as hedging instruments:				
Foreign exchange contracts[2]	**4.1**	**0.1**	18.2	0.6
Total	**4.1**	**0.1**	18.2	0.6

Notes:

1. The derivative assets and liabilities are both classified as level 2 within the Group's fair value hierarchy set out in note 42 of the consolidated financial statements.
2. The foreign exchange cash flow hedges have been entered into on behalf of the Group's subsidiary companies.

6. Financial investments

	2020 £m	2019 £m
Fair value through other comprehensive income debt securities[1]	**–**	85.0

Note:

1. At 31 December 2019, the fair value through other comprehensive income debt securities are corporate debt securities of £79.9 million classified as level 2 and fixed interest UK sovereign debt of £5.1 million classified as level 1 within the Group's fair value hierarchy which is set out in note 42 of the consolidated financial statements.

7. Cash and cash equivalents

	2020 £m	2019 £m
Cash at bank and in hand	–	(0.2)
Short-term deposits with credit institutions[1]	266.1	124.4
Total	**266.1**	124.2

Note:
1. This represents money market funds.

8. Share capital, capital reserves and distributable reserves

Full details of the share capital and capital reserves of the Company are set out in notes 30 and 31 to the consolidated financial statements.

Of the Company's total equity, £1,329.5 million (2019: £1,329.0 million), being the total of its retained earnings, is considered to be distributable reserves.

9. Tier 1 notes

Full details of the Tier 1 notes of the Company are set out in note 32 to the consolidated financial statements.

10. Subordinated liabilities

	2020 £m	2019 £m
Subordinated Tier 2 notes	**511.9**	253.4

£250 million 9.25% subordinated Tier 2 notes due 2042

The subordinated guaranteed dated notes with a nominal value of £500 million were issued on 27 April 2012 at a fixed rate of 9.25% and have a redemption date of 27 April 2042. On 8 December 2017, the Company repurchased £250 million nominal value of subordinated guaranteed dated notes for a purchase price of £330.1 million including accrued interest of £2.7 million and associated transaction costs of £0.6 million.

The remaining notes, with a nominal value of £250 million, have a redemption date of 27 April 2042 with the option to repay the notes on 27 April 2022. If the notes are not repaid on that date, the terms of the notes provide that the rate of interest will be reset at a rate of 6-month LIBOR plus 7.91%. If LIBOR has been discontinued by this time, the terms of the notes provide for an ultimate fall-back rate of interest of 9.25% for subsequent interest periods. The terms of the notes do not automatically provide for the transition of LIBOR to SONIA, which would require a separate agreement between the Group and the noteholders.

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

£260 million 4.0% subordinated Tier 2 notes due 2032

On 5 June 2020, the Company issued subordinated Tier 2 notes at a fixed rate of 4.0%. The notes have a redemption date of 5 June 2032 and may be redeemed at the option of the Company commencing on 5 December 2031 until the maturity date.

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

The 2032 and 2042 notes are unsecured, and subordinated obligations of the Company and rank pari passu and without any preference among themselves. In the event of a winding-up or of bankruptcy they are to be repaid only after the claims of all other senior creditors have been met and will rank at least pari passu with the claims of holders of other Tier 2 capital.

The aggregate fair value of subordinated guaranteed dated notes at 31 December 2020 was £589.0 million (2019: £297.8 million).

11. Borrowings

	2020 £m	2019 £m
Loans from fellow subsidiaries within the Group[1]	**116.4**	116.3

Note:
1. Included in the above is a loan of £71.4 million (2019: £84.4 million) from UK Assistance Accident Repair Centres Limited. All loans from fellow Group subsidiaries are repayable by 31 December 2024 and are subject to interest on outstanding balances based on the average 3-month LIBOR rate.

12. Trade and other payables

	2020 £m	2019 £m
Total payables to third parties	**1.1**	1.0

13. Dividends

Full details of the dividends paid and proposed by the Company are set out in note 14 to the consolidated financial statements.

14. Share-based payments

Full details of share-based compensation plans are provided in note 36 to the consolidated financial statements.

15. Contingent liabilities

The Company will guarantee the debts and liabilities of its UK subsidiary, Brolly UK Technology Limited, at the balance sheet date in accordance with section 479C of the Companies Act 2006. The Company has assessed the probability of loss under this guarantee as remote.

16. Risk management

The risks faced by the Company, arising from its investment in subsidiaries, are considered to be the same as those in the operations of the Group. Details of the key risks and the steps taken to manage them are disclosed in note 3 to the consolidated financial statements. The Company also holds, on behalf of its subsidiaries, designated hedging instruments which relate to foreign currency supplier payments.

17. Directors and key management remuneration

The Directors and key management of the Group and the Company are the same. The aggregate emoluments of the Directors are set out in note 10 to the consolidated financial statements, the compensation for key management is set out in note 43 to the consolidated financial statements and the remuneration and pension benefits payable in respect of the highest paid Director are included in the Directors' Remuneration Report in the Governance section of the Annual Report & Accounts.

Financial calendar[1]

2021

Date	Event
08 March	Preliminary Results 2020 announcement
08 April	"Ex-dividend" date for 2020 final dividend
09 April	Record date for 2020 final dividend
05 May	Final date for election under the Dividend Reinvestment Plan
05 May	Trading update for the first quarter of 2021
13 May	Annual General Meeting
20 May	Payment date for 2020 final dividend
03 August	Half-year Report 2021
12 August	"Ex-dividend" date for 2021 interim dividend
13 August	Record date for 2021 interim dividend
19 August	Final date for election under the Dividend Reinvestment Plan
03 September	Payment date for 2021 interim dividend
09 November	Trading update for the third quarter of 2021

Annual General Meeting

The 2021 AGM will be held at, and broadcast live from, the registered office of the Company at Churchill Court, Westmoreland Road, Bromley, BR1 1DP on 13 May 2021, starting at 11.00 am. All shareholders will receive a separate notice convening the AGM. This will explain the resolutions to be put to the meeting.

The Articles of Association of the Company and the letters of appointment of the Executive Directors, the Chair and the Non-Executive Directors are available for inspection at the Company's registered office and at the offices of Allen & Overy LLP.

Market

The Company has a premium listing on the UK Listing Authority's Official List. The Company's Ordinary Shares (EPIC: DLG) are admitted to trading on the London Stock Exchange.

Note:

1. These dates are subject to change.

Share ownership

Share capital

You can find details of the Company's share capital in note 30 to the consolidated financial statements.

Dividends

The Company pays its dividends in sterling to shareholders registered on its register of members at the relevant record date.

Shareholders can arrange to receive their cash dividend payments in a bank or building society account by completing a dividend mandate form. This is available from the Company's registrar, Computershare Investor Services Plc ("**Registrar**"), in the UK. You can find the Registrar's contact details on page 232. Alternatively, shareholders can access their shareholdings online and download a dividend mandate form from the Investor Centre. You can find details of this below.

Dividend Reinvestment Plan

The Company offers a Dividend Reinvestment Plan. This enables shareholders to use their cash dividends to buy the Company's Ordinary Shares in the market. You can find more details on the Company's website.

Shareholder enquiries

Shareholders with queries about anything relating to their shares can contact our Registrar.

Shareholders should notify the Registrar of any change in shareholding details, such as their address, as soon as possible.

Shareholders can access their current shareholding details online at www.investorcentre.co.uk/directline. Investor Centre is a free-to-use, secure, self-service website that enables shareholders to manage their holdings online. The website allows shareholders to:

- check their holdings;
- update their records, including address and direct credit details;
- access all their securities in one portfolio by setting up a personal account;
- vote online; and
- register to receive electronic shareholder communications.

To access information, the website requires shareholders to quote their shareholder reference number. Shareholders can find this number on their share certificates.

Corporate website

The Group's corporate website is www.directlinegroup.co.uk. It contains useful information for the Company's investors and shareholders. For example, it includes press releases, details of forthcoming events, essential shareholder information, a dividend history, a financial calendar, and details of the Company's AGM. You can also subscribe to email news alerts.

Shareholder warning

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that prove to be worthless or non-existent, or they can offer to buy shares at an inflated price in return for you paying upfront. They promise high profits. However, if you buy or sell shares in this way, you will probably lose your money.

How to avoid share fraud

- Remember that FCA-authorised firms are unlikely to contact you unexpectedly offering to buy or sell shares.
- Do not converse with them. Note the name of the person and firm contacting you, then end the call.
- To see if the person and firm contacting you are authorised by the FCA, check the Financial Services Register at www.fca.org.uk/register.
- Beware of fraudsters claiming to be from an authorised firm; copying its website; or giving you false contact details.
- If you want to phone the caller back, use the firm's contact details listed on the Financial Services Register at www.fca.org.uk/register.
- If the firm does not have contact details on the Register or they tell you the details are out of date, call the FCA on 0800 111 6768.
- Search the list of unauthorised firms to avoid at www.fca.org.uk/consumers/unauthorised-firms-individuals.
- Remember that if you buy or sell shares from an unauthorised firm, you cannot access the Financial Ombudsman Service or Financial Services Compensation Scheme.
- Get independent financial and professional advice before handing over any money.
- If it sounds too good to be true, it probably is.

Report a scam

If fraudsters approach you, tell the FCA using the share fraud reporting form at www.fca.org.uk/consumers/report-scam-unauthorised-firm. You can also find out more about investment scams on the same web page.

You can call the FCA Consumer Helpline on 0800 111 6768.

If you have already paid money to share fraudsters, call Action Fraud on 0300 123 2040.

Tips on protecting your shares

- Keep all your certificates in a safe place. Alternatively, consider holding your shares in the UK's electronic registration and settlement system for equity, called CREST, or via a nominee;
- Keep correspondence from the Registrar that shows your shareholder reference number in a safe place, and shred unwanted correspondence;
- Inform the Registrar as soon as you change your address;
- If you receive a letter from the Registrar regarding a change of address and you have not recently moved, contact them immediately;
- Find out when your dividends are paid and contact the Registrar if you do not receive them;
- Consider having your dividends paid direct into your bank account. You will need to complete a dividend mandate form and send it to the Registrar. This reduces the risk of cheques being stolen or lost in the post;
- If you change your bank account, inform the Registrar of your new account details immediately;
- If you are buying or selling shares, only deal with brokers registered in the UK or in your country of residence; and
- Be aware that the Company will never call you concerning investments. If you receive such a call from a person saying they represent the Group, please contact the Company Secretary immediately, by calling +44 (0)1132 920 667.

Electronic communications and voting

The Group produces various communications. Shareholders can view these online, download them, or receive paper copies by contacting the Registrar.

Shareholders, who register their email address with our Registrar, or at the Investor Centre, can receive emails with news on events, such as the AGM. They can also receive shareholder communications electronically, such as the Annual Report & Accounts and Notice of Meeting.

Dealing facilities

Shareholders who wish to buy, sell or transfer their shares may do so through a stockbroker or a high street bank; or through the Registrar's share-dealing facility.

You can call or email the Registrar regarding its share-dealing facility using this contact information:

- For telephone sales, call +44 (0)370 703 0084 between 8.00 am and 6.00 pm, Monday to Friday, excluding public holidays, and
- For internet sales, go to www.investorcentre.co.uk/directline. You will need your shareholder reference number, as shown on your share certificate, or your welcome letter from the Chair.

Dividend tax allowance

The dividend tax-free allowance is £2,000 across an individual's entire share portfolio. Above this amount, individuals will pay tax on their dividend income. The rate of this tax depends on their income tax bracket and personal circumstances. The Company will continue providing registered shareholders with a confirmation of the dividends paid. Shareholders should include this with any other dividend income they receive when calculating and reporting total dividend income received to HMRC. The shareholder is responsible for including all dividend income when calculating tax requirements. If you have any tax queries, please contact your financial adviser.

Term	Definition and explanation
Actuarial best estimate ("ABE")	The probability-weighted average of all future claims and cost scenarios. It is calculated using historical data, actuarial methods and judgement. A best estimate of reserves will therefore normally include no margin for optimism or, conversely, caution.
Annual Incentive Plan ("AIP")	This incentivises the performance of Executive Directors and employees over a one-year operating cycle. It focuses on the short to medium-term elements of the Group's strategic aims.
Assets under management ("AUM")	This represents all assets managed or administered by or on behalf of the Group, including those assets managed by third parties.
Association of British Insurers ("ABI")	The trade body that represents the insurance and long-term savings industry in the UK.
Available-for-sale ("AFS") investments	Available-for-sale investments are non-derivative financial assets that are designated as such, or are not classified as loans and receivables, held-to-maturity, or financial assets at fair value through profit or loss.
Average written premium	The total written premium at inception divided by the number of policies.
Bootstrapping	A statistical sampling technique used to estimate reserve variability around the Actuarial Best Estimate ("**ABE**"). Results produced from bootstrapping historical data are used to set and inform the level of margin incorporated in the Management Best Estimate ("**MBE**").
Buy-As-You-Earn Plan	The HM Revenue & Customs approved Buy-As-You-Earn Share Incentive Plan gives all employees the opportunity to become shareholders in the Company.
Capital	The funds invested in the Group, including funds invested by shareholders and Tier 1 notes. In addition, the subordinated liability in the Group's balance sheet is classified as Tier 2 capital for Solvency II purposes.
Carbon emissions	**Scope 1** – covers direct emissions from owned or controlled sources, including fuels used in office buildings, accident repair centres and owned vehicles. **Scope 2** – covers indirect emissions from the generation of purchased electricity, steam, heating and cooling for office buildings and accident repair centres. **Scope 3 under our direct control** – includes indirect emissions that occur in the Group's value chain, under its direct control, such as waste disposal and business travel. **Total Scope 3** – includes all other indirect emissions that occur in the Group's value chain and purchased goods and services, excluding investments.
Claims frequency	The number of claims divided by the number of policies per year.
Claims handling provision (provision for losses and loss-adjustment expense)	Funds set aside by the Group to meet the estimated cost of settling claims and related expenses that the Group considers it will ultimately need to pay.
Clawback	The Group's ability to claim repayment of paid amounts both cash and equity settled share-based payments.
Combined operating ratio	The sum of the loss, commission and expense ratios. The ratio measures the amount of claims costs, commission and operating expenses, compared to net earned premium generated. A ratio of less than 100% indicates profitable underwriting. **Normalised combined operating ratio** adjusts loss and commission ratios for weather and changes to the Ogden discount rate. (See page 227 alternative performance measures.)
Commission expenses	Payments to brokers, partners and price comparison websites for generating business.
Commission ratio	The ratio of commission expense divided by net earned premium. (See page 227 alternative performance measures.)
Company	Direct Line Insurance Group plc.
Current-year attritional loss ratio	The loss ratio for the current accident year, excluding the movement of claims reserves relating to previous accident years and claims relating to major weather events. (See page 227 alternative performance measures.)
Current-year combined operating ratio	This is calculated using the combined operating ratio less movement in prior-year reserves. (See page 227 alternative performance measures.)
Current-year normalised operating profit	This is calculated using the normalised operating profit adjusted for prior-year reserve movements. (See page 227 alternative performance measures.)
Deferred Annual Incentive Plan ("DAIP")	For Executive Directors and certain members of senior management, at least 40% of the AIP award is deferred into shares typically vesting three years after grant. The remainder of the award is paid in cash following year end.
Direct own brands	Direct own brands include Home and Motor under the Direct Line, Churchill, Darwin and Privilege brands, Rescue under the Green Flag brand and Commercial under the Direct Line for Business and Churchill brands.

Term	Definition and explanation
Earnings per share	The amount of the Group's profit after deduction of the Tier 1 coupon payments allocated to each Ordinary Share of the Company.
Employee Representative Body ("ERB")	The forum that represents all employees, including when there is a legal requirement to consult employees.
Expense ratio	The ratio of operating expenses divided by net earned premium. (See page 227 alternative performance measures.)
Finance costs	The cost of servicing the Group's external borrowings and including the interest on right-of-use assets.
Financial Conduct Authority ("FCA")	The independent body responsible for regulating the UK's financial services industry.
Financial leverage ratio	Tier 1 notes and financial debt (subordinated Tier 2 notes) as a percentage of total capital employed.
Financial Reporting Council	The UK's regulator for the accounting, audit and actuarial professions, promoting transparency and integrity in business.
Gross written premium	The total premiums from contracts that were incepted during the period.
Group	Direct Line Insurance Group plc and its subsidiaries.
Incremental borrowing rate ("IBR")	The rate of interest that a lessee would have to pay to borrow, over a similar term and security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.
Incurred but not reported ("IBNR")	Funds set aside to meet the cost of claims for accidents that have occurred but have not yet been reported to the Group. This includes an element of uplift on the value of claims reported.
In-force policies	The number of policies on a given date that are active and against which the Group will pay, following a valid insurance claim.
Insurance liabilities	This comprises insurance claims reserves and claims handling provision, which the Group maintains to meet current and future claims.
International Accounting Standards Board ("IASB")	A not-for-profit public interest organisation that is overseen by a monitoring board of public authorities. It develops International Financial Reporting Standards ("**IFRSs**") that aim to make worldwide markets transparent, accountable and efficient.
Investment income yield	The income earned from the investment portfolio, recognised through the income statement during the period (excluding unrealised and realised gains and losses, impairments and fair value adjustments) divided by the average assets under management ("**AUM**"). The average AUM derives from the period's opening and closing balances for the total Group. (See page 227 alternative performance measures.)
Investment return	The investment return earned from the investment portfolio, including unrealised and realised gains and losses, impairments and fair value adjustments.
Investment return yield	The investment return divided by the average AUM. The average AUM derives from the period's opening and closing balances. (See page 227 alternative performance measures.)
Long-Term Incentive Plan ("LTIP")	Awards made as nil-cost options or conditional share awards, which vest to the extent that performance conditions are satisfied after a period of at least three years.
Loss ratio	Net insurance claims divided by net earned premium. (See page 227 alternative performance measures.)
Malus	An arrangement that permits unvested remuneration awards to be forfeited, when the Company considers it appropriate.
Management's best estimate ("MBE")	These reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal ABE.
Net asset value	The difference between the Group's total assets and total liabilities, calculated by subtracting total liabilities (including Tier 1 notes) from total assets.
Net earned premium	The element of gross earned premium less reinsurance premium ceded for the period where insurance cover has already been provided.
Net insurance claims	The cost of claims incurred in the period less any claims costs recovered under reinsurance contracts. It includes claims payments and movements in claims reserves.
Net investment income yield	This is calculated in the same way as investment income yield but includes the cost of hedging. (See page 227 alternative performance measures.)
Net promoter score ("NPS")	This is an index that measures the willingness of customers to recommend products or services to others. It is used to gauge customers' overall experience with a product or service, and customers' loyalty to a brand.

Term	Definition and explanation
Ogden discount rate	The discount rate set by the Lord Chancellor and used by courts to calculate lump sum awards in bodily injury cases.
Operating expenses	These are the expenses relating to business activities excluding restructuring and one-off costs. (See page 227 alternative performance measures.)
Operating profit	The pre-tax profit that the Group's activities generate, including insurance and investment activity, but excluding finance costs, restructuring and one-off costs. **Normalised operating profit** is operating profit adjusted for weather and changes to the Ogden discount rate. (See page 229 alternative performance measures.)
Own Risk and Solvency Assessment ("ORSA")	A forward-looking assessment of the Group's risks and associated capital requirements, over the business planning period.
Periodic payment order ("PPO")	These are claims payments as awarded under the Courts Act 2003. PPOs are used to settle certain large personal injury claims. They generally provide a lump-sum award plus inflation-linked annual payments to claimants who require long-term care.
Prudential Regulation Authority ("PRA")	The PRA is a part of the Bank of England. It is responsible for regulating and supervising insurers and financial institutions in the UK.
Reinsurance	Contractual arrangements where the Group transfers part or all of the accepted insurance risk to another insurer.
Reserves	Funds that have been set aside to meet outstanding insurance claims and IBNR.
Restructuring costs	These are costs incurred in respect of the business activities where the Group has a constructive obligation to restructure its activities.
Return on equity	This is calculated by dividing the profit attributable to the owners of the Company after deduction of the Tier 1 coupon payments by average shareholders' equity for the period.
Return on tangible equity ("RoTE")	This is adjusted profit after tax divided by the Group's average shareholders' equity less goodwill and other intangible assets. Profit after tax is adjusted to exclude restructuring and one-off costs and to include the Tier 1 coupon payments. It is stated after charging tax using the UK standard rate of 19%. (See page 228 alternative performance measures.)
Right-of-use ("ROU") asset	A lessee's right to use an asset over the life of a lease, calculated as the initial amount of the lease liability, plus any lease payments made to the lessor before the lease commencement date, plus any initial direct costs incurred, minus any lease incentives received.
Science-Based Targets ("SBT")	Science-Based Targets are a set of goals developed by a business to provide it with a clear route to reduce greenhouse gas emissions. An emissions reduction target is defined as "science-based" if it is developed in line with the scale of reductions required to keep global warming below 2˚C from pre-industrial levels.
Scope 1, Scope 2, Scope 3 under our direct control and total Scope 3	Please refer to the glossary definition for carbon emissions on page 224.
Solvency II	The capital adequacy regime for the European insurance industry, which became effective on 1 January 2016. It establishes capital requirements and risk management standards. It comprises three pillars: Pillar I, which sets out capital requirements for an insurer; Pillar II, which focuses on systems of governance; and Pillar III, which deals with disclosure requirements.
Solvency capital ratio	The ratio of Solvency II own funds to the solvency capital requirement.
Tangible equity	This shows the equity excluding Tier 1 notes and intangible assets (for comparability with companies which have not acquired businesses or capitalised intangible assets). (See page 228 alternative performance measures).
Tangible net assets per share	This shows the amount of tangible equity allocated to each ordinary share (for comparability with companies which have not acquired businesses or capitalised intangible assets). (See page 228 alternative performance measures).
Total Shareholder Return ("TSR")	Compares share price movement with reinvested dividends as a percentage of the share price.
UK Endorsement Board	The UK Endorsement Board endorses and adopts new or amended International Financial Reporting Standards issued by the International Accounting Standards Board.
Underwriting result profit / (loss)	The profit or loss from operational activities, excluding investment return and other operating income. It is calculated as net earned premium less net insurance claims and total expenses, excluding restructuring and one-off costs.

Appendix A – Alternative performance measures

The Group has identified Alternative Performance Measures ("**APMs**") in accordance with the European Securities and Markets Authority's published Guidelines. The Group uses APMs to improve comparability of information between reporting periods and reporting segments, by adjusting for either uncontrollable or one-off costs which impact the IFRS measures, to aid the user of the annual report and accounts in understanding the activity taking place across the Group. These APMs are contained within the main narrative sections of this document, outside the financial statements and notes, and may not necessarily have standardised meanings for ease of comparability across peer organisations.

Further information is presented below, defined in the glossary on pages 224 to 226 and reconciled to the most directly reconcilable line items in the financial statements and notes. Note 4 on page 185 of the consolidated financial statements presents a reconciliation of the Group's business activities on a segmental basis to the consolidated income statement. All note references in the table below are to the notes to the consolidated financial statements on pages 162 to 214.

Group APM	Closest equivalent IFRS measure	Definition and / or reconciliation	Rationale for APM
Combined operating ratio	Profit before tax	Combined operating ratio is defined in the glossary on page 224 and reconciled in note 4 on page 185.	This is a measure of underwriting profitability and excludes non-insurance income, whereby a ratio of less than 100% represents an underwriting profit and a ratio of more than 100% represents an underwriting loss.
Commission ratio	Commission expense	Commission ratio is defined in the glossary on page 224 and is reconciled in note 4 on page 185.	Expresses commission expense, in relation to net earned premium.
Current-year attritional loss ratio	Net insurance claims	Current-year attritional loss ratio is defined in the glossary on page 224 and is reconciled to the loss ratio (discussed below) on page 24.	Expresses claims performance in the current accident year in relation to net earned premium.
Current-year combined operating ratio	Profit before tax	Current-year combined operating ratio is defined in the glossary on page 224 and is reconciled on page 24.	This is a measure of underwriting profitability, excluding the effect of prior-year reserve movements.
Current-year normalised operating profit ratio	Profit before tax	Current-year normalised operating profit ratio is defined in the glossary on page 224 and reconciled on page 229.	Expresses a relationship between current-year normalised operating profit and normalised operating profit.
Expense ratio	Total expenses	Expense ratio is defined in the glossary on page 225 and is reconciled in note 4 on page 185.	Expresses underwriting and policy expenses in relation to net earned premium.
Investment income yield	Investment income	Investment income yield is defined in the glossary on page 225 and is reconciled on page 228.	Expresses a relationship between the investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Investment return yield	Investment return	Investment return yield is defined in the glossary on page 225 and is reconciled on page 228.	Expresses a relationship between the investment return and the associated opening and closing assets adjusted for portfolio hedging instruments.
Loss ratio	Net insurance claims	Loss ratio is defined in the glossary on page 225 and is reconciled in note 4 on page 185.	Expresses claims performance in relation to net earned premium.
Net investment income yield	Investment income	Net investment income yield is defined in the glossary on page 225 and is reconciled on page 228.	Expresses a relationship between the net investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Normalised combined operating ratio	Profit before tax	Combined operating ratio and normalised combined operating ratio are defined in the glossary on page 224 and reconciled on page 229.	This is a measure of underwriting profitability excluding the effects of weather, Ogden discount rate changes and restructuring and one-off costs. It also excludes non-insurance income. A ratio of less than 100% represents an underwriting profit and a ratio of more than 100% represents an underwriting loss.
Operating expenses	Total expenses	Operating expenses are defined in the glossary on page 226 and reconciled in note 4 on page 185.	This shows the expenses relating to business activities excluding restructuring and one-off costs.

Appendix A – Alternative performance measures continued

Group APM	Closest equivalent IFRS measure	Definition and / or reconciliation	Rationale for APM
Operating profit	Profit before tax	Operating profit is defined in the glossary on page 226 and reconciled in note 4 on page 185.	This shows the underlying performance (before tax and excluding finance costs and restructuring and one-off costs) of the business activities.
Return on tangible equity	Return on equity	Return on tangible equity is defined in the glossary on page 226 and is reconciled on page 230.	This shows performance against a measure of equity that is more easily comparable to that of other companies.
Tangible equity	Equity	Tangible equity is defined in the glossary on page 226 and is reconciled in note 16 on page 193.	This shows the equity excluding Tier 1 notes and intangible assets for comparability with companies which have not acquired businesses or capitalised intangible assets.
Tangible net asset value per share	Net asset value per share	Tangible net asset value per share is defined in the glossary on page 226 and reconciled in note 16 on page 193.	This shows the equity excluding Tier 1 notes and intangible assets per share for comparability with companies which have not acquired businesses or capitalised intangible assets.
Underwriting profit	Profit before tax	Underwriting profit is defined in the glossary on page 226 and is reconciled in note 4 on page 185.	This shows underwriting performance calculated as net earned premium less net claims and operating expenses, excluding restructuring and one-off costs.

Investment income and return yields[1]

	Notes[2]	**2020 £m**	2019 £m
Investment income	6	**127.1**	146.4
Hedging to a sterling floating rate basis[3]	6	**(20.3)**	(22.1)
Net investment income		**106.8**	124.3
Net realised and unrealised (losses) / gains excluding hedging		**(11.7)**	10.3
Investment return	6	**95.1**	134.6
Opening investment property		**291.7**	322.1
Opening financial investments		**4,673.4**	4,737.8
Opening cash and cash equivalents		**948.6**	1,154.4
Opening borrowings		**(52.3)**	(62.0)
Opening derivatives asset[4]		**81.8**	11.8
Opening investment holdings		**5,943.2**	6,164.1
Closing investment property	20	**292.1**	291.7
Closing financial investments	28	**4,681.4**	4,673.4
Closing cash and cash equivalents	29	**1,220.1**	948.6
Closing borrowings	29	**(51.9)**	(52.3)
Closing derivatives asset[4]		**8.0**	81.8
Closing investment holdings		**6,149.7**	5,943.2
Average investment holdings[5]		**6,046.5**	6,053.7
Investment income yield[1]		**2.1%**	2.4%
Net investment income yield[1]		**1.8%**	2.1%
Investment return yield[1]		**1.6%**	2.2%

Notes:

1. See glossary on page 225 for definitions.
2. See notes to the consolidated financial statements.
3. Includes net realised and unrealised gains / (losses) on derivatives in relation to AUM.
4. See footnote 1 on page 34 (Investment holdings).
5. Mean average of opening and closing balances.

Normalised combined operating ratio[1]

	Home 2020	Home 2019	Commercial 2020	Commercial 2019	Total 2020	Total 2019
Loss ratio	**55.6%**	46.8%	**51.4%**	52.7%	**57.9%**	61.9%
Commission ratio	**8.1%**	9.7%	**18.7%**	18.5%	**8.6%**	7.1%
Expense ratio	**23.4%**	23.8%	**25.4%**	24.5%	**24.5%**	23.2%
Combined operating ratio	**87.1%**	80.3%	**95.5%**	95.7%	**91.0%**	92.2%
Effect of weather						
Loss ratio	**3.4%**	7.2%	**0.4%**	3.7%	**0.7%**	2.0%
Commission ratio	**(0.2%)**	(0.6%)	**–**	–	**–**	(0.1%)
Combined operating ratio normalised for weather	**90.3%**	86.9%	**95.9%**	99.4%	**91.7%**	94.1%
Effect of Ogden discount rate						
Loss ratio	**–**	–	**–**	(0.2%)	**–**	(0.6%)
Combined operating ratio normalised for weather and Ogden discount rate	**90.3%**	86.9%	**95.9%**	99.2%	**91.7%**	93.5%

Note:
1. See glossary on page 224 for definition.

Normalised operating profit[1]

	Total 2020 £m	Total 2019 £m
Operating profit	**522.1**	546.9
Effect of:		
Ogden discount rate	**–**	16.9
Normalised weather – claims	**(20.8)**	(59.0)
Normalised weather – profit share	**1.3**	3.7
Normalised operating profit	**502.6**	508.5
Prior-year adjustments		
Prior-year reserve movement	**173.8**	294.5
Ogden discount rate	**–**	16.9
Prior-year normalised operating profit	**173.8**	311.4
Current-year normalised operating profit	**328.8**	197.1
Current-year normalised operating profit ratio	**65%**	39%

Note:
1. See glossary on page 226 for definition.

Operating expenses[1]

	Note[2]	2020 £m	2019 £m
Operating expenses (including restructuring and one-off costs)	10	**763.8**	704.9
Less restructuring and one-off costs	10	**(39.4)**	(11.2)
Operating expenses	10	**724.4**	693.7

Notes:
1. See glossary on page 226 for definition.
2. See notes to the consolidated financial statements.

Return on tangible equity[1]

	2020 £m	2019 £m
Profit before tax	**451.4**	509.7
Add back: restructuring and one-off costs	**39.4**	11.2
Coupon payments in respect of Tier 1 notes	**(16.6)**	(16.6)
Adjusted profit before tax	**474.2**	504.3
Tax charge (2019 and 2020 UK standard tax rate of 19%)	**(90.1)**	(95.8)
Adjusted profit after tax	**384.1**	408.5
Opening shareholders' equity	**2,643.6**	2,558.2
Opening goodwill and other intangible assets	**(702.5)**	(566.8)
Opening shareholders' tangible equity	**1,941.1**	1,991.4
Closing shareholders' equity	**2,699.7**	2,643.6
Closing goodwill and other intangible assets	**(786.8)**	(702.5)
Closing shareholders' tangible equity	**1,912.9**	1,941.1
Average shareholders' tangible equity[2]	**1,927.0**	1,966.3
Return on tangible equity	**19.9 %**	20.8 %

Notes:

1. See glossary on page 226 for definition.
2. Mean average of opening and closing balances.

Forward-looking Statements Disclaimer

This Annual Report & Accounts has been prepared for, and only for, the members of the Company as a body, and no other persons. The Company, its Directors, employees, agents or advisers do not accept responsibility to any other person to whom this document is shown, or into whose hands it may come, and any such responsibility or liability is expressly disclaimed.

Certain information contained in this document, including any information as to the Group's strategy, plans or future financial or operating performance, constitutes "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "aims", "ambition", "anticipates", "aspire", "believes", "continue", "could", "estimates", "expects", "guidance", "intends", "may", "mission", "outlook", "over the medium term", "plans", "predicts", "projects", "propositions", "seeks", "should", "strategy", "targets" or "will" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in several places throughout this document and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, among other things: the Group's results of operations, financial condition, prospects, growth, strategies and the industry in which the Group operates. Examples of forward-looking statements include financial targets and guidance which are contained in this document specifically with respect to the return on tangible equity, solvency capital ratio, the Group's combined operating ratio, percentage targets for current-year contribution to operating profit, prior-year reserve releases, cost reductions, reductions in expense and commission ratios, investment income yield, net realised and unrealised gains, capital expenditure and risk appetite range. By their nature, all forward-looking statements involve risk and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future and/or are beyond the Group's control. Forward-looking statements are not guaranteeing future performance.

The Group's actual results of operations, financial condition and the development of the business sector in which the Group operates may differ materially from those suggested by the forward-looking statements contained in this document, for example directly or indirectly as a result of, but not limited to:

- United Kingdom ("**UK**") domestic and global economic business conditions;
- the direct and indirect impacts and implications of the Covid-19 pandemic on the economy, nationally and internationally, on the Group, its operations and prospects, and on the Group's customers and their behaviours and expectations;
- the trade and co-operation agreement between the UK and the European Union ("**EU**") regarding the terms, following the end of the Brexit transition period, of the trading relationships between the UK and the EU and its implementation, and any subsequent trading and other relationship arrangements between the UK and the EU and their implementation;
- the terms of trading and other relationships between the UK and other countries following Brexit;
- market-related risks such as fluctuations in interest rates and exchange rates;
- the policies and actions of regulatory authorities and bodies (including changes related to capital and solvency requirements or to the Ogden discount rate or rates in response to the Covid-19 pandemic and its impact on the economy and customers) and changes to law and/or understandings of law and/or legal interpretation following the decisions and judgements of courts;
- regulations and requirements arising out of the FCA pricing practices review and changes in customer and market behaviours and practices arising out of that review and such regulations and requirements;
- the impact of competition, currency changes, inflation and deflation;
- the timing, impact and other uncertainties of future acquisitions, disposals, partnership arrangements, joint ventures or combinations within relevant industries; and
- the impact of tax and other legislation and other regulation and of regulator expectations, interventions and requirements and of court, arbitration, regulatory or ombudsman decisions and judgements (including in any of the foregoing in connection with the Covid-19 pandemic) in the jurisdictions in which the Group and its affiliates operate.

In addition, even if the Group's actual results of operations, financial condition and the development of the business sector in which the Group operates are consistent with the forward-looking statements contained in this document, those results or developments may not be indicative of results or developments in subsequent periods.

The forward-looking statements contained in this document reflect knowledge and information available as of the date of preparation of this document. The Group and the Directors expressly disclaim any obligations or undertaking to update or revise publicly any forward-looking statements, whether because of new information, future events or otherwise, unless required to do so by applicable law or regulation. Nothing in this document constitutes or should be construed as a profit forecast.

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