Insurance that is personal, inclusive and a force for good

Direct Line Group

Annual Report & Accounts 2020

2020 highlights

Profit before tax
£451.4m
(2019: £509.7m)

Return on tangible equity[1]
19.9%
(2019: 20.8%)

Combined operating ratio[1,2]
91.0%
(2019: 92.2%)

Solvency capital ratio[1,3]
191%
(2019: 189% adjusted[4])

Operating profit[1]
£522.1m
(2019: £546.9m)

Dividends and capital returns[5]
£595.2m
(Includes £195.5m special dividend to replace the cancelled 2019 final dividend)

(2019: £128.6m adjusted[4])

Customers
450k+
Customers benefited from support measures

People
£3.8m
Invested in free shares for our people

Society
£7m+
Donated to charities and good causes

Planet
100%
Carbon neutral via offsetting

Notes:
1. See glossary on pages 224 to 226 for definitions and Appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
2. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration. See glossary on page 224 for definitions.
3. Estimates based on the Group's Solvency II partial internal model.
4. The 2019 comparatives for dividends and capital returns and the solvency capital ratio have been adjusted to remove the cancelled 2019 final dividend and £120 million of share buyback. (The reported numbers were solvency capital ratio of 165% and capital returns of £447.0 million). See page 18 for further details.
5. See page 28 for the dividend policy.

Contents

Strategic report

Introduction	1
2020 highlights timeline	2
Investment case	4
Business model	6
Chair's statement	8
Section 172(1) statement	10
Chief Executive Officer's review	11
Market overview	16
Our key performance indicators	18
Finance review	20
Operating review	36
Sustainability	44
Streamlined Energy and Carbon Reporting	68
Non-financial information statement	68
Risk management	69

Governance

Chair's introduction	76
Board of Directors	78
Executive Committee	81
Corporate governance report	83
Committee reports	97
Directors' Remuneration Report	113
Directors' report	140

Financial Statements

Contents	145
Independent Auditor's report	146
Consolidated Financial Statements	157
Notes to the Consolidated Financial Statements	162
Parent Company Financial Statements	215
Notes to the Parent Company Financial Statements	217

Other information

Additional information	222
Glossary and Appendices	224
Forward-looking Statements Disclaimer	231
Contact information	232

Our vision is to create a world where insurance is personal, inclusive and a force for good.

To deliver this we need to build an insurance company of the future with technology and data at its core, adapting to an ever-changing world, delivering more for customers at speed.

As we navigated the challenges that 2020 presented, we focused on supporting our customers, the wellbeing of our people, contributing to society and stepping up our plans to tackle climate change.

We believe embracing sustainable practices creates a better corporate culture, more reliable products and brings long-term rewards for our shareholders.

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

2020 Highlights

Claims teams take over 6,500 calls from customers helping to support them following Storm Ciara

Sign Social Mobility Pledge

New ad campaign launches for **Direct Line**

£3.5 million Community Fund launches, distributing £2 million in two weeks to charities supporting the most vulnerable

£2m
distributed in two weeks

Our Finance team delivers a new cloud-based Oracle accounting ledger and claims payment system

2020

January

Privilege offers full end-to-end motor insurance service on new platform, for both new business and renewal customers

March

Direct Line for Business rolls out new Van and Tradesperson products on its digital platform

Covid-19: The Group moves the majority of its operations to homeworking, guaranteeing usual pay regardless of whether individual working practices are affected

May

Green Flag refreshes "Green Flag Rescue Me" app allowing more claims to be serviced digitally

Our Travel team continues to settle claims for over 26,000 customers and repatriate over 900 customers stranded abroad

900+
travel insurance customers repatriated

Darwin live on four price comparison websites (“PCWs”)

Migrates to a new mainframe platform as part of the Group’s technology transformation

Group becomes a 100% carbon-neutral business by investing in high social impact projects to offset our Scope 1, 2 and 3[1] emissions

Launch a new counter fraud operating system

Group successfully transitions a number of business areas to **agile ways of working**

450k+

customers benefit from support measures[2]

August

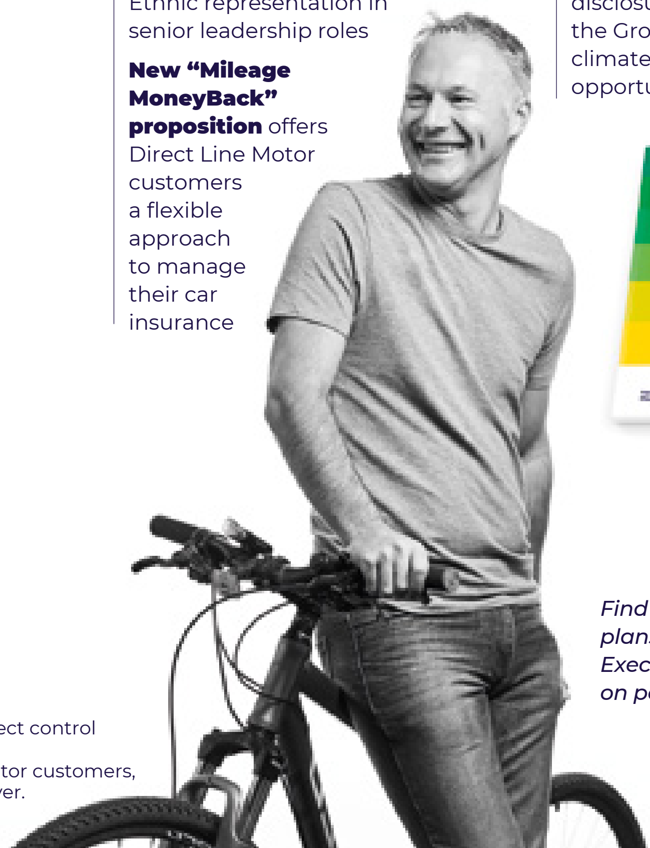
Group announces intention to set **Science-Based Targets** to strengthen our disclosures on tackling emissions

Strong Churchill new business growth, increased share of new business on PCWs across Motor and Home

October

Group announces new **diversity and inclusion targets** for improving Black, Asian and Minority Ethnic representation in senior leadership roles

New “Mileage MoneyBack” proposition offers Direct Line Motor customers a flexible approach to manage their car insurance



December

Task Force on Climate-related Financial Disclosures: Issue our first comprehensive disclosure on how the Group approaches climate change risks and opportunities

Find out more about our plans for 2021 in the Chief Executive Officer’s Review on pages 11 to 17

Notes:

1. Scope 3 emissions which are under our direct control – see page 61.
2. Payment deferrals, mileage refunds for motor customers, waiving cancellation fees and reducing cover.

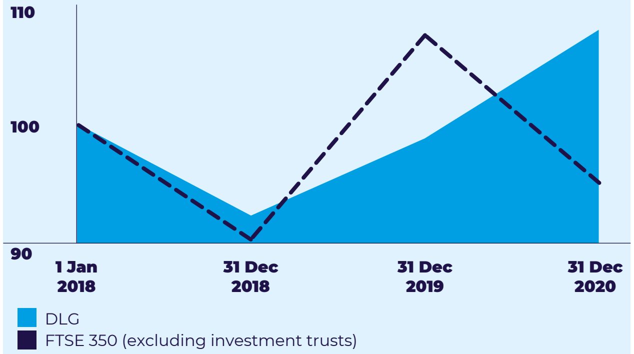
Transforming to drive competitiveness

Delivering strong shareholder returns

We have a track record of delivering strong returns to shareholders, having distributed £1.2 billion in dividends over the past three years. This, together with our share price performance, has delivered an attractive total shareholder return.

Total shareholder return (%)

This represents the cumulative dividends paid and change in share price over a three-year period



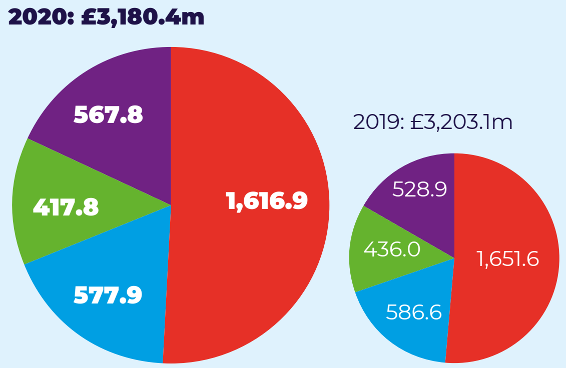
£1.2bn

Dividends paid to shareholders in the last three years

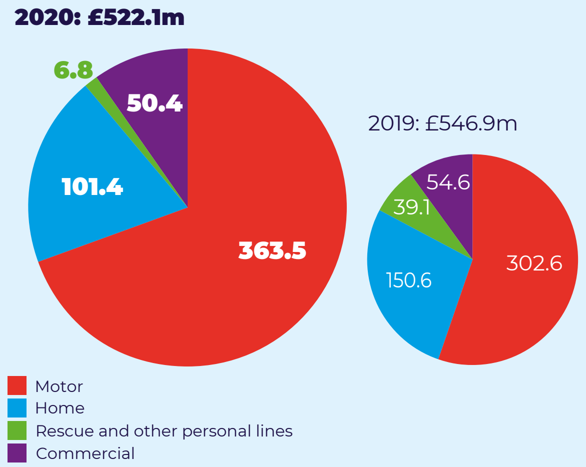
Diversified business model

As a UK-focused company, we have the ability to be a deep specialist in our chosen markets and our range of channels and products gives us real diversification and scale.

Gross written premiums (£m)



Operating profit (£m)



Transforming to drive competitiveness

We are transforming our technology and changing the way we work to increase the competitiveness of our business, with the aim of improving the quality of our earnings, with a greater proportion coming from current-year business.

Best at direct
To be the UK's leading insurer, because we anticipate our customers' needs and develop services and products they want to buy.

Win on price comparison websites (PCWs)
To deliver a step change in our pricing and trading capability so that our leading PCW brands win customers from our competitors.

Extend our reach
To utilise the potential of our investments and capabilities to win more customers through acquisitions and brand partnerships.

Technical edge
To use our data, scale, skill and insight across claims, pricing and underwriting to deliver value to customers.

Nimble and cost efficient
To transform into an agile, cost effective business to drive efficiency and simplicity for us and our customers.

Great people
A home for empowered people who celebrate difference, and challenge the status quo to deliver for our customers.

See page 12 for more information

Improving the sustainability of our earnings

In 2020 we made good progress against our targets to improve the sustainability of our earnings, growing current-year contribution to operating profit and delivering a strong combined operating ratio. Our focus on supporting our customers, our people and wider society led to an increase in costs in 2020.

Costs
Target: Expense ratio[1,2] of 20% in 2023

2020:

24.5%

Normalised current-year operating profit[1,3]
Target: At least 50% contribution to total operating profit by 2021

2020:

65.4%

Following an elevated contribution in 2020 due to lower claims frequency associated with Covid-19 disruption

Normalised combined operating ratio ("COR")[1,4]
Target: Between 93-95% throughout the medium term

2020:

91.7%

Return on tangible equity ("RoTE")[1]
Target: At least 15% per annum over the long term

2020:

19.9%

Notes:

1. See glossary on pages 224 to 226 for definitions and Appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
2. Applies to operating expenses excluding restructuring and one-off costs.
3. Normalised for weather and changes to the Ogden discount rate. Reported contribution 66.7%.
4. Normalised for weather and changes to the Ogden discount rate. Reported COR 91.0%.

Protecting our customers

We help people carry on with their lives, giving them peace of mind now and in the future.
Across the business we have a number of real strengths and our customers and our people are at the heart of our business.

Giving customers a choice of brands and channels

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

Motor

We are Britain's leading personal motor insurer measured by in-force policies[1], mainly represented through our well-known brands Direct Line, Churchill, Privilege, our Darwin brand, and also through our partners

Home

We are one of Britain's leading personal home insurers measured by in-force policies[1]. We reach our customers by selling home insurance products through our brands Direct Line, Churchill and Privilege, and our partner NatWest Group

Rescue and other personal lines

We are one of the leading providers of rescue, travel and pet insurance in the UK. Green Flag is the third largest roadside recovery provider[2]. We are also the second largest travel and the fourth largest pet insurer[3]

Commercial

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

Notes:

1. Includes Direct Line, Churchill, Privilege, Darwin and partner brands: RBS, NatWest. © Ipsos MORI 2021, Financial Research Survey (FRS), six months ended January 2021. c. 14,000 adults (aged 16+) surveyed across Great Britain. Interviews were conducted online and by telephone, and weighted to reflect the overall profile of the adult population.
2. Mintel Vehicle Recovery – September 2020.
3. Mintel Pet Insurance – August 2020 & Mintel Travel Insurance – February 2021.

This is how we create value

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

A triple win

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

Premiums

Our diversified model enables us to offer a range of products across a range of distribution channels.

Investment return

Our diversified investment portfolio provides additional income whilst also ensuring we can support our long-term claim commitments. See page 33.

Accident repair centres

We own 21 accident repair centres, the largest owned network of any insurer, delivering lower repair costs and providing data-led insight enabling us to react to emerging trends and helping inform pricing.

Claims management

We have deep specialism in claims handling, including market-leading counter-fraud capability.

Costs

We invest in market-leading brands and strong customer service, whilst targeting cost reduction measures in order to increase our competitiveness.

Tax

We manage our tax obligations responsibly contributing either directly or indirectly £888 million in tax to the Exchequer this year. See more on page 35.

A win for customers

by sharing real value with them.

Our customers

We earn our customers' trust by demonstrating how we are acting in their best interests.

450k+

Customers benefited from support measures

A win for our people and shareholders

who are invested in our success.

Our people

We encourage a culture that celebrates difference and empowers people so that they can thrive.

£3.8m

Invested in free shares for our people

Shareholders

We have a track record of delivering strong returns to shareholders. This, together with our share price performance, has delivered an attractive total shareholder return.

£1.2bn

Paid in dividends over the last three years

A win for society and the planet

because our long-term success is intrinsically linked to the success of the community and environment around us.

Society

We use our expertise to improve outcomes for society and the communities we serve.

£7m+

Donated to charities and good causes

The planet

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

100%

Carbon neutral via offsetting

Danuta Gray
Chair of the Board

In 2020, our resilience and agility enabled us to support our customers and communities, distribute surplus capital and progress building the capability designed to deliver our sustainable strategy.

I would like to start my first statement as Chair by recognising the efforts of all my Direct Line Group (the "**Group**") colleagues in navigating the turbulent conditions that we experienced in 2020.

The resilience and adaptability demonstrated by our people has been commendable. The Covid-19 pandemic has affected all our stakeholders and I am proud of the senior leadership team for responding swiftly and effectively and for addressing the rapidly changing needs of the Group's stakeholders, including our customers, our workforce and the communities we serve.

In the extraordinary market conditions caused by lockdowns and market uncertainty related to Brexit and other global economic factors, our disciplined underwriting model produced a combined operating ratio of 91.0% (2019: 92.2%). Profit before tax was down 11.4% to £451.4 million (2019: £509.7 million) but our strong capital position has enabled us to increase our final dividend to 14.7 pence and commence a share buyback of up to £100 million. This is on top of the £30 million share buyback we made in March 2020 before we prudently cancelled the programme against a background of market volatility.

New leadership and Board changes

I am delighted to have been chosen by my fellow Directors to succeed Mike Biggs as Chair following his retirement from office in August 2020. It was a pleasure to have served with him as an independent Non-Executive Director and, on behalf of the Board, I extend our thanks to Mike for his exemplary stewardship of the Board as Chair since before the Company separated from the Royal Bank of Scotland and listed on the London Stock Exchange in 2012. Mike formed the Board, led it through the IPO and was instrumental in defining the Group's enviable culture and ambition. We are indebted to him for his wisdom, for the contribution of his deep experience, honed over four decades in the financial services sector, and for his legacy of inclusivity and solidarity in the Board's culture. The selection process which led to my appointment as Chair is summarised in the Governance report on page 91.

> **"The resilience and adaptability demonstrated by our people has been commendable."**

We announced in December that Jane Hanson, who was appointed as an independent Non-Executive Director in December 2011, will be stepping down from the Board at the conclusion of the Annual General Meeting in May 2021. On behalf of the Board, I would like to thank Jane for her energetic leadership of the Board Risk Committee and for her hard work as a member of the Audit, Investment and Sustainability Committees.

Adrian Joseph OBE joined the Board as an independent Non-Executive Director on 1 January 2021. As the business is transformed into a technology- and data-led company, with the customer at its heart, Adrian's deep experience of digital, artificial intelligence and data will be an important addition to the Board's capabilities.

We are committed to our diversity and inclusion agenda, including our target of increasing female representation in our senior leadership team. Details about the progress we are making on Board diversity appear in our Nomination and Governance Committee report on pages 106 to 108 and further information about changes to the Board and its Committees is set out on page 91.

Strategy

Our vision is to create a world where insurance is personal, inclusive and a force for good. Our purpose is to help people carry on with their lives, giving them peace of mind now and in the future. We have worked exceptionally hard to deliver against that purpose throughout the challenging events of 2020.

Our strategic objectives aim to ensure that we build technological and organisational capability to continue providing products which meet our customers' changing needs and are available through multiple channels, to continue providing outstanding customer service and value for money, to create value for our investors, to support our communities and to protect the environment.

Dividend and capital management

The Group's solvency capital ratio as at 31 December 2020, prior to any proposed dividends or incremental capital returns, was 213%.The Board has recommended a final dividend of 14.7 pence per share, an increase of 2.1% on the special interim dividend of 14.4 pence announced with our interim results, which reflected a full catch up of the cancelled 2019 final dividend.

Reflecting the strength of the Group's capital position, and in line with our dividend policy to return capital to shareholders which is expected to be surplus to the Group's requirements for a prolonged period, the Group intends to commence a share buyback programme. The Board has approved a share buyback programme 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.

After the proposed final dividend and £100 million share buyback, the estimated solvency capital ratio was 191% as at 31 December 2020. The Group has outstanding Tier 2 debt issued in 2012 with nominal value of £250 million and a first call date during the first half of 2022. Excluding this debt, the Group's solvency ratio after the proposed final dividend and share buyback would be 172%. In February 2021, the Group acquired the head lease of its Bromley office site, which reduced the Group's coverage ratio by an additional 6 percentage points.

Assuming a return to more normal circumstances, the Group intends to move towards the middle of its risk appetite range of 140% to 180% of its solvency capital requirement, consistent with its previously stated target.

Our customers

Customer experience is at the heart of everything we do, and it is the central element that connects all our people regardless of role. We recognise that the Covid-19 pandemic has had a huge, in some cases devastating, effect on many of our customers and we have sought to respond with sensitivity to customers whose travel plans have been disrupted, who find themselves under financial strain, or who have experienced bereavement. The Board oversees the Group's conduct, aiming to ensure that the Group acts in our customers' best interests and that there is an active and constructive dialogue with its insurance regulators on customer conduct matters.

Linking remuneration to performance

We remain focused on ensuring that executive pay is aligned with the Group's strategy of targeting sustainable shareholder and customer value, that it reflects investor experience and, particularly in respect of 2020, that it reflects the way in which the business has interacted with its customers, its people and its communities.

A significant proportion of executive remuneration is delivered through shares and shareholding requirements and our incentive schemes' performance measures are aligned with the long-term performance measures considered important by investors.

> **"We have responded with sensitivity to the huge disruption that Covid-19 has caused to many of our customers."**

The Group's share price on 31 December 2020 was 319.0 pence (2019: 312.5 pence). Total shareholder return ("**TSR**"), which includes dividend payments, increased by 9.0 percentage points for the year (2019: 7.0 percentage point increase). During 2020, the Group's share price grew by 2.1% (2019: 1.9% decrease), reflecting increased investor confidence following the Capital Markets Day at the end of 2019 and the delivery of strong financial results in March 2020. This was partially offset by concerns over margin contraction in Motor and Home following the publication of the FCA's Pricing Practices Report ("**PPR**") which put pressure on UK Personal Lines stocks.

In April 2020, the Group took the difficult decision to cancel the 2019 final dividend of 14.4 pence and the £150 million share buyback programme, in recognition of heightened uncertainty in the macroeconomic environment due to Covid-19, although its solvency position was strong. At the time of the interim results in August 2020, the Group's financial resilience in the face of Covid-19 enabled it to declare a regular interim dividend and catch-up on the cancelled 2019 final dividend. We are grateful to our shareholders for their understanding during this challenging period.

Over the past three years, the Group has delivered a TSR of 7.9% compared to the FTSE 350 (excluding investment trusts) reduction of 5.0%, having returned £1.2 billion to shareholders during the period.

More information on the Group's remuneration policy and share awards is disclosed in the Directors' remuneration report on pages 113 to 139.

Sustainability and culture

In December 2020, we published our first Task Force on Climate-related Financial Disclosures Report and our first Sustainability Report. These set out the progress the Group has made against its Environment, Social and Governance agenda, including the Group's intention to set Science Based Targets which will strengthen our disclosures across Scope 1, Scope 2 and Scope 3 emissions, as well as the actions we took in response to the Covid-19 pandemic to support our people, customers and communities. For definitions of terms used, please see the glossary on pages 224 to 226.

Climate-related risks and opportunities have grown in importance for us as a business. As an insurance company, understanding and managing risk is of fundamental importance, and we recognise that climate change poses material long-term risks to the business.

We are embracing the sustainable practices that we believe underpin a better corporate culture, offering products that meet our customers' needs and providing greater long-term sustainability for investors.

The Board believes that working for all our stakeholders is the foundation needed for delivering long-term sustainability. The Board recognises the importance of setting the tone of the Group's culture and embedding it throughout the organisation. More information about this can be found in the Governance introduction on page 76.

In November 2019, we set out our vision for building a world where insurance is personal, inclusive and a force for good. At that time, we could not have anticipated the extraordinary events of 2020 and now more than ever, it is essential that we live up to that ambition and play our part in supporting the communities we serve. The DLG Community Fund of £3.5 million is being used to support the communities where our largest sites are based as well as several national charities.

Our People

We pride ourselves in having an empowering culture that celebrates difference and authenticity, and encourages each colleague to bring their whole self to work. The Group's success and resilience is due in no small part to the contribution of its people. In a year which could have produced very different outcomes, the Board and I are grateful for the hard work, initiative and commitment of our people, who have continued to live the Group's values and to demonstrate dedication to serving our customers.

I would also like to thank each member of the Board for their significant contribution, commitment and service and I look forward to my first full year as Chair of the Board working with them in supporting and encouraging our management team in the execution of the Group's ambitious strategy.

DANUTA GRAY
Chair of the Board

Section 172(1) statement

Direct Line Group is a leading motor, home and commercial insurer which depends on its reputation for high standards of business conduct and on the trust and confidence of its stakeholders to operate sustainably in the long term. The Group seeks to put its customers' best interests first, continually invests in and engages with its employees, supports the communities in which it operates and strives to generate value for shareholders.

The Directors of Direct Line Insurance Group plc (the "**Company**") have been subject to the duties codified in law, which include the duty to act in the way in which they consider, in good faith, would be most likely to promote the success of the Group for the benefit of its members as a whole, having regard to the stakeholders and matters set out in Section 172(1) of the Companies Act 2006 ("**Section 172(1)**").

The Board recognises that the Group has a range of stakeholders with diverse interests and an analysis of its principal stakeholders can be found on pages 48 to 61 and on page 86.

Section 172(1) considerations are embedded in decision-making at Board-level and are demonstrated throughout its governance framework.

The underlying principles of promoting the success of the Company for the benefit of its members as a whole, and of considering stakeholders when making decisions that could affect them, is understood by the senior leadership team and consideration and respect for stakeholders is demonstrated throughout the Group.

The Group has adapted to a change of working practices throughout the year and keeps engagement mechanisms under review so that they remain effective and so that the Board understands the evolving needs of its stakeholders.

In taking decisions, the Directors carefully consider the balance of interests of the stakeholders who might be affected. The Board and its Committees discuss stakeholders and their interests during the cycle of Board meetings, and in 2020 we increased both the frequency and length of meetings, not least to focus on stakeholder needs as a result of the Covid-19 pandemic.

We are committed to ensuring that the Group takes action both to protect the business and to reduce its direct and indirect impact on the environment.

In March 2020, the Board considered it prudent to cancel its share buyback programme and, in April 2020, to cancel the 2019 final dividend as a result of the volatile conditions arising from the Covid-19 pandemic, although an interim and a special interim dividend were paid later in the year when conditions stabilised and on the basis of a strong capital position. See pages 86 to 87 for more detailed examples of how the Board considered Section 172(1) when making decisions that affected its stakeholders.

Navigating an extraordinary year

Penny James
Chief Executive Officer

Despite the many challenges we faced in the year as a result of the Covid-19 pandemic, we traded well and prioritised support for our customers, our people and local communities. I am proud that our people, even when working remotely, have continued both to care for our customers and to help us build an insurance company of the future.

I am proud of what the Group has achieved during 2020. Once again, we have demonstrated financial resilience by delivering another good set of results, whilst supporting our customers, our people and local communities through the challenges of the pandemic. Despite the disruption and uncertainty that 2020 has brought, we have made real progress towards becoming a technology-driven business which can adapt quickly to the changing world around us and deliver more for our customers at speed. We could not have done this without our highly engaged people, who have demonstrated the commitment and flexibility needed to do what it takes for our customers and to drive forward our business plans regardless of their personal circumstances. I am grateful to them for their dedication, skill and support.

Business performance and the impact of Covid-19

In 2020, we delivered another year of strong profitability at the same time as growing our direct own brand policy count. The investments we have made in systems and capability over the last few years are showing through in this growth and are contributing to underlying improvements in current-year underwriting profitability. Overall Covid-19 led to a modest net benefit to the result. Despite the impact of the pandemic, we made further progress in delivering the change required to implement the Group's transformation plans.

"In 2020, we delivered another year of strong profitability at the same time as growing our direct own brand policy count."

We traded well through the year, delivering growth in our Home, Commercial and Green Flag Rescue businesses despite prolonged periods of lockdown when new business shopping dropped significantly. Retention has held up well. In contrast average premiums have fallen as risk mix has reduced, with fewer new drivers on the road as no driving tests have been conducted for parts of the year and fewer new cars have been purchased. In the midst of these trends we are happy to see direct own brand policy growth of 2.2% and gross written premium broadly flat.

At a headline level we delivered operating profit of £522.1 million, a combined operating ratio of 91.0% and a return on tangible equity of 19.9%, well ahead of our target of at least 15% over the long term. Operating profit of £522.1 million was £24.8 million lower than 2019 (£546.9 million) due to higher major weather costs of £43.0 million (2019: £6.0 million) and reduced prior-year reserve releases, partially offset by improved current-year profitability.

Forging ahead with our strategy

Our values

- **Do the right thing**
- **Aim higher**
- **Take ownership**
- **Say it like it is**
- **Work together**
- **Bring all of yourself to work**

Our vision and purpose

Vision

We want to create a world where insurance is personal, inclusive and a force for good

Purpose

We help people carry on with their lives, giving them peace of mind now and in the future

Performance against strategic objectives

Best at direct

- Superhero branding campaign launched
- New Motor "Mileage MoneyBack" proposition
- Launched Van and Tradesperson products on new Direct Line for Business platform
- Green Flag awarded "Superbrand" status

Win on price comparison websites

- Privilege Motor new business and renewals now live on the new platform
- Increased PCW focus including Churchill Home
- Darwin brand launched on two more PCWs
- Churchill Motor started roll-out to new platform in Q1 2021

Extend our reach

- Agreed a two-year extension with NatWest Group for Home
- Enhanced API capabilities to enable potential Home partners to link and test
- Increased our presence in the on-demand mobility market

Technical edge

- Launched new market-leading Motor counter-fraud system
- Expanded electric vehicle repair capabilities
- Launched a free on-line risk management portal for every NIG policyholder
- Green Flag launched a new cloud-based claims system

Nimble and cost efficient

- New agile operating model embedded across digital, data and pricing
- Increased proportion of service interactions through digital channels
- Launched new property strategy following success of remote working

Great people

- Our people continued to deliver our transformation agenda while working remotely
- Our engagement scores remained high as we focused on the security and wellbeing of our people
- Awarding free shares and ensuring all eligible employees receive a bonus for the year

Sustainability pillars *See page 44 for more information*

- **Customers**
- **People**
- **Society**
- **Planet**
- **Governance**

Overall, the impact of the pandemic led to a modest net benefit to our financial result, with the effects concentrated in four main areas:

- Reduction in motor claims frequency falling to below normal levels from Q2
- Increase in Travel claims, relating to both claims volumes and claims handling costs as well as additional commission payments
- An estimated £6 million in Covid-19 related business interruption claims
- Investments to support our customers, people and society totalling £93 million

Motor claims frequency levels were significantly lower than normal due predominantly to lockdown restrictions leading to claims frequency falling to around half normal levels during Q2. Whilst it increased during the second half of the year, claims frequency did not return to pre-Covid-19 levels during 2020. However, severity costs have increased due to the costs of making accident repair centres Covid-19 safe, longer repair times and consequently higher credit hire costs. We have seen an increase in the volume of claims within our Travel business and so have also incurred additional claims handling costs supporting our customers. In terms of business interruption, our standard wordings were clear from the outset and we were not party to the FCA's test case nor the appeal to the Supreme Court, which has been relevant to many commercial insurers, and our overall Covid-19 related business interruption claims are estimated at £6 million.

Consistent with our "Force for Good" vision, we have invested extensively in our customers in the form of premium refunds, waived fees and reduced premiums, and also in our people by protecting jobs at the most critical points in lockdown, preserving salaries and incentives in return for flexibility and investing in strengthening home working capability. And finally we have invested in society: we have helped local communities with over £7 million of donations helping 100,000s of households and contributing to the ABI Covid-19 Support Fund. In total these initiatives represent an impact of around £93 million, of which £34 million is within our operating expenses and £59 million is within our loss ratio.

"As we transform the business both in terms of the technology we use and our agility, we are changing the way the organisation works."

A further effect was felt in our investment portfolio where we saw investment return fall from £134.6 million in 2019 to £95.1 million in 2020, reflecting the dual impact of lower reinvestment rates and a small number of writedowns in the investment portfolio. When we look at some of the volatility in the market over the period we are pleased with the overall performance of the portfolio.

Prior to the pandemic we had set out to achieve improvements in our current-year loss ratio and therefore to improve the profitability of the business we write. Offsetting this we had expected to see the level of releases from prior year business reduce, reflecting changes in the level of Motor excess of loss reinsurance some years ago. During 2020, prior-year reserve releases reduced to £173.8 million (2019: £294.5 million). Although the improvements in our loss ratio undoubtedly benefited from the impact of the Covid-19 pandemic, we are confident we have made progress in increasing the current-year contribution to operating profit.

Overall we have sought to do the right thing by all our stakeholders throughout 2020, and believe the underlying performance and quality of change delivery in the year indicate we are on track to deliver on our targets.

Strategic update

2020 was always a critical change delivery year on our path to building the insurance company of the future – technology and data led but with the customer at its heart. I have been very pleased by our ability to continue delivering major transformational change, even from our homes. The table opposite outlines some of our key achievements.

Many of the foundation blocks are now in place and we are increasingly moving to extracting benefits from the technology we have implemented rather than focusing purely on technology delivery.

As we transform the business both in terms of the technology we use and our agility, we are changing the way the organisation works. We have found through 2020 that we can create and protect the culture of the Group, even with almost everyone working from home, and our regular people surveys tell us that our people want the personal flexibility that homeworking offers. Our intention, therefore, is to take this opportunity to change the way we use our premises in future so they support collaboration, training and teamwork rather than being an everyday place of work for most people.

We will remain focused around our core hub sites so our people can get together, but believe our approach gives both cost savings and advantages for our people, allowing us to support greater social mobility and assist us in identifying top talent. To this end we are reviewing our office site property strategy and have chosen to buy out our Bromley lease, the run costs of which were above market rate. This will accelerate the costs from the future 17 years of the lease and so we will take a charge to Solvency II own funds in 2021 of £85 million as we effectively de-leverage the business and, in return, make savings in excess of £10 million per annum from 2022, incremental to our original cost target plans. We will then have greater freedom to create the nature of property usage this business needs.

With the potential impact of the FCA Pricing Practices report, discussed in the Market Overview section later, combined with whiplash reform, currently due to be effective from May 2021, a mixed picture is emerging in terms of lockdowns in H1 and uncertainty over the long-term level of driving in our new "normal", and there are clearly many moving parts.

That said, capital generation has been strong and our perception is that the level of risk in the system, with vaccines rolling out and a Brexit deal in place, is beginning to reduce. As a result we are declaring a final dividend of 14.7 pence per share and announcing a share buyback programme, as we reiterate our target of operating around the middle of our risk appetite range of 140% to 180% in normal circumstances. The share buyback will be for 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.

As you move through the Strategic report we will seek not only to guide you through understanding our financial performance and how that positions us for the future but also to bring to life examples of the technology development and the benefit we believe it will bring. I hope it will allow you to feel why we are so excited about the progress we have made and the opportunity ahead.

Looking into 2021 we will be continuing the roll-out of our technology transformation and increasingly turning our attention to utilising these new platforms to deliver benefits for our customers.

Our plans include:

- Continuing the migration of Direct Line and Churchill Motor policies onto our new platform, enabling us to improve customers' online journey and extend our product range even further.
- Continuing the journey towards greater digitalisation, applying advanced analytical techniques to enhance the customer experience.
- Rolling out a new policy and pricing system for Green Flag enabling it to grow beyond traditional breakdown services and look after customers' motoring needs in and out of an emergency.
- Being well placed for customers and at a competitive advantage to other players in a post FCA pricing practices market.

We are also heavily focused on improving efficiency in order to meet our cost targets by:

- Continuing organisational transformation to further digitalise customer journeys, automate business processes and adopt new ways of working, as we aim to step change both customer experience and the efficiency of our cost base.
- Realising the benefits of agile ways of working throughout the organisation with the aim of reducing the cost and increasing the pace of change.

These plans are designed with fantastic customer experience and propositions at their heart. Supporting our activities and central to the long-term sustainability of the business, we have deeply embedded and fundamental principles:

- Our values sit at the very heart of our everyday behaviours.
- Our sustainability pillars bring environmental, social and governance ("**ESG**") factors into the heart of our strategic thinking, whether that's our customers, our people, our society, our planet, or the importance of strong governance – they all play central roles in helping deliver our business in a sustainable way.

'Bring all of yourself to work' is a value lived vibrantly across the Group but after extensive discussions with our people, we launched a new diversity and inclusion strategy and set ourselves stretching targets around ethnicity and gender in our leadership so that we are truly inclusive and reflect the customers we serve.

2020 - a year like no other

Supporting our customers

450k+
Over 450,000 customers supported through payment deferrals, waiving cancellation fees and mileage refunds

26k+
More than 26,000 customer travel claims settled and over 900 customers repatriated

Free
Free Rescue cover, fast-track claims and free home emergencies cover for NHS staff

Supporting our people

9,000
Moved 9,000 people to home working and supported our motor accident repair centres to open safely and keep Britain moving

Protected
Protected roles and salaries during initial lockdown, without government support, and offered maximum flexibility to help our people manage home and work

Free shares
£3.8 million distributed as a thank you to our people

Supporting our communities

£3.5m
Established our first Community Fund which distributed £3.5 million to 250 charities, helping over 200,000 people

£1.5m
Extended our Community Fund into 2021 with £1.5 million to support charities dealing with the impact of the Covid-19 pandemic

£3.6m
Contributed £3.6 million to the Association of British Insurers Covid-19 Support Fund

Supporting a greener future

Reduce
Committed to setting Science-Based Targets[1] for Scope[1] 1, 2 and 3 to help the Group reduce its carbon footprint

Carbon neutral
Became a 100% carbon-neutral business by investing in high social impact projects to offset our Scope[1] 1, 2 and 3[2] emissions

Report
Published our first Task Force on Climate-related Financial Disclosures ("TCFD") Report[3]

Notes:

1. See glossary on pages 224 to 226 for definitions.
2. Scope 3 emissions which are under our direct control.
3. For more information please see our published 2020 TCFD Report on the Group's website at www.directlinegroup.co.uk/2020_TCFD.

Market overview

Consumer trends

In 2020 we saw a number of trends emerging through the year. Ultimately these tell us that our strategy is the right one. Those trends are:

- Consumers' willingness to interact digitally has been transformed. Digitalisation is at the heart of our technology transformation so this trend is entirely aligned with our plans.
- Agility is a must. We need to be quicker at implementing changes to fulfil changing customer needs.
- The working model has changed. Knowing our people can deliver from home has provided an opportunity to change how we use our offices in a way that supports what our people tell us they want and offers opportunities to recruit people irrespective of geography.
- Car technology continues to evolve rapidly. Having the largest owned repair network of any UK insurer gives us the opportunity to develop further commercial insights.
- Cross collaboration is a must. We can achieve more by working together; co-operation across industries is essential to tackling climate change and ensuring greater diversity.

Financial Conduct Authority Pricing Practices

In September 2020 the FCA released its General Insurance Pricing Practices Final Report, which remains a key focus for us. It included the FCA's proposed remedy package aiming to ensure retail home and motor insurance products offer fair value to customers. The FCA recognised that insurers do not make excessive profits and their key proposal was that firms should offer renewal prices no higher than the equivalent new business price through the same sales channel. The consultation period ended on 25 January 2021 and we look forward to understanding the final details some time in Q2 2021.

This is an area where we have already been proactive for several years by implementing a range of measures to reduce the differential in pricing between our new business and renewal customers. We are supportive of the aims of the FCA and believe that, in a world where prices become less of a differentiator, our strong brands, diversified business model and the capabilities we are building will enable us to win in the future market. On the way there is uncertainty around the detailed application of the rules, the timelines for implementation and the nature of short-term volatility as the market rebalances. We have prepared for a range of outcomes and we continue to work with the FCA to assist it in navigating some of the issues and are seeking to help shape the right outcome for our customers and shareholders.

"We recognise that our actions as a business can contribute to climate risk mitigation and help accelerate the transition to a low carbon and sustainable future."

Climate

The impact of climate change has far reaching implications for economies around the world. Our Planet pillar, which aims to protect our business from the impact of climate change and give back to the planet more than we take out, drives our approach. We recognise that our actions as a business can contribute to climate risk mitigation and help accelerate the transition to a low carbon and sustainable future. We take this seriously and have continued to challenge ourselves to reduce emissions and energy consumption through greater transparency.

We have previously published our Scope 1 and 2 emissions[1], but this year we wanted to go further. For the first time we broke down our emissions across our offices and our accident repair centres to help us to focus our plans on where we can have the most impact. Alongside this we evaluated our Scope 3 emissions[1] starting with those under our direct control and purchased goods and services which make a substantial contribution to our overall emissions. Our first comprehensive TCFD report (see page 62) provides us with a roadmap to strengthen our strategic response in tackling climate change and we see the Bank of England's Climate Biennial Exploratory Scenario ("**CBES**"), in which the Group has been invited to participate, as a way to help enhance our climate change scenario analysis capability.

The Group's focus in 2021 is to evaluate the Scope 3 emissions[1] arising out of our investment portfolio and we will begin to scope out Science-Based Targets, which are a set of goals to provide a clear route to reduce emissions, to submit to the Science Based Target Initiative ("**SBTi**") for approval. Finally, we know that we are on a journey and cannot reduce our emissions overnight, therefore we became carbon neutral through offsetting, as we work to reduce our emissions over time.

Note:

1. See glossary on pages 224 to 226 for definitions.

UK economy and Brexit

Following the recession in 2020, economic uncertainty is expected to remain high throughout H1 2021 as a result of the Covid-19 pandemic, although the UK Government has acted to support UK businesses and employees and prevent lasting damage to the economy. However, the uncertainty surrounding the pandemic makes the overall impact and recovery progress unclear.

The disruption to global trade and supply chains caused by the pandemic could increase the risk of inflation in the long term. The Group's investment portfolio is positioned defensively and additional steps could be taken, such as further shifting the portfolio towards 'defensive' sectors or increasing more allocation to cash. The portfolio also contains a proportion of short-maturity bonds which could be sold relatively quickly if necessary.

As a UK-based business with UK customers, we identified that the biggest potential financial exposure for the Group, from a disruptive or disorderly Brexit, would be to market volatility. We continue to work through the operational effects of Brexit for customers and supply chains but the potential effects have been helped by a trade deal which has avoided otherwise expected tariffs on EU goods needed to serve our customers.

"Given the progress we are making on our transformation, we enter 2021 with real momentum and are confident in delivering our vision of being a technology and data led insurance company of the future with our customers at its heart."

Outlook

The capability delivered as the Group looks to transition from technology transformation into business transformation underpins the improvement in the current-year profitability and provides a platform for growth, underwriting improvements and cost efficiency. Through increased digitalisation and self-serve, enabled by new ways of working, we aim to deliver significant customer and efficiency improvements and underpin our target of an operating expense ratio of 20% by 2023. The new ways of working during 2020 have enabled us to think more ambitiously about how we use our office space and we have therefore launched a property strategy which aims to help deliver incremental savings to this target. In addition, greater pricing sophistication and counter-fraud initiatives aim to continue the improvement in the current-year loss ratio. The Group remains on track to maintain the contribution from current-year operating profit at more than half of the Group's total operating profit and we reiterate our ongoing target of achieving at least a 15% return on tangible equity per annum.

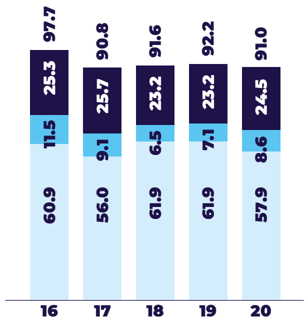
The Group targets a combined operating ratio of 93-95% for 2021 and over the medium term, normalised for weather, although we acknowledge there will be increased uncertainty for a period as we progress through the implementation of the FCA pricing practices proposals and as the market reacts to the ongoing Covid-19 pandemic.

2020 has been a testing year for everyone and I am proud of how we have responded as a Group, demonstrating throughout the resilience of our business model. We had strong momentum coming into the Covid-19 crisis and have delivered a good financial result whilst simultaneously navigating the Covid-19 pandemic, supporting our various stakeholders and staying true to our vision and purpose throughout. Given the progress we are making on our transformation, we enter 2021 with real momentum and are confident in delivering our vision of being a technology and data led insurance company of the future with our customers at its heart.

Penny James
Chief Executive Officer

Our key performance indicators

Combined operating ratio[1] (%)



Definition

A measure of financial year underwriting profitability. A COR of less than 100% indicates profitable underwriting. The COR is the sum of claims, expense and commission ratios and compares the cost of doing business against net earned premium generated.

Aim

We aim to make an underwriting profit. The target in the medium term is a COR in the range of 93% to 95% normalised for weather.

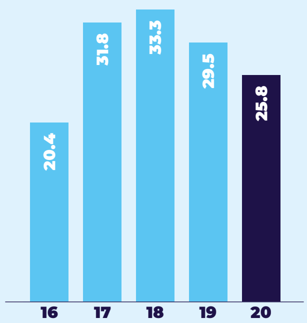
For additional performance information see page 24

Remuneration

We base part of the Annual Incentive Plan ("**AIP**") awards on profit before tax. The COR is closely linked to this.

For additional information see pages 117 and 123

Basic earnings per share[1] (pence)



This is calculated by dividing the earnings attributable to shareholders less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares in issue.

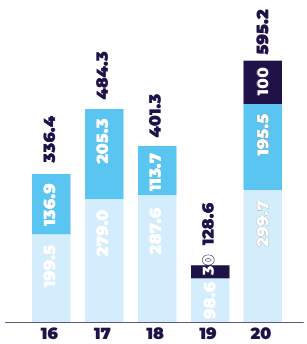
We have not set a target. However, growing earnings per share is considered an indicator of a healthy business.

For additional performance information see page 27

This is a broad measure of earnings and reflects the results of the Group after tax less Tier 1 coupon payments. We base part of the AIP awards on profit before tax.

For additional information see page 117 and 123

Capital returns[2] (£m)



The amount of cash paid in dividends to shareholders and amount of share buybacks funded from the Group's retained profits. (See page 192 for dividend breakdown).

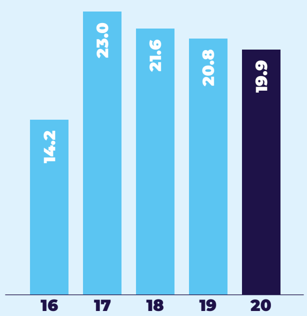
We aim to grow the regular dividend in line with business growth. Additionally, we look to return any capital to shareholders which is expected to be surplus to our requirements for a prolonged period.

For additional performance information see page 28

We base Long-Term Incentive Plan ("**LTIP**") awards partly on relative total shareholder return performance, which includes dividends. Directors also receive dividends on their beneficial shareholdings and accrue these on unvested LTIP awards.

For additional information see pages 117 and 127

Return on tangible equity[1] (%)



The return generated on the capital that shareholders have in the business. This is calculated by dividing adjusted earnings by average tangible equity.

We aim to achieve at least a 15% RoTE per annum over the long term.

For additional performance information see page 27

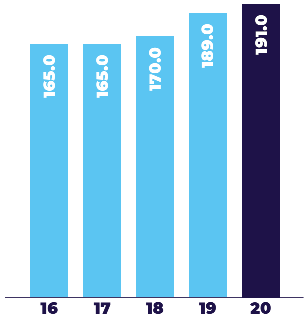
We base the LTIP awards partly on adjusted RoTE over a three-year performance period.

For additional information see page 117 and 127

Notes:

1. See glossary on pages 224 to 226 and Appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
2. The 2019 dividends and capital returns have been adjusted to remove the cancelled 14.4p final dividend and £120 million of the share buyback as announced in March/April 2020. (The reported number were dividends and capital returns of £447.0 million).
3. The 2019 solvency capital ratio has been adjusted to remove the cancelled 14.4p final dividend and £120 million of the share buyback as announced in March/April 2020. (The reported number was a solvency capital ratio of 165%.)

Solvency capital ratio[3,4] (%)



Definition

A risk-based measure expressing the level of capital resources held as a percentage of the level of capital that is required under Solvency II.

Aim

Under normal circumstances, the Group aims to maintain a solvency capital ratio around the middle of the risk appetite range of 140% to 180%.

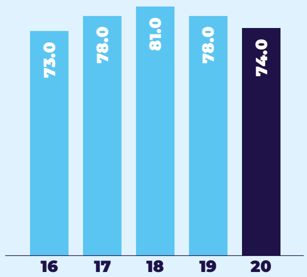
For additional performance information see page 28

Remuneration

Solvency capital ratio within our risk appetite is an indicator of capital strength, which is one of the gateways for the AIP awards and an underpin for LTIP awards.

For additional information see page 117

Employee engagement (%)



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

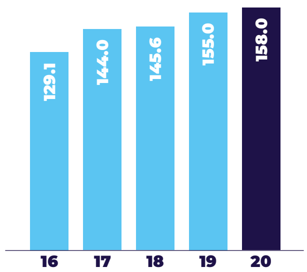
To make the Group best for employees and best for our customers. We gauge employee engagement through our employee opinion survey and we aim for high employee engagement scores each year.

For additional People information see page 50

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

For additional information see page 117 and 125

Net promoter score[5,6] (points)



Net promoter score ("**NPS**") is an index that measures the willingness of customers to recommend products or services to others. It is used to gauge customers' overall experience with a product or service, and customers' loyalty to a brand.

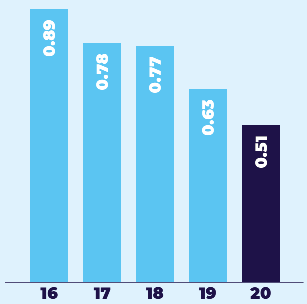
We aim to increase our net promoter score over time.

For additional performance information see page 48

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

For additional information see page 117 and 124

Customer complaints[6,7] (%)



The number of complaints we received during the year as a proportion of the average number of in-force policies.

This measure indicates where our customer service has not met expectations to the extent that the customer has initiated a complaint. We aim to improve this over time.

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

For additional information see page 117 and 124

4. Estimates based on the Group's Solvency II partial internal model.
5. On an aggregated 12-month rolling basis, with 2013 rebased to 100.
6. For the Group's principal underwriter, U K Insurance Limited.
7. FCA complaints reporting requirements have changed for periods after 29 June 2016. Before 29 June 2016, only complaints resolved after two business days were classed as FCA reportable. From July 2016 all complaints resolved are classed as FCA reportable.

Strong capital position, good results

Neil Manser
Acting Chief Financial Officer

We made good progress against our targets to improve the sustainability of our earnings in a challenging environment and maintained our balance sheet strength.

Financial highlights

Direct own brands in-force policies grew by 2.2% driven by strong segments of growth across the business including Home, Commercial and Green Flag Rescue, whilst Motor was broadly stable. Total in-force policies reduced due to lower partnerships and Travel volumes.

Direct own brands gross written premium was stable with growth across Home and Commercial direct own brands and Green Flag Rescue offset by lower average premiums in Motor. Overall gross written premium reduced by 0.7% due to falling partnership and Travel premium.

Increased major weather costs of £43.0 million (2019: £6.0 million) contributed to lower operating profit of £522.1 million, £24.8 million (4.5%) lower than 2019 (£546.9 million). Covid-19 restrictions reduced claims frequency in Motor and Commercial, although this was partially offset by investment in initiatives to protect our customers, people and society, lower investment asset returns and the impact of the Covid-19 pandemic on Travel. Overall, the impact of the pandemic was a modest net benefit to the result.

Combined operating ratio improved to 91.0% (2019: 92.2%). Normalised combined operating ratio[1], of 91.7%, was ahead of target of 93% to 95% predominantly due to the lower claims frequency in Motor.

Progress on the Group's transformation continued to drive improved current-year profitability via increased pricing and underwriting sophistication in Commercial and improved counter-fraud capability in Motor.

Profit before tax of £451.4 million was £58.3 million lower than 2019, following the reduction in operating profit alongside £39.4 million of restructuring and one-off costs as the Group invested in cost-saving initiatives.

Proposed final ordinary dividend of 14.7 pence per share, increased 2.1%[2] and announcing a share buyback programme of up to £100 million. Intention to move back towards the middle of the Group's capital risk appetite range assuming more normal circumstances.

Notes:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
2. The 2019 final dividend of 14.4 pence was subsequently cancelled and paid as a special interim dividend in 2020.

Financial highlights continued

	FY 2020 £m	FY 2019 £m
In-force policies (thousands)	14,615	14,789
Of which: direct own brands (thousands)	7,454	7,290
Gross written premium	3,180.4	3,203.1
Of which: direct own brands	2,225.6	2,227.8
Net earned premium	2,960.5	2,984.9
Underwriting profit	267.8	232.1
Instalment and other operating income	159.2	180.2
Investment return	95.1	134.6
Operating profit	522.1	546.9
Restructuring and other one-off costs	(39.4)	(11.2)
Finance costs	(31.3)	(26.0)
Profit before tax	451.4	509.7
Tax	(84.2)	(89.8)
Profit after tax	367.2	419.9
Key metrics		
Current-year attritional loss ratio[1,2]	62.3%	71.6%
Loss ratio[1,2]	57.9%	61.9%
Commission ratio[1,2]	8.6%	7.1%
Expense ratio[1,2]	24.5%	23.2%
Combined operating ratio[1,2]	91.0%	92.2%
Investment income yield[2]	2.1%	2.4%
Net investment income yield[2]	1.8%	2.1%
Investment return yield[2]	1.6%	2.2%
Basic earnings per share (pence)	25.8	29.5
Diluted earnings per share (pence)	25.5	29.2
Return on tangible equity[2]	19.9%	20.8%
Return on equity	13.1%	15.5%
Dividend per share – interim (pence)	7.4	7.2
– final (pence)	14.7	14.4
– total ordinary (pence)	22.1	21.6
– special (pence)	14.4	–
Share buyback actioned (10.4 million shares)	30.0	–
Share buyback proposed[3]	100.0	150.0

	31 Dec 2020	31 Dec 2019
Net asset value per share (pence)	199.7	193.4
Tangible net asset value per share (pence)	141.5	142.0
Solvency capital ratio post dividends[3,4]	191%	165%

Notes:

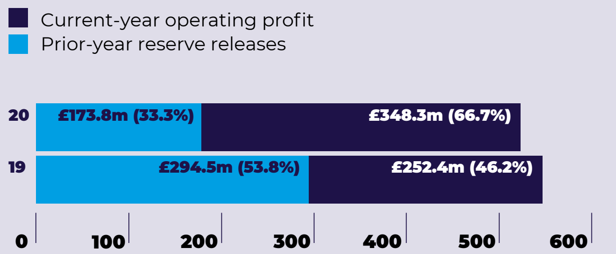
1. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration.
2. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.
3. The solvency capital ratio as reported at 31 December 2019 is after taking into account the then expected 14.4p final dividend and the £150 million share buyback announced on 3 March 2020. The impacts of the cancellation of the dividend (as announced on 8 April 2020) and of the share buyback programme (as announced on 19 March 2020 after £30 million of the buyback had been executed) would have added 24 percentage points to the ratio as reported to give an adjusted solvency capital ratio of 189%.
4. Estimates based on the Group's Solvency II partial internal model.

Performance

Operating profit[1]

	FY 2020 £m	FY 2019 £m
Underwriting profit	267.8	232.1
Instalment and other operating income	159.2	180.2
Investment return	95.1	134.6
Operating profit	522.1	546.9

Operating profit (£m)



Note:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.

The Group again delivered an operating profit in 2020 above £500 million and saw underlying progress towards achieving more than 50% of the profit arising from the current year. The results have been affected by the usual variability around weather events but the addition of the factors surrounding Covid-19 make them more difficult to navigate than in previous years.

First, the Group experienced major weather event claims of £43.0 million in 2020, below our expectations of £64 million but higher than the very benign weather experienced in 2019 (£6.0 million).

Second, the impact of the Covid-19 pandemic can be seen across all the main lines within the income statement, with the largest impact from reduced claims frequency in Motor. Whilst it is difficult to be exact about the impact of Covid-19 on the results, as the length of the pandemic has made initially 'one-off' impacts now more business as usual in their nature, (for example motor market pricing), this review will indicate the broad direction of these impacts.

Overall the Group incurred £93 million in supporting customers, our people and society as part of our "Force for Good" initiatives. This support included customer refunds, job protection, charity donations and supplier support measures. Over this period the Group has not taken any Government support. The cost of these initiatives are all recognised in the underwriting result.

Furthermore, within the underwriting result there are four additional factors: a net reduction in motor claims from significantly reduced driving, partly offset by higher claims severity; a reduction in motor premiums as a result of fewer new drivers and market-wide premium deflation; additional travel claims and claims handling costs; and business interruption claims in Commercial. These factors together had a net positive impact on the underwriting result.

Outside of the impact from Covid-19, prior-year releases reduced to £173.8 million during 2020 (2019: £294.5 million), reflecting changes in the level of Motor excess of loss reinsurance some years ago and were materially offset by improvements in the underlying current-year loss ratio across Motor and Commercial.

Overall this delivered an increase in underwriting profit to £267.8 million (2019: £232.1 million).

Lower motor premium and claims volumes, primarily arising from the Covid-19 pandemic, led to a reduction in instalment and other operating income to £159.2 million (2019: £180.2 million).

Investment return decreased to £95.1 million (2019: £134.6 million), reflecting the dual impact of lower reinvestment rates and lower valuations on property in the investment portfolio.

Taking all of this together, operating profit decreased by £24.8 million to £522.1 million (2019: £546.9 million) and current-year operating profit, as a proportion of total operating profit, improved to 66.7% (65.4% on a normalised basis). Whilst current-year profitability has benefited from the impact of Covid-19 related factors in 2020, the Group remains on track for its target of achieving more than half of the Group's annual operating profit from current-year earnings by the end of 2021.

In-force policies and gross written premium

In-force policies (thousands)

At	31 Dec 2020	31 Dec 2019
Direct own brands	3,943	3,921
Partnerships	118	122
Motor	4,061	4,043
Direct own brands	1,837	1,765
Partnerships	801	829
Home	2,638	2,594
Rescue	3,400	3,450
Travel	3,499	3,648
Pet	145	157
Other personal lines	61	122
Rescue and other personal lines	7,105	7,377
Of which: Green Flag direct	1,114	1,063
Direct own brands	560	541
NIG and other	251	234
Commercial	811	775
Total in-force policies	14,615	14,789
Of which: direct own brands	7,454	7,290

Own brand policies increased to 7.5 million (2019: 7.3 million) driven by growth in Home, Commercial and Green Flag Rescue, whilst Motor was broadly stable. Total in-force policies reduced slightly to 14.6 million (2019: 14.8 million) primarily due to reductions in Home partnerships, as Prudential and Sainsbury's partnerships are closed to new business, and the impact of Covid-19 on Travel sales.

Gross written premium

	FY 2020 £m	FY 2019 £m
Direct own brands	1,567.6	1,591.7
Partnerships	49.3	59.9
Motor	1,616.9	1,651.6
Direct own brands	411.6	407.7
Partnerships	166.3	178.9
Home	577.9	586.6
Rescue	166.7	167.5
Travel	134.0	151.3
Pet	72.8	72.6
Other personal lines	44.3	44.6
Rescue and other personal lines	417.8	436.0
Of which: Green Flag direct	83.1	79.0
Direct own brands	163.3	149.4
NIG and other	404.5	379.5
Commercial	567.8	528.9
Total gross written premium	3,180.4	3,203.1
Of which: direct own brands	2,225.6	2,227.8

Gross written premium of £3,180.4 million (2019: £3,203.1 million) reduced by 0.7% with strong premium growth in Commercial offset by lower Motor and Home partnership premiums and the impact of Covid-19 disruption in Travel. Direct own brands gross written premium was broadly stable at £2,225.6 million (2019: £2,227.8 million). Growth across Commercial, Green Flag Rescue and Home own brands was offset by Motor.

Underwriting profit and combined operating ratio[1]

	FY 2020	FY 2019
Underwriting profit (£ million)	267.8	232.1
Loss ratio	57.9%	61.9%
Commission ratio	8.6 %	7.1%
Expense ratio	24.5%	23.2%
Combined operating ratio	91.0%	92.2%

Note:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation.

Overall underwriting profit increased to £267.8 million (2019: £232.1 million) with an improvement in the combined operating ratio to 91.0% (2019: 92.2%). The loss ratio improved significantly to 57.9% (2019: 61.9%) as higher major weather-related claims and lower prior-year reserve releases were more than offset by the net positive effect of Covid-19 related factors. These included reduced claims frequency in Motor, only partially offset by premium deflation in Motor, higher claims handling costs in Travel and a cautious estimate of Travel claims. The improvement in the loss ratio was partially offset by a higher commission ratio and higher expense ratio. The commission ratio increased primarily as a result of increased profit share payments, particularly on packaged bank accounts, and volume related commission payments to PCWs, while the expense ratio increased due to investment in initiatives to protect our customers, people and society. Excluding costs related to the protection of our customers and people against the Covid-19 pandemic, the Group made progress in reducing its underlying expense base.

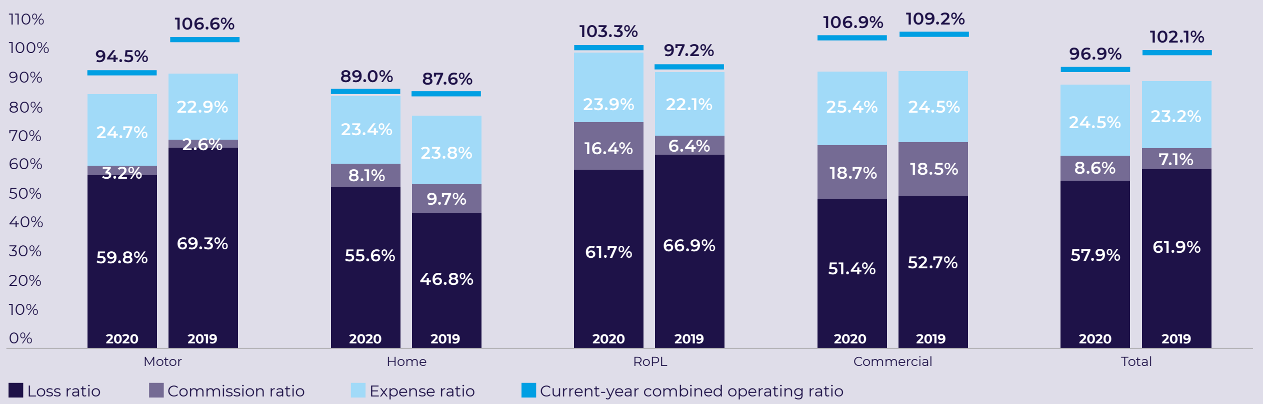
Ratio analysis by division

	Notes	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
For the year ended 31 December 2020						
Net earned premium	4	1,484.8	555.8	422.9	497.0	2,960.5
Net insurance claims	4	888.1	309.1	261.1	255.3	1,713.6
Prior-year reserve releases	34	100.6	10.8	5.6	56.8	173.8
Major weather events		n/a	(27.0)	n/a	(16.0)	(43.0)
Attritional net insurance claims		988.7	292.9	266.7	296.1	1,844.4
Loss ratio – current-year attritional		66.6%	52.7%	63.0%	59.6%	62.3%
Loss ratio – prior-year reserve releases		(6.8%)	(1.9%)	(1.3%)	(11.4%)	(5.9%)
Loss ratio – major weather events[1]		n/a	4.8%	n/a	3.2%	1.5%
Loss ratio – reported	4	59.8%	55.6%	61.7%	51.4%	57.9%
Commission ratio	4	3.2%	8.1%	16.4%	18.7%	8.6%
Expense ratio	4	24.7%	23.4%	23.9%	25.4%	24.5%
Combined operating ratio	4	87.7%	87.1%	102.0%	95.5%	91.0%
Current-year combined operating ratio		94.5%	89.0%	103.3%	106.9%	96.9%
For the year ended 31 December 2019						
Net earned premium	4	1,507.7	573.6	425.2	478.4	2,984.9
Net insurance claims	4	1,043.3	268.4	284.4	251.5	1,847.6
Prior-year reserve releases	34	180.5	41.4	7.6	65.0	294.5
Major weather events		n/a	(3.0)	n/a	(3.0)	(6.0)
Attritional net insurance claims		1,223.8	306.8	292.0	313.5	2,136.1
Loss ratio – current-year attritional		81.2%	53.5%	68.7%	65.6%	71.6%
Loss ratio – prior-year reserve releases		(11.9%)	(7.2%)	(1.8%)	(13.6%)	(9.9%)
Loss ratio – major weather events[1]		n/a	0.5%	n/a	0.7%	0.2%
Loss ratio – reported	4	69.3%	46.8%	66.9%	52.7%	61.9%
Commission ratio	4	2.6%	9.7%	6.4%	18.5%	7.1%
Expense ratio	4	22.9%	23.8%	22.1%	24.5%	23.2%
Combined operating ratio	4	94.8%	80.3%	95.4%	95.7%	92.2%
Current-year combined operating ratio		106.6%	87.6%	97.2%	109.2%	102.1%

Note:

1. Home and Commercial claims for major weather events, including inland and coastal flooding and storms.

Ratio analysis by division



The current-year attritional loss ratio excludes prior-year reserve releases and claims costs from major weather events, although in 2020 it was impacted by Covid-19 disruption. The Group's current-year attritional loss ratio of 62.3% improved by 9.3 percentage points compared to 2019, due to reduced Motor claims frequency alongside improved underlying current-year performance across all lines. Home and Commercial experienced increased major weather costs, up £24.0 million and £13.0 million respectively compared to 2019.

Prior-year reserve releases reduced in 2020 to £173.8 million (2019: £294.5 million), equivalent to 5.9% of net earned premium (2019: 9.9%) and were concentrated towards more recent accident years. In 2019 prior-year reserve releases included a £16.9 million reserve strengthening in relation to the change in the Ogden discount rate to minus 0.25%. Assuming current claims trends continue, prior-year reserve releases are expected to remain a significant contribution to profits. The sensitivity analysis on page 32 includes information on the effect of claims inflation.

The Group's current-year combined operating ratio improved by 5.2 percentage points to 96.9% (2019: 102.1%) as a 9.3 percentage point improvement to the current-year attritional loss ratio was partly offset by a 1.3 percentage point increase in claims due to major weather events, a 1.5 percentage point increase in the commission ratio and a 1.3 percentage point increase in the expense ratio.

Operating expenses before restructuring and one-off costs

	Note	FY 2020 £m	FY 2019 £m
Staff costs[1]		255.6	261.5
IT and other operating expenses[1,2]		196.0	158.0
Marketing	10	106.6	113.9
Insurance levies	10	80.4	81.5
Depreciation and amortisation[3,4]	10	85.8	78.8
Total operating expenses before restructuring and one-off costs		724.4	693.7

Notes:

1. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
2. IT and other operating expenses include professional fees and property costs.
3. Depreciation and amortisation includes 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.
4. Includes depreciation on right-of-use assets of £14.8 million (2019: £14.2 million).

Operating expenses before restructuring and one-off costs increased by £30.7 million to £724.4 million (2019: £693.7 million). This resulted in an increase in the expense ratio of 1.3 percentage points to 24.5% (2019: 23.2%). The increase in costs was entirely due to investment in initiatives for our customers, people, suppliers and the wider society in the context of the Covid-19 pandemic. In total these initiatives are estimated to have increased operating expenses by £34 million and in some cases had the effect of delaying cost saving programmes which were planned for 2020. Adjusting for these initiatives, operating expenses were broadly flat year on year and we reiterate our 20% expense ratio ambition for 2023.

Instalment and other operating income

	Note	FY 2020 £m	FY 2019 £m
Instalment income		109.3	114.0
Other operating income:			
Revenue from vehicle recovery and repair services	7	24.0	28.3
Vehicle replacement referral income	7	12.2	19.1
Legal services income	7	8.8	11.3
Other income[1]	7	4.9	7.5
Other operating income		49.9	66.2
Total instalment and other operating income		159.2	180.2

Note:

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

Instalment and other operating income, which is primarily driven by premium and claims volumes, decreased by £21.0 million to £159.2 million. Instalment income fell primarily due to lower motor premium, whereas lower other operating income reduced due to Covid-19 related lower motor claims frequency.

Investment return

	Note	FY 2020 £m	FY 2019 £m
Investment income		127.1	146.4
Hedging to a sterling floating rate basis		(20.3)	(22.1)
Net investment income		106.8	124.3
Net realised and unrealised (losses)/gains excluding hedging		(11.7)	10.3
Total investment return	6	95.1	134.6

Investment yields

	FY 2020	FY 2019
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%

Note:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.

Total investment return decreased by £39.5 million to £95.1 million (2019: £134.6 million) with a reduction in investment income and write downs on investment property. Lower reinvestment rates, following interest rate cuts made by both the US Federal Reserve and the Bank of England during Q1 2020, led to a lower net investment income yield of 1.8% (2019: 2.1%).

Realised and unrealised losses excluding hedging were predominantly driven by lower investment property valuations and a reduction in gains from bond disposals. Overall the investment portfolio performed well in the context of challenging market conditions.

In 2021, the Group expects a net investment income yield of around 1.5% with minimal gains.

The Group's investment strategy aims to deliver several objectives, which are summarised below:

- to ensure there is sufficient liquidity available within the investment portfolio to meet stressed liquidity scenarios;
- to match periodic payment orders ("**PPOs**") and non-PPO liabilities in an optimal manner; and
- to deliver a suitable risk-adjusted investment return commensurate with the Group's risk appetite.

Reconciliation of operating profit

	Note	FY 2020 £m	FY 2019 £m
Motor	4	363.5	302.6
Home	4	101.4	150.6
Rescue and other personal lines	4	6.8	39.1
Commercial	4	50.4	54.6
Operating profit	4	522.1	546.9
Restructuring and one-off costs		(39.4)	(11.2)
Finance costs	11	(31.3)	(26.0)
Profit before tax	4	451.4	509.7
Tax	12	(84.2)	(89.8)
Profit for the year attributable to the owners of the Company		367.2	419.9

Operating profit by segment

All divisions contributed to profit in 2020, demonstrating the diversity of the Group's multi-product, multi-brand and multi-channel portfolio. Motor operating profit increased significantly primarily due to the reduction in claims frequency whereas Home operating profit reduced primarily due to higher weather-related costs and lower prior-year reserve releases. Commercial continued to generate strong profit despite higher weather claims while improved Rescue operating profit of £51.2 million (2019: £45.2 million) offset a weak result in other personal lines, mainly from Travel.

Restructuring and one-off costs

In order to support its cost reduction targets, the Group announced approximately £60 million of restructuring and one-off costs across 2019 and 2020 at its Capital Markets Day in November 2019. The Group incurred £39.4 million of restructuring and one-off costs in 2020 bringing the total cost to date to £50.6 million. As part of the Group's response to the Covid-19 pandemic to support its people it paused some elements of its restructuring programme. The Group expects the remaining £9 million in relation to this cost reduction programme to be incurred during 2021.

In addition, the Group is reviewing its office site property strategy and has bought out the lease of its Bromley office thus accelerating payment of an existing long-term liability. This transaction will incur restructuring costs of £85 million in 2021.

Finance costs
Finance costs increased to £31.3 million (2019: £26.0 million) primarily due to interest on the £260 million Tier 2 subordinated debt issued in June 2020.

Effective corporation tax rate
The effective tax rate for 2020 was 18.7% (2019: 17.6%), which was slightly lower than the standard UK corporation tax rate of 19.0% (2019: 19.0%) driven primarily by tax relief for the Tier 1 coupon payments partly offset by disallowable expenses. The effective rate is higher than 2019, which benefited from the release of an overprovision from a prior year.

On 3 March 2021 the Chancellor 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.

Profit for the year and return on tangible equity[1]
Profit for the year was lower at £367.2 million (2019: £419.9 million) in line with the reduction in operating profit as well as increased restructuring and one-off costs and finance costs.

Return on tangible equity decreased to 19.9% (2019: 20.8%) due primarily to a £24.4 million decrease in adjusted[1] profit after tax to £384.1 million (2019: £408.5 million). Profit after tax was adjusted for restructuring and one-off costs and coupon payments in respect of Tier 1 notes.

Note:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.

Earnings per share
Basic earnings per share decreased by 12.5% to 25.8 pence (2019: 29.5 pence). Diluted earnings per share decreased by 12.7% to 25.5 pence (2019: 29.2 pence) mainly reflecting the reduction in profit after tax.

Cash flow
The Group's cash and cash equivalents increased by £271.9 million during the year (2019: £196.1 million decrease) to £1,168.2 million.

The Group generated operating cash flows before movements in working capital of £398.6 million (2019: £370.3 million), an increase of £28.3 million due to the increase in profit for the year adjusted for non-cash movements. After taking into account movements in working capital, the Group generated £402.6 million (2019: £182.4 million), an increase of £220.2 million. The Group has considerable assets under management; the cash generated from these reduced by £58.0 million to £315.9 million following reductions in the Group's assets under management, as a result of dividend payments. Net cash generated from operating activities was £584.7 million (2019: £462.1 million).

Net cash used in investing activities of £161.0 million reflected the Group's continuing investment in its major IT programmes (2020: £140.7 million, 2019: £175.7 million).

Net cash used in financing activities of £151.8 million comprised £312.5 million (2019: £420.7 million) in dividends and Tier 1 capital coupon payments in the year, partly offset by net proceeds of £257.2 million on the Tier 2 subordinated debt issued in June. Dividends paid in the year comprised the 7.4 pence first interim dividend and 14.4 pence special dividend announced in the half-year results in 2020.

Net cash used in financing and investing activities partly offset the £584.7 million generated from operating activities and resulted in a net increase in cash and cash equivalents of £271.9 million (2019: £196.1 million decrease) to £1,168.2 million (2019: £896.3 million).

The levels of cash and other highly liquid sources of funding that the Group holds to cover its claims obligations is continually monitored to ensure that the levels remain within the Group's risk appetite.

Net asset value

At 31 December	Note	**2020 £m**	2019 £m
Net assets[1]	16	2,699.7	2,643.6
Goodwill and other intangible assets	16	(786.8)	(702.5)
Tangible net assets	16	1,912.9	1,941.1
Closing number of Ordinary Shares (millions)	16	1,351.8	1,366.6
Net asset value per share (pence)	16	199.7	193.4
Tangible net asset value per share (pence)	16	141.5	142.0

Note:

1. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation to financial statement line items.

Net assets at 31 December 2020 increased to £2,699.7 million (31 December 2019: £2,643.6 million) and tangible net assets decreased to £1,912.9 million (31 December 2019: £1,941.1 million) reflecting the 2020 retained profit and increases in available-for-sale reserves. This was offset by additional expenditure on intangible assets as the Group continued to invest in the business.

Balance sheet management

Capital management and dividend policy

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

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

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

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

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

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

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

Capital analysis

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

Capital position

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

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

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

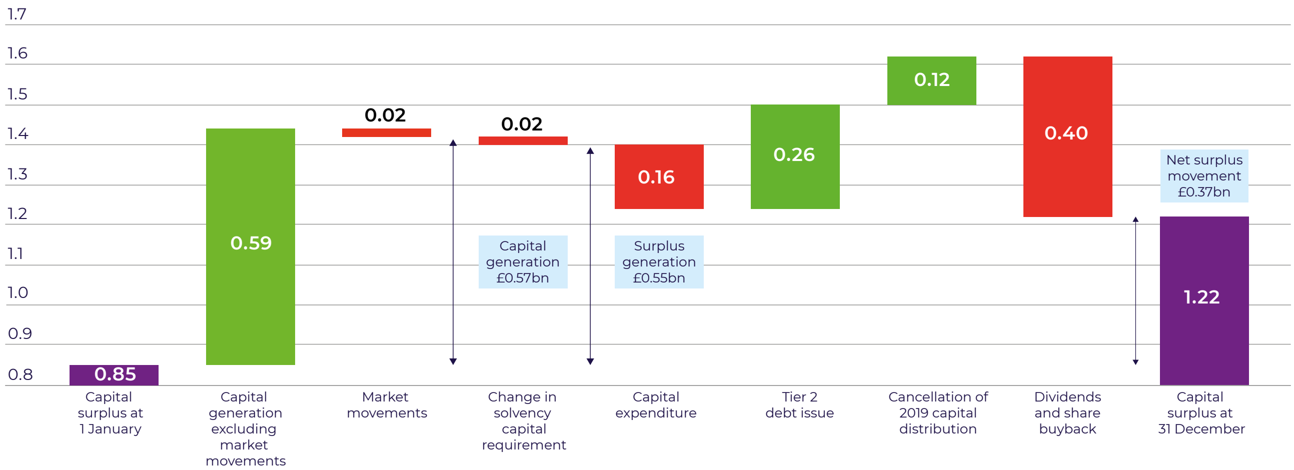
Movement in capital surplus

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

Notes:

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

Movement in capital surplus (£bn)



In 2020, the Group generated £0.57 billion of Solvency II capital and added £0.26 billion via a Tier 2 debt issue, whilst cancelled distributions added £0.12 billion to own funds. This was offset by £0.16 billion of capital expenditure and distributions of £0.40 billion. Capital expenditure reflects the significant investment the Group is making in building future capability, including the development of the next generation core personal lines IT systems. In 2021 annual capital expenditure levels are expected to reduce to around £120 million. In addition, £85 million of restructuring costs in relation to the purchase of the Bromley office lease will decrease capital generation in 2021.

Change in solvency capital requirement

	2020 £bn
Solvency capital requirement at 1 January	1.32
Model and parameter changes	–
Exposure changes	0.02
Solvency capital requirement at 31 December	1.34

The Group's SCR has increased by £0.02 billion in the year due to exposure changes. Model and parameter changes were largely offsetting.

Scenario and sensitivity analysis

The following table shows the impact on the Group's estimated solvency capital ratio in the event of the following scenarios as at 31 December 2020. The impact on the Group's solvency capital ratio arises from movements in both the Group's solvency capital requirement and own funds.

	Impact on solvency capital ratio	
Scenario	**31 Dec 2020**	31 Dec 2019
Deterioration of small bodily injury motor claims equivalent to that experienced in 2008/09	(6pts)	(7pts)
One-off catastrophe loss equivalent to the 1990 storm "Daria"	(8pts)	(9pts)
One-off catastrophe loss based on extensive flooding of the River Thames	(8pts)	(9pts)
Change in Solvency II reserving basis for PPOs to use a real discount rate of minus 1%[1]	(10pts)	(8pts)
100bps increase in credit spreads[2]	(9pts)	(9pts)
100bps decrease in interest rates with no change in the PPO real discount rate	(3pts)	1pt

Notes:

1. The PPO real discount rate used is an actuarial judgement which is reviewed annually based on the economic outlook for wage inflation relative to the PRA discount rate curve.
2. Only includes the impact on available-for-sale ("AFS") assets (excludes illiquid assets such as infrastructure debt) and assumes no change to the SCR.

Own funds

The following table splits the Group's own funds by tier on a Solvency II basis.

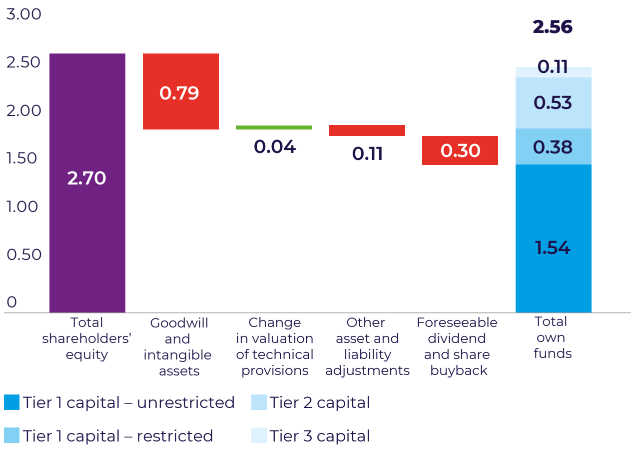
At 31 December	2020 £bn	2019 £bn
Tier 1 capital before foreseeable distributions	1.84	1.80
Foreseeable dividend and share buyback	(0.30)	(0.35)
Tier 1 capital – unrestricted	1.54	1.45
Tier 1 capital – restricted	0.38	0.37
Tier 1 capital	1.92	1.82
Tier 2 capital – subordinated debt	0.53	0.26
Tier 3 capital – deferred tax	0.11	0.09
Total own funds	2.56	2.17

During 2020, the Group's own funds increased from £2.17 billion to £2.56 billion. Tier 1 capital after foreseeable distributions represents 75% of own funds and 143% of the estimated SCR. Tier 2 capital relates solely to the Group's £0.53 billion subordinated debt. The amount of Tier 2 and Tier 3 capital permitted under the Solvency II regulations is 50% of the Group's SCR and of Tier 3 alone is less than 15%. Therefore, the Group currently has no ineligible capital. The maximum amount of Restricted Tier 1 capital permitted as a proportion of total Tier 1 capital under the Solvency II regulations is 20%. Restricted Tier 1 capital relates solely to the Tier 1 notes issued in 2017.

Reconciliation of IFRS shareholders' equity to Solvency II own funds

At 31 December	2020 £bn	2019 £bn
Total shareholders' equity	2.70	2.64
Goodwill and intangible assets	(0.79)	(0.70)
Change in valuation of technical provisions	0.04	(0.06)
Other asset and liability adjustments	(0.11)	(0.08)
Foreseeable dividend and share buyback	(0.30)	(0.35)
Tier 1 capital – unrestricted	1.54	1.45
Tier 1 capital – restricted	0.38	0.37
Tier 1 capital	1.92	1.82
Tier 2 capital – subordinated debt	0.53	0.26
Tier 3 capital – deferred tax	0.11	0.09
Total own funds	2.56	2.17

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



Leverage

The Group's financial leverage increased by 5.6 percentage points to 24.2% (2019: 18.6%). The increase was primarily due to the issue of £260 million of Tier 2 subordinated debt in June 2020.

At 31 December	2020 £m	2019 £m
Shareholders' equity	2,699.7	2,643.6
Tier 1 notes	346.5	346.5
Financial debt – subordinated debt	516.6	259.0
Total capital employed	3,562.8	3,249.1
Financial-leverage ratio[1]	24.2%	18.6%

Note:

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

Credit ratings

Moody's Investors Service provide insurance financial-strength ratings for U K Insurance Limited, the Group's principal underwriter. Moody's rate U K Insurance Limited as "A1" for insurance financial strength (strong) with a stable outlook.

Reserving

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. The Group considers the class of business, the length of time to notify a claim, the validity of the claim against a policy, and the claim value. Claims reserves could settle across a range of outcomes, and settlement certainty increases over time. However, for bodily injury claims the uncertainty is greater due to the length of time taken to settle these claims. The possibility of annuity payments for injured parties also increases this uncertainty.

The Group seeks to adopt a conservative approach to assessing liabilities, as evidenced by the favourable development of historical claims reserves. Reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal actuarial best estimate. This margin is set by reference to various actuarial scenario assessments and reserve distribution percentiles. It also considers other short and long-term risks not reflected in the actuarial inputs, as well as management's view on the uncertainties in relation to the actuarial best estimate.

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 of England and Wales. The Ogden discount rate will be reviewed again at the latest in 2024. There has been an ongoing reduction in large bodily injury exposures as a result of continued positive prior-year development of claims reserves, and a higher proportion of reserves being covered by reinsurance as a result of the decision to opt for a lower reinsurance attachment point from 2014 onwards.

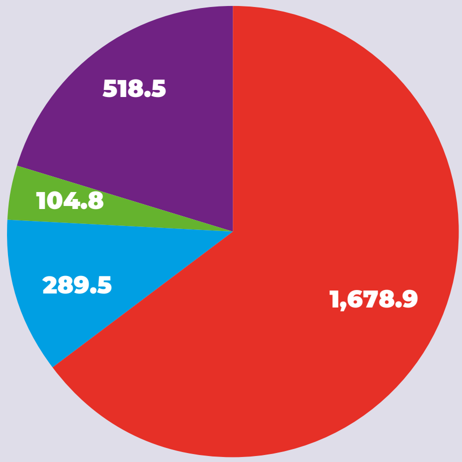
If the claimant prefers, large bodily injury claims can be settled using a PPO. This is an alternative way to provide an indemnity for recurring costs, making regular payments, usually for the rest of the claimant's life. These claims are reserved for using an internal discount rate, which is progressively unwound over time. As it is likely to take time to establish whether a claimant will prefer a PPO or a lump sum, until a settlement method is agreed the Group makes assumptions about the likelihood that claimants will opt for a PPO. This is known as the PPO propensity.

The Group's prior-year reserve releases were £173.8 million (2019: £294.5 million) with good experience in large bodily injury claims being a key contributor.

Looking forward, the Group expects to continue setting its initial management best estimate with an appropriate degree of conservatism. Assuming current claims trends continue, the contribution from prior-year reserve releases is expected to remain significant.

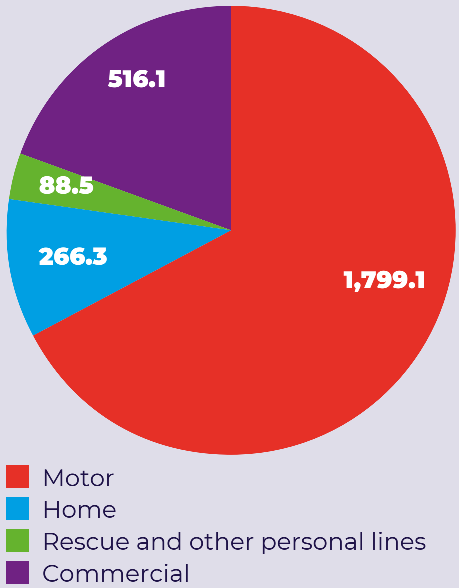
Claims reserves net of reinsurance 2020 (£m)

£2,591.7m



Claims reserves net of reinsurance 2019 (£m)

£2,670.0m



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, 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 and these can be found in the table below.

Sensitivity analysis – the discount rate used in relation to PPOs, changes in the assumed Ogden discount rate and claims inflation

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

	Increase / (decrease) in profit before tax[1,2]	
At 31 December	**2020 £m**	2019 £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 as the direct impact of the change in the real discount rate with all other factors remaining unchanged.
4. Ogden discount rate sensitivity has been calculated on the direct impact of a permanent change in the discount rate 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.

Reinsurance

The objectives of the Group's reinsurance strategy are to reduce the volatility of earnings, facilitate effective capital management, and transfer risk outside the Group's risk appetite. This is achieved by transferring risk exposure through various reinsurance programmes:

- Catastrophe reinsurance to protect against an accumulation of claims arising from a natural perils event. The retained deductible is £130 million and cover is placed annually on 1 July up to a modelled 1-in-200 year loss event of £1,125 million.
- Motor reinsurance to protect against a single claim or an accumulation of large claims which renews on 1 January. The retained deductible is set at an indexed level of £1 million per claim but the reinsurance is only 75% placed up to a level of £10 million and the protection above £10 million is subject to an additional aggregate retention of £37.5 million. This programme was renewed on 1 January 2021.
- Commercial property risk reinsurance to protect against large individual claims with a retained deductible of £4.0 million which renews annually on 1 July.

Investment portfolio

The investment strategy aims to deliver several objectives, which are summarised below:

- to ensure there is sufficient liquidity available within the investment portfolio to meet stressed liquidity scenarios
- to match PPO and non-PPO liabilities in an optimal manner
- to deliver a suitable risk-adjusted investment return commensurate with the Group's risk appetite

Asset and liability management

The following table summarises the Group's high-level approach to asset and liability management.

Liabilities	Assets	Characteristics
More than 10 years, for example PPOs	Property and infrastructure debt	Inflation-linked or floating
Short and medium term – all other claims	Investment-grade credit	Fixed – "Key rate duration matched"
Tier 1 equity	Investment-grade credit	Fixed
Tier 2 sub-debt (swapped fixed to floating)	Commercial real estate loans and cash	Floating
Tier 2 sub-debt (fixed)	Investment-grade credit and cash	Fixed or floating
Surplus – tangible equity	Investment-grade credit, short-term high yield, cash and government debt securities	Fixed or floating

Asset allocation and benchmarks – U K Insurance Limited

The current strategic asset benchmarks for U K Insurance Limited are detailed in the following table:

At 31 December	**Benchmark holding 2020**	**Actual holding 2020**	Benchmark holding 2019	Actual holding 2019
Investment-grade credit	66.0%	63.8%	65.0%	62.5%
High yield	6.0%	6.0%	6.0%	6.9%
Investment-grade private placements	3.0%	1.8%	3.0%	1.8%
Credit	75.0%	71.6%	74.0%	71.2%
Sovereign	3.0%	0.4%	5.0%	1.7%
Total debt securities	78.0%	72.0%	79.0%	72.9%
Infrastructure debt	4.0%	4.5%	5.0%	4.9%
Commercial real estate loans	6.5%	3.5%	4.0%	3.7%
Cash and cash equivalents	6.0%	15.0%	7.0%	13.4%
Investment property	5.5%	5.0%	5.0%	5.1%
Total investment holdings	100.0%	100.0%	100.0%	100.0%

Investment holdings and yields – total Group

	2020			2019		
	Allocation (£m)	Income (£m)	Yield (%)	Allocation (£m)	Income (£m)	Yield (%)
Investment-grade credit[1]	3,736.6	76.3	2.1%	3,676.8	82.1	2.3%
High-yield	349.0	18.9	5.1%	390.8	21.2	5.4%
Investment-grade private placements	103.9	2.7	2.6%	104.0	2.8	2.6%
Credit	4,189.5	97.9	2.3%	4,171.6	106.1	2.3%
Sovereign[1]	25.5	0.7	1.1%	99.8	2.3	1.8%
Total debt securities	4,215.0	98.6	2.3%	4,271.4	108.4	2.5%
Infrastructure debt	264.5	5.8	2.1%	278.1	7.0	2.5%
Commercial real estate loans	206.7	6.5	3.3%	205.7	6.9	3.4%
Cash and cash equivalents[2]	1,168.2	2.5	0.2%	896.3	7.9	0.8%
Investment property	292.1	13.7	4.7%	291.7	16.2	5.3%
Equity investments[3]	3.2	–	0.0%	–	–	0.0%
Total Group	6,149.7	127.1	2.1%	5,943.2	146.4	2.4%

Notes:

1. Asset allocation at 31 December 2020 includes investment portfolio derivatives, which have a mark-to-market asset value of £7.7 million included in investment-grade credit and £0.3 million in sovereign debt (31 December 2019: £81.8 million and nil respectively). This excludes non-investment derivatives that have been used to hedge interest on subordinated debt and operational cash flows.
2. Net of bank overdrafts: includes cash at bank and in hand and money market funds.
3. Equity investments consist of an equity fund which is valued based on external valuation reports received from a third-party fund manager.

At 31 December 2020, total investment holdings of £6,149.7 million were 3.5% higher than at the start of the year, primarily reflecting the cash received on issue of the Tier 2 subordinated debt. Total debt securities were £4,215.0 million (31 December 2019: £4,271.4 million), of which 2.6% were rated as ‘AAA’ and a further 54.4% were rated as ‘AA’ or ‘A’. The average duration at 31 December 2020 of total debt securities was 2.8 years (31 December 2019: 2.5 years).

At 31 December 2020, total unrealised gains, net of tax, on available-for-sale investments were £83.9 million (31 December 2019: £47.5 million).

Tax management

The Board recognises that the Group has an important responsibility to manage its tax position effectively. The Board has delegated day-to-day management of taxes to the Chief Financial Officer and oversight is provided by the Audit Committee.

These arrangements are intended to ensure that the Group: complies with applicable laws and regulations; meets its obligations as a contributor and a collector of taxes on behalf of the tax authorities; and manages its tax affairs efficiently, claiming reliefs and other incentives where appropriate.

Tax authorities

The Group has open and cooperative relationships with the tax authorities with whom it deals in the countries where the Group operates, namely the UK, the Republic of Ireland, South Africa and India.

Tax policy and governance

The Group’s tax policy has been reviewed and approved by the Audit Committee. The Group Tax function supports the Chief Financial Officer in ensuring the policy is adhered to at an operational level.

For more information please see our published Group Tax policy on the Group’s website at https://www.directlinegroup.co.uk/en/who-we-are/governance/other-policies.html.

Total tax contribution

The Group's direct and indirect tax contribution to the UK Exchequer is significantly higher than the UK corporation tax that the Group pays on its profits. The Group collects taxes relating to employees and customers on behalf of the UK Exchequer and other national governments. It also incurs a significant amount of irrecoverable value added tax relating to overheads and claims. Taxes borne and collected in other tax jurisdictions have not been included in this note as the amounts are minimal in the context of the wider UK Group.

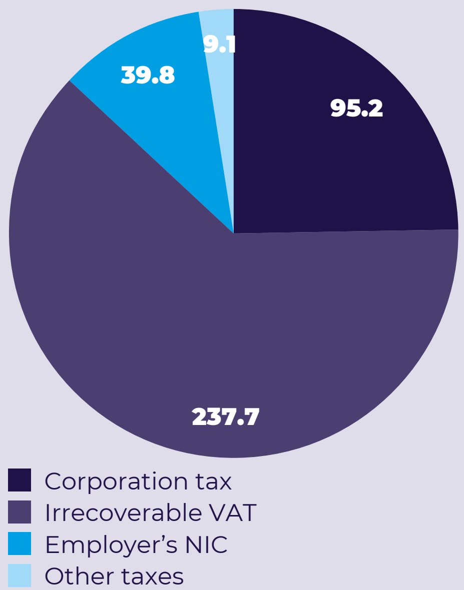
During 2020 the sum of taxes either paid or collected across the Group was £888.0 million. The composition of this between the various taxes borne and collected by the Group is shown below.

At 31 December	2020 £m
Current-year corporation tax charge	95.2
Irrecoverable value added tax incurred on overheads	79.1
Irrecoverable value added tax embedded within claims spend	158.6
Employer's national insurance contributions	39.8
Other taxes	9.1
Total taxes borne	381.8

At 31 December	2020 £m
Insurance premium tax	397.0
Value added tax	11.3
Employee's pay as you earn and national insurance contributions	97.9
Total taxes collected	506.2

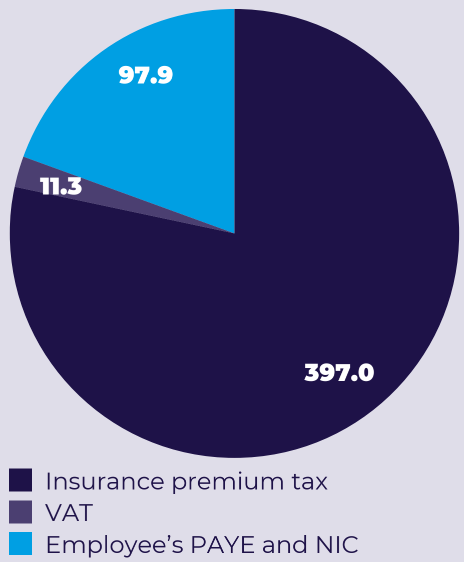
Total taxes borne by tax type (£m)

£381.8m



Total taxes collected by tax type (£m)

£506.2m



Neil Manser
Acting Chief Financial Officer

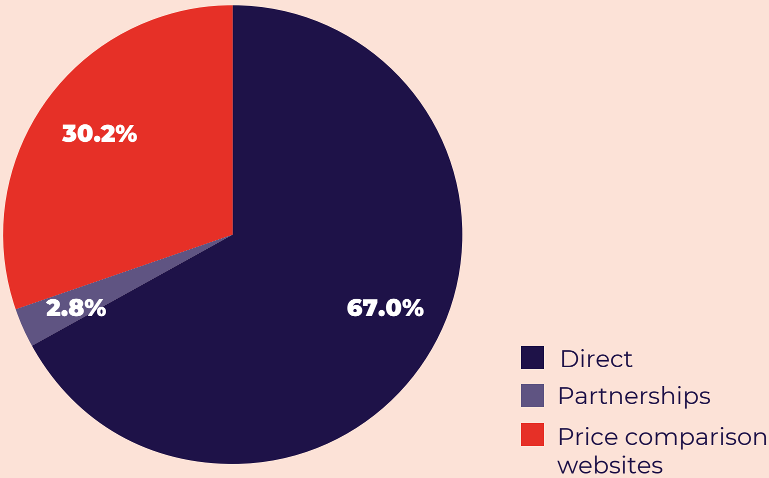
Motor

Own brand in-force policies increased by 0.6%, with an overall increase in in-force policies of 0.4% to 4.1 million.

Own brand gross written premium reduced by 1.5%, overall gross written premium reduced by 2.1%.

Operating profit of £363.5 million was £60.9 million higher than prior year due to lower claims frequency, mainly due to Covid-19 restrictions, partly offset by lower prior-year reserve releases.

Gross written premium by channel



In-force policies (‘000s)

4,061

(2019: 4,043)

Gross written premium

£1,616.9m

(2019: £1,651.6m)

Operating profit

£363.5m

(2019: £302.6m)

Combined operating ratio

87.7%

(2019: 94.8%)

	2020	2019
In-force policies (thousands)	**4,061**	4,043
Of which direct own brands	**3,943**	3,921
Gross written premium	**£1,616.9m**	£1,651.6m
Loss ratio	**59.8%**	69.3%
Commission ratio	**3.2%**	2.6%
Expense ratio	**24.7%**	22.9%
Combined operating ratio	**87.7%**	94.8%
Operating profit	**£363.5m**	£302.6m

Overview

In 2020, the motor market experienced disruption driven by Covid-19 lockdowns, with reductions in claims frequency and lower new business shopping. These trends were reflected in lower average premiums.

Against this backdrop, the Group focused on providing financial support to its customers experiencing financial difficulties while maintaining a focus on underwriting discipline and indemnity management in a highly competitive market.

During the year, the Group continued to focus on technology and business transformation. Despite the operational challenges in moving to remote working, further progress was made on the roll-out of the Group's new motor platform with roll-out completed for Privilege new business and renewal customers in the year and scheduled to be started for Churchill PCW and new phone business in Q1 2021. Motor improved its PCW competitiveness with the launch of the Darwin brand on two more PCWs helping drive strong growth during the year. In addition, the Group launched a new "Mileage Moneyback" proposition for Direct Line Motor customers.

The Group's in-house vehicle repair network continued to repair customers' vehicles and prioritised repairs for NHS workers.

The combination of market dynamics and strategic progress resulted in a current-year attritional loss ratio of 66.6% (2019: 81.2%).

Performance

Motor in-force policies grew by 0.4% to 4.1 million with own brand in-force policies up by 0.6% at 3.9 million. Strong retention was partially offset by a slow down in the new business market as new car sales fell and fewer new drivers entered the market. The Group saw good growth in the PCW channel as both Churchill and Darwin strengthened their propositions.

The Group offered premium refunds to all customers where miles driven were expected to be lower than anticipated at policy inception. Furthermore, the Group launched a "Mileage MoneyBack" proposition for all Direct Line customers such that customers would be able to receive a refund at the end of the policy period where they had driven less than expected. Gross written premium reduced by 2.1% to £1,616.9 million, primarily due to lower average premium.

Motor own brand average premium[1] reduced 2.0% during 2020 due predominantly to a 4.0% impact from reducing risk mix following lower new car sales and fewer new drivers entering the market. Motor risk-adjusted prices, before taking account of lower claims frequency, increased by 1.8%. Market premium deflation accelerated through 2020 as claims frequency remained low.

The Motor result has been significantly affected by the factors surrounding Covid-19, with the current-year attritional loss ratio improving by 14.6 percentage points to 66.6% (2019: 81.2%). The majority of this reduction reflects lower levels of claims frequency as driving patterns evolved through the year. A relatively normal first quarter was followed by a halving of claims frequency during the second quarter with less significant but still lower levels of claims frequency through the rest of the year. While claims frequency was down as fewer miles were driven, claims severity was higher than the Group's medium-term expectation of 3% to 5% inflation per annum. Claims severity has been impacted by longer repair times and consequent greater credit hire costs and additional cleaning and by extending the scope of vehicle replacement as part of the customer initiatives.

Although it is not possible to entirely adjust for all of the above factors, the Group believes that it made some underlying progress in reducing the current-year loss ratio during the year.

In total, prior-year reserve releases were £79.9 million lower year on year at £100.6 million. The 2019 prior-year reserve releases included a strengthening of £15.9 million as a result of the change in the Ogden discount rate to minus 0.25% from an assumed rate of 0%.

Overall Motor's reported combined operating ratio improved by 7.1 percentage points to 87.7% (2019: 94.8%). The improvements in the current-year attritional loss ratio were offset by a 0.6 percentage point increase in the commission ratio, primarily due to increased volume related commission payments to PCWs, a 1.8 percentage point increase in the expense ratio and a 5.1 percentage point reduction in prior-year reserve releases.

Note:

1. Average incepted written premium excluding IPT for Motor own brands (covering 96.5% of Motor) for year end 31 December 2020.

Mileage refunds

For our customers who were experiencing immediate financial difficulty due to the impact of Covid-19, we implemented a range of support measures. We waived cancellation fees and offered payment deferrals for people who had lost their job or seen changes to their employment. We recognised that the lockdown was changing customers' behaviour and invited every customer to contact us if their annual mileage had reduced, resulting in thousands of premium refunds and waived administration fees. We also launched a new Direct Line "Mileage MoneyBack" proposition giving customers the flexibility to update their mileage at the end of their policy and claim a refund on the miles not driven when the policy comes up for renewal.

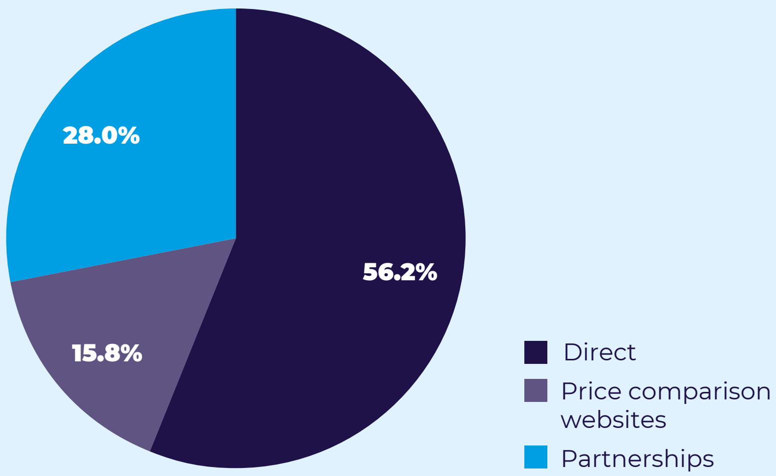
Home

Total in-force policies 1.7% higher at 2.6 million. Own brand policies were 4.1% higher at 1.8 million principally due to strong growth in the PCW channel where new business sales increased by over 30%.

Total gross written premium was 1.5% lower at £577.9 million. Own brand gross written premium was 1.0% higher.

Total operating profit was £49.2 million lower than prior year due to £27.0 million of major weather costs (2019: £3.0 million) alongside a reduction in prior-year reserve releases.

Gross written premium by channel



In-force policies ('000s)

2,638

(2019: 2,594)

Gross written premium

£577.9m

(2019: £586.6m)

Operating profit

£101.4m

(2019: £150.6m)

Combined operating ratio

87.1%

(2019: 80.3%)

	2020	2019
In-force policies (thousands)	**2,638**	2,594
Of which direct own brands	**1,837**	1,765
Gross written premium	**£577.9m**	£586.6m
Loss ratio	**55.6%**	46.8%
Commission ratio	**8.1%**	9.7%
Expense ratio	**23.4%**	23.8%
Combined operating ratio	**87.1%**	80.3%
Operating profit	**£101.4m**	£150.6m

Overview

In 2020 the home market continued to shift towards the PCW channel and Covid-19 led to changes in claims mix with fewer claims for escape of water and theft as more people were at home.

The Home segment grew direct own brands policy count due to strong PCW performance reflecting the Group's improved focus and capability in this channel. Direct Line policies remained stable over the period. Partnership policy count continued to reduce, partly due to the continued run-off of some schemes whilst bank branch sales reduced due to lower footfall.

Home continued to focus on its transformation with the acquisition of Brolly, a small digital insurer. The team behind Brolly joined the Group and will help fast track our ability to deliver tailored products to the market. We also agreed a two year extension with NatWest Group for Home insurance.

Home operating profit of £101.4m was lower due to higher weather-related claims costs, lower prior-year reserve releases and lower investment return, partly offset by favourable claims experience across other perils.

Notes:

1. Average incepted written premium excluding IPT for Home own brands for year end 31 December 2020.
2. See glossary on pages 224 to 226 for definitions and appendix A – Alternative performance measures on pages 227 to 230 for reconciliation.

Performance

In-force policies for Home's own brands increased by 4.1% in 2020 to 1.8 million policies. Retention and new business were strong with particular strength in PCW new business which grew over 30%. This reflected the Group's increased focus on, and capability in, the PCW channel. Partnership volumes reduced by 3.4%; Prudential and Sainsbury's partnerships are closed to new business and continued to run off in line with expectations.

Gross written premium was 1.5% lower than 2019, primarily due to the reduction in partnership volumes. Own brands gross written premium increased by 1.0% as growth in in-force policies was offset by lower average premium.

Home own brand average premium[1] reduced by 3.8% primarily reflecting a change in mix towards lower risk and consequently lower average premium policies in the PCW channel. Risk-adjusted prices reduced by 1.2% reflecting initiatives taken to reduce claims inflation and actions taken to reduce the differential between new business and renewal prices.

The current-year attritional loss ratio, excluding major weather event claims, improved by 0.8 percentage points to 52.7%. Home has experienced a change in mix towards more accidental damage claims and fewer theft claims during 2020 with continuing positive trends in escape of water severity. Whilst the Covid-19 pandemic is believed to have contributed positively to these trends, the impact is not significant.

The commission ratio of 8.1% was 1.6 percentage points lower than 2019 due to lower profit share payments to partners.

Home's combined operating ratio increased by 6.8 percentage points to 87.1% (2019: 80.3%). This was driven primarily by a 5.3 percentage point reduction in prior-year releases and a 4.3 percentage point increase in major weather costs partly offset by an improvement in the current-year attritional loss ratio. Normalised for weather, the combined operating ratio was 3.4% percentage points higher than 2019 at 90.3%[2] (2019: 86.9%).

Peace of mind when it matters most

At the start of the year we supported customers affected by Storms Ciara and Dennis, which saw the Group provide in the region of £25 million in claims payments so customers could get their lives back on track.

At one point 6,500 customers got in touch to tell us their homes had been damaged by Storm Ciara's 100mph winds and torrential rain – over four times the calls we had seen the previous week. Our Claims teams coordinated our Group response, as well as colleagues on the ground in our Direct Line Defenders and Churchill branded vehicles who were there for our customers when it mattered most, so they could give them peace of mind that we were able to help at this difficult time.

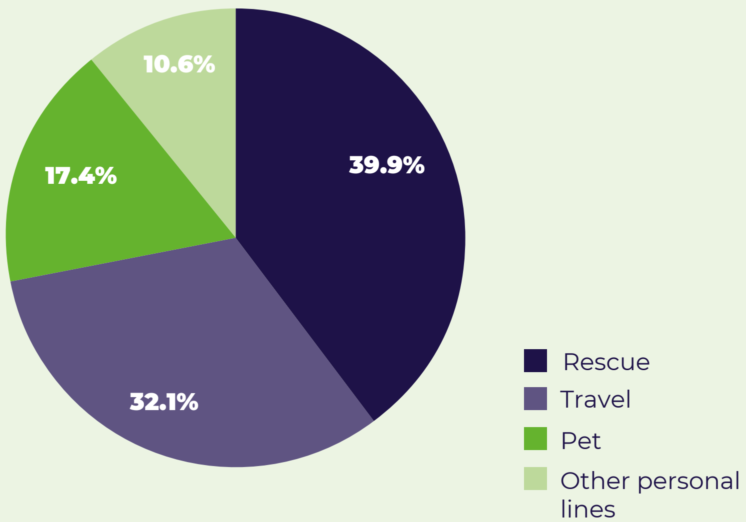
Rescue and other personal lines

The Group's direct Rescue brand, Green Flag, grew in-force policies by 4.8% and gross written premiums by 5.2% in the year.

Total in-force policies and gross written premium reduced by 3.7% and 4.2% respectively, reflecting lower premium from Travel partly offset by higher premium in Green Flag.

Operating profit of £6.8 million included £51.2 million (2019: 45.2 million) profit for Rescue largely offset by loss of £44.4 million (2019: £6.1 million loss) for Other Personal Lines.

Gross written premium by product



In-force policies ('000s)

7,105

(2019: 7,377)

Gross written premium

£417.8m

(2019: £436.0m)

Operating profit

£6.8m

(2019: £39.1m)

Combined operating ratio

102.0%

(2019: 95.4%)

Meeting our customers' travel needs

We have invested in and enhanced our digital platform, which has enabled us to deliver for our travel customers. This year we significantly accelerated our digital capabilities, and quickly mobilised an online claims process after the national lockdown. This new online forms and prioritisation process has helped us handle claims up to five times faster. The Travel team have been exceptionally busy with travel claims over the pandemic; during this period, we received 87,500 Covid-19 related travel claims and have brought home over 900 customers who were stranded overseas. To cope with the increased demand, we retrained over 500 of our colleagues to understand the changes in travel guidance as the pandemic progressed.

	2020	2019
In-force policies (thousands)	**7,105**	7,377
Of which direct own brands	**1,114**	1,063
Gross written premium	**£417.8m**	£436.0m
Loss ratio	**61.7%**	66.9%
Commission ratio	**16.4%**	6.4%
Expense ratio	**23.9%**	22.1%
Combined operating ratio	**102.0%**	95.4%
Operating profit	**£6.8m**	£39.1m

Overview

Rescue and other personal lines consists of Rescue products, including those sold through the Green Flag brand, and other personal lines insurance, including Travel, Pet and Creditor, which are sold through own brands and partnership arrangements.

Green Flag's ongoing transformation, positioning itself as the challenger brand in the rescue market, continued in 2020 with the launch of a new claims system. Throughout the pandemic in 2020 Green Flag offered free breakdown cover to NHS workers and offered free vehicle health checks to all its customers.

Green Flag's in-force policy count continued to grow, and in August it recorded its biggest sales month since 2012. Policy count growth was slower overall as there were fewer cars on the road and fewer miles driven due to lockdown restrictions. The restrictions and changes to customer behaviours also led to lower claims in the year which contributed to an increase in Rescue operating profit to £51.2 million.

Travel experienced elevated claims being registered in 2020, particularly during the first lockdown and operational capacity was strengthened to support customers. In addition, the Group has taken a cautious stance in its approach to Travel claims reserving.

Overall Rescue and other personal lines made a small operating profit of £6.8 million as the strong profit in Rescue was largely offset by a loss of £44.4 million in other personal lines due to Travel.

Performance

The combined operating ratio for Rescue and other personal lines increased by 6.6 percentage points to 102.0% (2019: 95.4%) due predominantly to Travel which incurred increased claims handling costs supporting customers throughout 2020 and higher commissions to partners. The Group has taken a cautious stance in its reserving for travel claims.

Rescue in-force policies reduced by 1.4% to 3.4 million and gross written premium reduced by 0.5% to £166.7 million. Green Flag Rescue continued to grow its higher average premium direct business during 2020, increasing in-force policies by 4.8% to 1.1 million and gross written premium by 5.2% to £83.1 million. Other Rescue lines, which include the linked channel, where cover can be purchased with a Group Motor policy, and Rescue partnerships, saw in-force policies and gross written premium reduce by 4.2% and 5.5% respectively.

The combined operating ratio for **Rescue** of 76.5% was 5.0 percentage points better than 2019's ratio of 81.5%. Lower claims frequency during Covid-19 lockdown alongside lower claims costs due to fewer long-distance recoveries, was partially offset by supplier network support payments and free rescue given to NHS staff. Approximately half of the improvement in the combined operating ratio is expected to be one-off.

Other personal lines (comprising Travel, Pet, Creditor and policies tailored to mid- to high-net worth customers) in-force policies reduced by 5.7% to 3.7 million primarily due to lower Travel, following the Group's suspension of sales in Q2 and Q3, as a result of the Covid-19 lockdown, and continued reductions in packaged bank volumes. Gross written premium for Other personal lines decreased by 6.5% with reductions across all lines except Pet, where premium levels were maintained.

Other personal lines combined operating ratio increased by 14.4 percentage points to 118.5%. The increase is entirely due to Travel where the Group has incurred increased claims handling costs supporting customers throughout 2020, has taken a cautious stance in its reserving and has incurred additional commission payments, particularly on packaged bank account business.

Transforming the way rescue service is delivered

Being able to anticipate and adapt quickly is at the heart of our strategy. This year, Green Flag expanded its service to support the NHS during lockdown, whilst updating its user-friendly "Green Flag Rescue Me" app which has seen more customers interact digitally and receive exceptional[1] service. It has coordinated 78,931 rescues and seen a 30% increase in people accessing it during 2020.

Part of the app's success is based on the ability to introduce enhancements quickly, giving the Green Flag team greater agility to meet customer needs and service more claims digitally.

Elsewhere, Green Flag continues to record digital milestones by using advanced technology systems to reduce our mileage by sending customers the right resource first time. This leads to an efficient customer service but also helps minimise our carbon emissions in what is one of the most carbon intensive parts of our operation. Similarly our "Phone Fix" initiative means we are fixing approximately 6% of jobs over the phone with customers, an increase of 3%, across all jobs, in "Phone Fix" compared to the previous year, resulting in saving miles driven.

Note:

1. Trustpilot score of 4.4/5 (23/02/21).

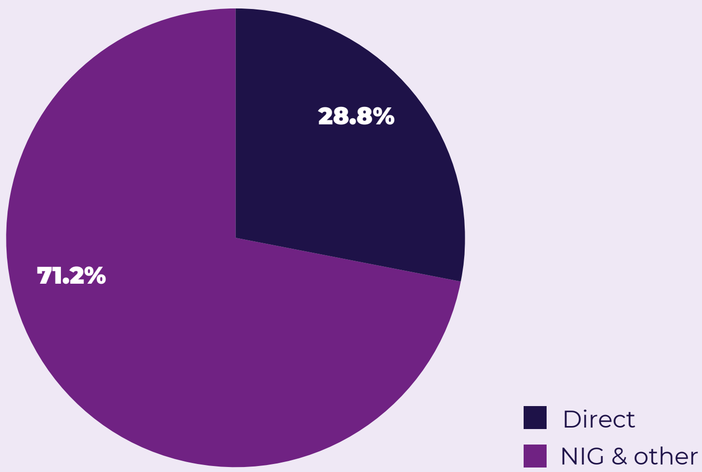
Commercial

Total gross written premium increased by 7.4% with direct own brands increasing by 9.3%.

Strong performance in Direct Line for Business as it continued to focus on micro business tailored propositions.

NIG and other gross written premium grew by 6.6%, benefiting from improvements arising from the re-platforming of the products on its award-winning electronic trading platform and improvements in Van insurance pricing.

Gross written premium by channel



In-force policies ('000s)

811

(2019: 775)

Gross written premium

£567.8m

(2019: £528.9m)

Operating profit

£50.4m

(2019: £54.6m)

Combined operating ratio

95.5%

(2019: 95.7%)

	2020	2019
In-force policies (thousands)	**811**	775
Of which direct own brands	**560**	541
Gross written premium	**£567.8m**	£528.9m
Loss ratio	**51.4%**	52.7%
Commission ratio	**18.7%**	18.5%
Expense ratio	**25.4%**	24.5%
Combined operating ratio	**95.5%**	95.7%
Operating profit	**£50.4m**	£54.6m

Overview

In 2020 customers continued to seek cover in the direct market that was flexibly tailored to their individual needs. Against this backdrop, Commercial maintained underwriting discipline and grew its policy count across all product lines.

Direct Line for Business continued to grow policy count through its ongoing focus on offering micro business tailored propositions, with the launch of its Van insurance product at the start of the year.

Commercial also grew policy count through more competitive pricing in the traditional broker channel as well as through the PCW channel via the Churchill brand, following investment and focus on digital, pricing and marketing of the brand.

Commercial's current-year attritional loss ratio continued to improve. Higher weather event costs were offset by fewer claims associated with the Covid-19 pandemic and UK lockdowns and underlying claims benefits from Commercial's ongoing investment in pricing and underwriting.

Performance

Commercial in-force policies of 811,000 increased by 4.6% compared with 2019, reflecting strong growth in both Commercial direct own brands and NIG and other.

Commercial direct own brands grew in-force policies by 3.5% supported by the growth in Van for Direct Line, where the product was added to the new Commercial direct platform, and for Churchill where Van is sold through the PCW channel. Gross written premium increased by 9.3% to £163.3 million with increases across all Commercial direct product lines.

NIG and other in-force policy numbers were 7.3% higher and gross written premium grew by 6.6% to £404.5 million. This reflected growth across all categories as the book continued to benefit from improvements arising from the re-platforming of the products on its award-winning electronic trading platform and improvements in Van insurance pricing.

The current-year attritional loss ratio in Commercial improved by 6.0 percentage points to 59.6%. This was driven by improvements to underwriting through pricing and risk selection as well as frequency benefits in motor lines since the end of Q1. This was partially offset by Covid-19 related business interruption claims at £6 million.

Prior-year reserve releases were £8.2 million lower at £56.8 million, primarily due to lower general liability reserve releases on older accident years. 2019's result included a £1.0 million strengthening of prior-year reserves as a result of the change in the Ogden discount rate to minus 0.25% from an assumed rate of 0%.

The combined operating ratio for Commercial improved slightly by 0.2 percentage points to 95.5% (2019: 95.7%) as an improvement in the current-year attritional loss ratio of 6.0 percentage points was largely offset by an increase in claims related to severe weather, a reduction in prior-year reserve releases and an increase of 0.9 percentage points on the expense ratio.

NIG self-help online portal

The NIG Risk Assist tool was launched to help business owners manage and respond to a broad range of risks through a comprehensive range of easy-to-use online tools.

The online portal offers a wide range of services, such as: unlimited online access to health & safety and HR professionals for support and guidance on specific issues facing their businesses; unlimited phone counselling and medical advice; a suite of online eLearning courses to help train and develop staff; assessments, guides and templates to keep up with changing rules and regulations; business continuity planning to keep our customers in business when disaster strikes; and much more. The proposition was launched during the Covid-19 pandemic and has since been a valuable support for our customers.

Building a sustainable future

Our approach to sustainability is based on a simple premise: the role we play as a business to support the stakeholders we interact with on a daily basis – customers, shareholders, suppliers, our people, communities and the planet – makes the Group stronger and can bring future rewards.

We are transforming to maintain a competitive edge, but doing it in a way that is sustainable and mindful of our impact on society and the environment.

Our established five pillar sustainability strategy, underpinned by our vision and purpose, has given the Group confidence when responding to the unforeseen circumstances of 2020. By aiming to be a force for good and giving people peace of mind we have tried at all times to deliver on our ambition of doing the right thing for all of our stakeholders.

Sustainability pillars

Customers

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

People

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

Society

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

Planet

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

Governance

Look to the long term for our stakeholders, build a reputation for high standards of business conduct and a sustainable business.

Gaining confidence from 2020

We remained focused on our sustainability strategy despite the disruption created by the Covid-19 pandemic. Far from restricting the Group, it enhanced our response. The way we supported customers in need, made remote working effective, created flexible insurance products and made ourselves accountable for reducing carbon emissions are all significant milestones. We also supported partners in our supply chain when lockdown impacted their operations.

2020 has opened up new possibilities, provided fresh insight and given the business more confidence to drive sustainable outcomes, many of which have the potential to leave a lasting impact. More detail can be found in our summary of activity for each of our sustainability pillars on pages 48 to 61.

This year we published our first Sustainability Report which you can view online at: www.directlinegroup.co.uk/2020_Sustainability_Report

Maximising our impact for all our stakeholders

In 2019, we conducted our first in-depth Materiality Assessment. It has helped shape the Group's sustainability strategy as it prioritises what our stakeholders value, alongside the impact on the business and how we can use this insight to build a sustainable business for the future.

We asked a range of business and external stakeholders to prioritise a range of sustainability issues against our business priorities through a series of in-depth interviews and surveys to create a business impact assessment of risks, impacts and opportunities for the Group.

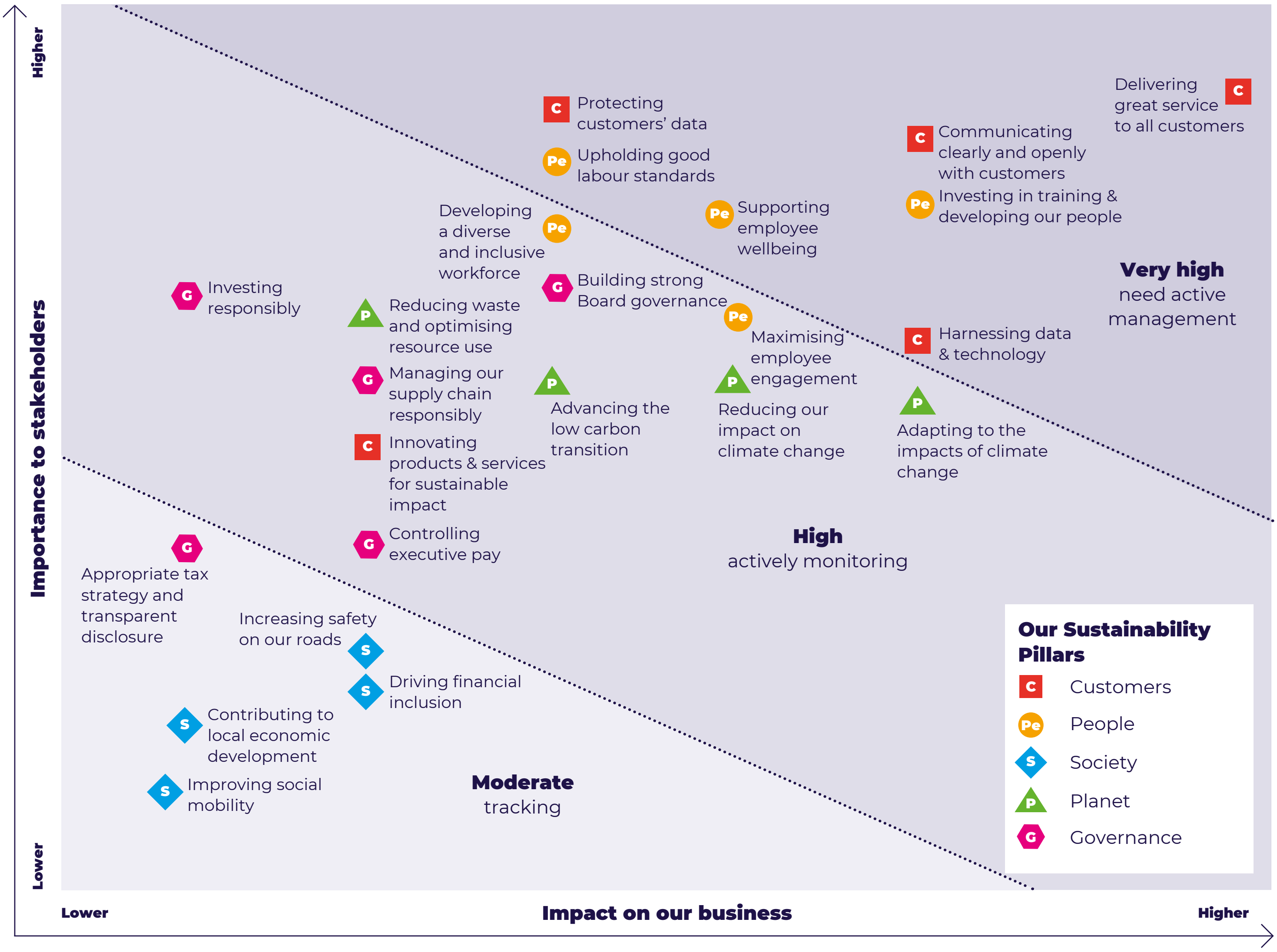
It means everything from delivering great service to all customers, investing in our people so they are supported, harnessing the latest data and technology and ensuring we manage our suppliers responsibly, including prompt payment.

Building on the four priorities outlined opposite, in 2020 we chose to actively prioritise social mobility, as well as developing a diverse and inclusive workforce and reducing our impact on climate change which our stakeholders place in the high category. We did this because each of these issues is an integral part of living up to our vision of a world where insurance is personal, inclusive and a force for good.

Priorities

1. **Meeting customer needs each and every day**
2. **Investing in and supporting our great people**
3. **Realising the potential of data and technology**
4. **Understanding and managing the impact of climate change**

Materiality matrix



United Nations SDGs

In 2015 the United Nations launched 17 Sustainable Development Goals ("**SDGs**") to help end poverty, fight inequality and tackle climate change by 2030. Through our sustainability work, we believe we can contribute to seven of the Goals.

	Detail	Group activity		Pillars	Sustainability priorities
Good Health and Well-being	Ensure healthy lives and promote well-being for all at all ages.	– Financial wellbeing – Mental health first aider network – Supporting Mind – Bereavement team	– Carbon offsetting projects: clean water in Kenya, clean cookstoves in Bangladesh	C P Pe S	2
Quality Education	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all.	– Apprenticeships – Graduate programme – Continuous learning – Donation to Teach First	– Carbon offsetting projects: clean water in Kenya, clean cookstoves in Bangladesh, rainforest protection in Brazil	Pe S P	2
Gender Equality	Achieve gender equality and empower all women and girls.	– New diversity and inclusion strategy – Women in Finance Charter	– Thrive network – Bespoke talent programmes	Pe	2
Affordable and clean energy	Ensure access to affordable, reliable, sustainable and modern energy for all.	– Carbon Offsetting Project: clean cookstoves in Bangladesh	– Sourcing 100% renewable energy sources for our operations	P	4
Decent Work and Economic Growth	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.	– Continuous learning – Social Mobility Pledge – Leadership targets for BAME and Black representation	– Carbon offsetting projects: clean water in Kenya, clean cookstoves in Bangladesh, rainforest protection in Brazil	Pe S P	2
Industry, Innovation and Infrastructure	Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation.	– Tech innovations at accident repair centres – Encouraging electric vehicle use – Supporting the adoption of autonomous vehicles	– Safe roads – Carbon offsetting project: clean water in Kenya	P S	1 3
Climate Action	Take urgent action to combat climate change and its impacts.	– Commitment to Science-Based Targets – Socially responsible investing	– Carbon offsetting projects: clean water in Kenya, rainforest protection in Brazil	P S	4 3

External memberships and benchmarks

Direct Line Group actively supports various initiatives related to climate change, ESG and sustainability. These supplement our identification and management of climate-related risks, and include:

CDP: The Carbon Disclosure Project is a globally recognised platform measuring reporting performance and this year the Group maintained its 'B' rating based on 2019 activity.

Sustainalytics: In 2020 the Group was ranked as an ESG leader out of all companies assessed in the property and casualty insurance sector and maintained its top ten position in the broader insurance industry group of 261 companies.

MSCI: The Group maintained its 'A' rating this year highlighting our Board-level diversity, staff training and development programmes and the strengthening of ESG integration into our investment portfolio. The Group is also in the top quartile for Corporate Governance and Human Capital development.

RE100: We are in the process of applying for membership of RE100, a global initiative dedicated to accelerating a global shift in clean energy. Under this initiative, we will continue our objective of sourcing 100% renewable electricity.

PRI: The UN Principles for Responsible Investment, launched in 2006, is a major collective initiative that seeks to promote responsible investment among investors and asset managers. We expect all of our external portfolio managers to be signatories.

SBTi: The Science Based Targets Initiative helps companies to determine emission reduction targets in line with climate science. In 2020 we began the process of setting new science-based reduction targets for our Scope 1 and Scope 2 emissions and Scope 3 emissions under our direct control. These targets will be submitted for approval within the two-years' time frame set by the SBTi (August 2022).

Customers

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

Our Covid-19 response for customers

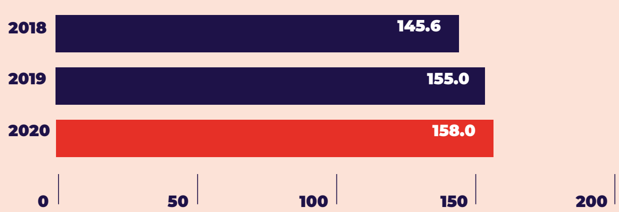
Throughout 2020 we adapted quickly to the changing world around us so that we could deliver more for customers at speed, helping them navigate the disruption to their lives. Some of the highlights included:

- free rescue cover, fast-track claims and free home emergencies for our NHS customers;
- individualised support for customers in financial difficulty;
- over 450,000 customers benefiting from support measures;
- our Travel team settled claims for over 26,000 customers with payments for those who saw their travel plans cancelled or curtailed due to Covid-19 disruption and repatriated over 900 customers stranded abroad; and
- retrained over 500 people to support travel customers to navigate the pandemic.

We seek to understand customer needs, providing real value across our brands and products. It requires a deep appreciation of customer expectations, a determination to provide an exceptional insurance experience and a consistent desire to innovate.

Our determination to deliver the best possible customer value and experience drove our response to Covid-19. We are proud that our net promoter scores have yet again demonstrated the willingness of our customers to recommend our Direct Line brand year on year.

Net promoter score[1] – Direct Line brand



Note:

1. Please see Net Promoter Score KPI on page 19 for further information.

We know that communicating clearly and openly with customers is important to our stakeholders and business. This is why our Customer Experience Pillars continue to guide the Group by using a clear framework with the aim of delivering great customer service. These principles have been invaluable this year when responding to the Covid-19 pandemic where we adapted to customer needs and changing circumstances across the business.

Customer pillars

Expectations
Manage and exceed my expectations

Ease
Make it as effortless as possible for me

Personalisation
Treat me like a real person and not like a process

Fix-it
Identify the issue, own it and fix it

Trust
Earn my trust

Empathy
Understand me and work hard to build a relationship

Strategic Report

Taking action on pricing

The insurance sector operates in a highly competitive market which works well for most customers. We support change to improve outcomes for long-standing customers and that is why we welcome the FCA's Market Study on General Insurance Pricing Practices. These reforms, that aim to equalise customer prices whether they are renewing or looking for a new policy, should reduce unnecessary turnover and deliver fairer prices to all.

Not all insurance products are equal across the market, with varying levels of cover and service. We offer a range of propositions to protect our customers, underpinned by a high-quality claims service for all customers to give them peace of mind.

We want to earn our customers' loyalty and give them a reason to stay with our brands by taking measures such as:

- actively reviewing customers' renewal price when they reach their five-year anniversary with us, as a result of which many of our customers have seen their premiums frozen or discounted;
- introducing a facility to enable a customer to opt out of automatic renewal through our web chat service; and
- investing in a major technology upgrade to help us make it easier for our customers to manage their protection, from the moment they think about buying a policy, managing their cover 24/7, all the way through to making a claim.

Caring for customers in need

Losing a loved one is always difficult and taking care of financial matters is the last thing on people's minds. This is why we created a dedicated team with specialist skills to help customers who want everything to be made as simple as possible when they experience a bereavement.

All queries are dealt with in one place by experienced consultants trained to handle the sensitive nature of these conversations. This helps to make a difficult task, that nobody wants to face alone, just that little bit easier.

Making claims easy

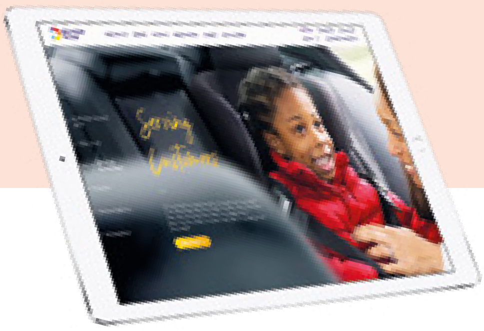
When customers make a claim they want peace of mind that it is being treated with due care, but we also know that speed matters. Whether it is fixing cars in our accident repair centres or assisting people who have suffered flooding or had their homes hit by storm damage, we want to help our customers get back to normal. This year our Travel customers' plans were turned upside down so we created a new claims prioritisation process that has handled claims up to five times faster for thousands of our travel customers.

Digital developments have also enabled us to make the claims process easier for customers who wish to claim online. As a result:

- our new online travel platform gives our customers the ability to settle small value claims in four minutes or less, without any human interaction at all; and
- customers seeking medical assistance abroad are offered localised care as we can recommend the nearest medical facility that can support them.

First end-to-end online Home claim

Our digital capability saw us deliver a first for the Group in 2020 by delivering an end-to-end online claims process for a Home customer – all registered, processed and settled fully online. This is the next step in our digital journey, giving customers the flexibility to handle their insurance matters how they want.



People

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

Our Covid-19 response for our people

The Group is nothing without its people. When lockdown happened we quickly moved 9,000 people to home working and supported our motor accident repair centres with enhanced safety measures, offering maximum flexibility to help our people manage home and work.

We aspire to create an environment where everyone feels free to be themselves and succeed in their careers. Our culture is one where we strive to care about our customers and one another. That's what our values are designed to achieve, and they underpin who we are and what we stand for.

Diversity and inclusion strategy

One of our values is "bring all of yourself to work" because as well as simply being the right thing to do, focusing on diversity and inclusion makes good business sense and delivers better outcomes.

This year we completed a comprehensive diversity and inclusion survey – to which nearly 6,500 of our people responded. It's shown us what we do well and where we need to improve, highlighting a gap between the experiences of different communities.

These findings have helped to inform a refreshed diversity and inclusion strategy, with greater ambition and reach.

Supporting race equality

Alongside our survey, we completed an in-depth analysis of our ethnicity data.

What we found:

- One in six or 17% of our colleagues is Black, Asian or Minority Ethnic ("**BAME**"); Black colleagues make up 3% of the total.
- BAME representation is concentrated in our lower and middle grades and reduces with seniority.
- If you are Black, mixed ethnicity, or from one of the smaller ethnic groups, it doesn't feel as positive to work for the Group as it does for other colleagues.

Our response:

We have signed Business in the Community's Race at Work charter and introduced new targets to hold ourselves to account for improving Black, Asian and Minority Ethnic representation in leadership roles by the end of 2022.

13%

Increasing BAME representation
in leadership roles from 10% to 13%

1.5%

Increasing Black representation
in leadership roles from 0.5% to 1.5%

Making progress

Supported by our employee networks, we have launched an awareness and education programme to build empathy and a greater understanding of issues. This includes a reverse mentoring scheme to help our senior leaders better appreciate the barriers and challenges faced by certain communities.

We have introduced new principles for senior-level recruitment to help protect from bias – including anonymised CVs and diverse shortlisting, as well as enhancing the mandatory training completed by recruiting managers.

All our leaders are completing inclusive leadership training and in 2021 we're launching a diversity and inclusion fluency programme to ensure all people managers are equipped to have better conversations and support their teams.

Diversity Network Alliance (DNA)

We have a vibrant DNA community that works together to promote and champion diversity and inclusion within our business.

Our strands

- BAME (Black, Asian & Minority Ethnic)
- Belief
- Generations, families & carers
- LGBT+
- Neurodiversity & disability
- Social mobility
- Thrive (representing gender)

The strands are led by volunteers from across the Group based in locations spanning the UK. They provide a network for colleagues and allies, as well as guiding our people policies and what we support externally.

Enabling gender equality

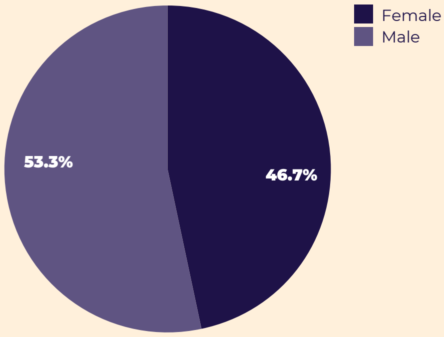
We are proud to be one of only a few companies in the FTSE 250 with a female Chief Executive Officer and Chair. We recognise that to enable women to fulfil their potential, we need to offer them support throughout their different career stages. Women have a different set of barriers to men and these need to be navigated in a different way.

In our 21 accident repair centres we want to encourage women to think about careers in the bodyshop industry through awareness of our engineering graduate programme.

Women in Finance Charter

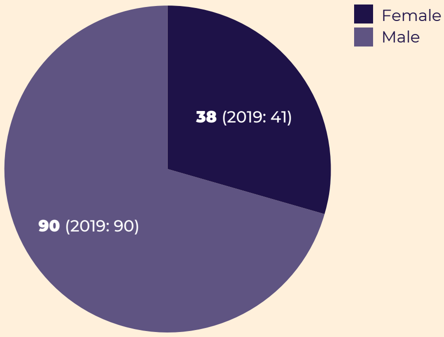
We are a signatory to the HM Treasury's Women in Finance Charter. At the end of 2020, 30% of our senior leadership were women. We are determined to go further and this year we took the decision to increase our target from 30% to 35% female representation in our senior leadership by the end of 2022 in order to maintain a keen focus on progression.

Gender diversity of all employees



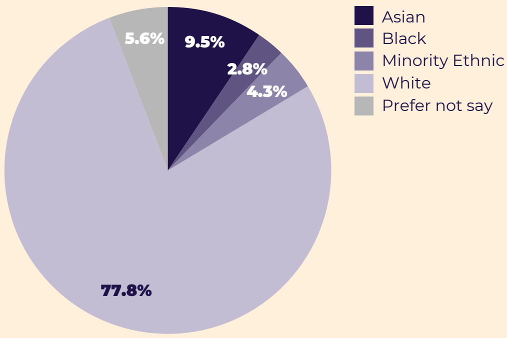
Excludes an estimated 0.5% colleagues who identify as non-binary, gender-fluid or other gender due to data reporting constraints

Gender diversity of senior leadership



Gender diversity of senior leadership figures based on 2020 Women in Finance reporting

Ethnicity of all employees



Excludes 13% of colleagues who have not submitted an option for ethnicity

For more information on leadership gender diversity see page 92

40%
female Board representation

30%
female senior leadership representation

Hampton Alexander Review
The Hampton Alexander Review set a target for FTSE 350 companies to have at least 33% representation of women on their Board and in their Executive Committee and direct reports by the end of 2020. We are pleased to have exceeded this with 40% and 39.1% representation[1], respectively.

Tech Talent Charter
As signatories to the Tech Talent Charter, we are committed to gender diversity across our technology teams. We are proud to have a 34% female tech team versus a UK average[2] of 19% and a signatory average of 25%.

Gender pay gap
Our gender pay gap continues to be low compared to the broader financial services sector; we know there is more to do. After three years of reporting we feel we understand our gender pay gap well, with a large portion of this being from the under-representation of women at more senior levels across the Group.

This is why we have continued to invest in development programmes for high-potential females to support them in progressing into senior leadership roles. This helps our women to think differently and start taking risks, put themselves forward and make a plan to advance more quickly through the organisation.

Flexibility
Additionally, our My Life policies, offered to all our people, provide flexibility and support at work to do the things that matter to people outside work. We believe it's important that everyone embraces flexibility because that's the only way we'll ever achieve gender equality. We have pushed this policy further over the last 12 months to ensure those with caring or home-schooling responsibilities as a result of Covid-19 are not disadvantaged.

Supporting and developing our people
As we adjust to this new way of working remotely, we remain committed to looking after our people. This includes a programme where both financial and mental wellbeing are top priorities.

Minimum salaries
Our success is down to the hard work and commitment of our people and we want to reward them for their contribution. Whilst we look for ways to boost the reward proposition for as many of our colleagues as possible, our focus is to ensure that those in our lowest-paid roles receive a meaningful pay increase. In March 2020, for the third year running, we increased our minimum salaries for full time colleagues working 37.5 hours from £19,000 to £19,500 which is 19% higher than the Government's National Minimum Wage and 5% higher than the Living Wage Foundation rate outside London, benefiting 5,200 of our people.

Annual incentive plan
The annual incentive plan ensures there is a strong link between pay and the Group's performance on specific metrics, such as our Customers' Experience agenda which focuses on making the customer's journey as easy as possible, and broadening our diversity impact to include BAME and Black representation targets at senior leadership positions.

Employee share incentive scheme
Despite the impact of Covid-19, we are continuing with our commitment to award free shares. The Group awarded eligible colleagues 180 shares which were worth £500 in April 2020. For employees who have been with the Group since our IPO in 2012, this was our fifth award of free shares totalling 626 shares which were worth £1,997 at 31 December 2020, plus dividends paid on those shares which amount to a further £793.

Mental health
We strongly encourage our people to be open about how they feel both in and out of work so we can best support them. Our mental health programme includes ensuring people managers receive specialist training on dealing with mental health issues. Pre-lockdown we had a network of trained mental health first aiders (MHFA) – one on each floor of each of our sites and we are proud of how quickly our approach adapted to deliver the same support remotely.

We are determined to raise the profile of mental health, supporting everyone to be open about how they feel in and out of work. Over the course of the pandemic the Group ran frequent pulse surveys to assess the sentiment and wellbeing of employees whilst many were working remotely.

Notes:
1. Board representation at 11 January 2021 and Executive Committee & direct report representation at 31 October 2020 as per Hampton-Alexander data sourcing.
2. Source: https://www.techtalentcharter.co.uk/toolkit

Talent pipeline

We have continued to invest in our graduate and apprenticeship programme over the years and we recognise they are key to driving our digital agenda and building a 'fit for the future' organisation. To date, we have recruited over 180 people into our graduate programme and it is designed to develop the people who will enable us to create an exciting future. Our apprenticeship scheme has won the Top 100 Apprenticeship employer three years running, which reflects our standing in the market.

New ways of working

Earlier this year we took the decision to radically change the way we worked and transform our trading and change areas into an agile business. Agile is a way of working that began in the tech sector to improve the speed that a product went from conception to market. We decided that adopting agile values, principles, tools and most importantly mindset would allow us to deliver customer value faster. We chose to press ahead with the transformation as the sudden change to our work and home lives only served to emphasise why our people needed to be empowered to self-organise and create new ways of doing things providing solutions for customers as quickly as possible. An immense amount of work went into consultation with our Employee Representative Body ("**ERB**") and our people so that we could create an agile model that's true to the Group and can take advantage of the investment we have already made in our technology.

Human rights

Happy people deliver better outcomes for our customers and the business overall so we strive to ensure that our employment practices and policies exceed those in the Universal Declaration of Human Rights. Whether that's our wellbeing strategy which supports mental, physical and financial health, or our My Life policies which help our people balance work and life priorities or our policy to pay more than the Living Wage to all our people. We want to help our people thrive in and outside of work.

Employee Representative Body

We are proud to have an active and engaged ERB. They help us share and discuss proposals and initiatives that may affect our future and are consulted as part of any future change programme. During the agile transformation the ERB helped individuals understand what the changes were, helped communicate the views of colleagues and provided alternative proposals and approaches.

Society

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

Our Covid-19 response for society

The Group wants to support communities throughout the UK which is why we prioritised social mobility in 2020 and established our Group Community Fund in response to the Covid-19 pandemic, working to deliver £3.5 million to 250 charities, helping over 200,000 people.

How we choose to give back to our communities and what to campaign on all have a bearing on society and in turn how we remain a force for good. The actions we take are all focused on making a tangible impact which leads to lasting change.

Our commitment to social mobility

Our diversity makes us stronger. We are a business employing thousands of people throughout the UK who all possess a variety of skills, experiences and, crucially, bring different perspectives to our work.

We pride ourselves on a culture that celebrates difference and authenticity, where colleagues can bring their whole self to work.

Celebrating difference, however, is more than simply catering for a multitude of voices. A person's background should never act as a barrier, but like other companies we know that people still feel held back from making progress.

Social Mobility

The reasons can be complex and specific for each individual. That's why we have a renewed sense of purpose in supporting people throughout their career. It's not simply about attracting people into the Direct Line Group family, but also what happens once they have joined so that people can be helped to fulfil their career potential.

That's why "Getting In, Getting On, Getting Ahead" is how we think about social mobility as a Company – creating an environment where people feel confident whatever their start in life.

SoMo DNA strand

Our newly established Social Mobility Employee Network – known across the business as "SoMo"– is a driving force behind how we talk about the issue. What started as a small group is now growing with over 100 active members.

SoMo seeks to raise awareness of social mobility issues, establish role models to inspire others from similar backgrounds, and encourage more open conversations about social mobility in the workplace. It has provided an open forum for people to speak about barriers and inspire confidence, as well as driving some of the Group's outreach activity.

Social Mobility Action Plan

SoMo group

With the support of our active Social Mobility Employee Network, we have backed up our decision to sign the Social Mobility Pledge by working towards creating our own bespoke Social Mobility Action Plan. This plan provides a candid assessment of our current approach and how we can improve.

- We are exploring how to take advantage of remote working so we can open up new recruitment areas, starting with a pilot scheme of over 20 apprentice home workers.
- We are reviewing our recruitment approach to target social mobility 'cold spots' where our main offices are based.
- We have surveyed colleagues to understand what our social mobility make-up is across the business because we know that with meaningful data our interventions will have more impact.

Insight day

In 2020 we partnered with the Social Mobility Business Partnership to run our first work insight and skills day for bright students from less advantaged backgrounds to give them the opportunity to hear from companies directly and learn what career opportunities are available. It was a pleasure to support their future career aspirations by explaining what life is like at the Group.

Auto-Raise

We're delighted to have made a corporate donation to Auto-Raise, a long-standing charity partner that supports youngsters who wish to enter the bodyshop industry and receive relevant qualifications so they become the vehicle repairers of the future.

Teach First

We've partnered with Teach First, who recruit, train and place teachers in schools in some of the most disadvantaged communities in England. Our funding will support the training and development of 17 teachers each year, who will go on to reach over 2,000 pupils. Colleagues will also be hosting work experience placements at our offices.

Achievement for All

Our Social Mobility DNA strand this year used the Group's Community Fund to partner with Achievement for All which provide wellbeing and education support for disadvantaged young people to thrive emotionally, socially and academically. Our partnership will focus on schools in Walsall, Barnsley and Doncaster where our commitment to social mobility is matched with tangible impact in communities located near to some of our main office sites, also offering the opportunity for colleagues to become mentors.

Envision

This year we supported Envision, who are long-term partners of our Bristol office to provide the Community-Apprentice Programme for school children. By setting group tasks it aims to empower young people through problem solving, building confidence, as well as testing teamwork skills, all guided by mentors from the Group. Through programmes such as this it supports participants to gain knowledge about what skills are required in the work place.

Our tax contribution

A key part of being a responsible corporate citizen is ensuring that we comply with all applicable tax laws and regulations and meet our responsibilities both as a contributor of corporate taxes and as a collector of taxes on behalf of HMRC. In 2020 the Group's total tax contribution was £888.0 million which includes the Group's direct and indirect taxation. More information can be found in the tax contribution section on page 35.

Suppliers

The Group is a long-standing signatory of the Prompt Payment Code. This year Green Flag supported our independent network of 200 local rescue businesses by offering a number of them support payments which contributed to the protection of over 4,000 key workers when lockdown started. We take our commitment to ensuring modern slavery is not present in our supply chain seriously. The Modern Slavery Act 2015 is incorporated into our risk profiling, with specific requirements incorporated in our due diligence and assurance processes.

Group's 2020 total tax contribution

Our customers	IPT	**£397.0m**
Our suppliers	VAT	**£11.3m**
Our people	PAYE NIC	**£97.9m**
Our operations	Other taxes including business rates	**£9.1m**
	Irrecoverable VAT	**£237.7m**
	Employer's NIC	**£39.8m**
Our profit	Corporation Tax	**£95.2m**

HM Treasury

£888.0m[1]
total tax contribution

Society

- **Public services**
- **Healthcare**
- **Infrastructure**
- **Welfare**
- **Education**
- **Defence**

Note:
1. The Group's total tax contribution in 2020, including direct and indirect tax contributions.

Road safety campaigners

As one of the UK's leading motor insurers we have a long tradition of campaigning for improved road safety. This year we worked with the Parliamentary Advisory Council on Transport Safety ("**PACTS**") to highlight increased numbers of road deaths and serious injury where people do not wear a seat belt. Our research discovered that almost a third (31 per cent) of those who died in vehicles on Britain's roads in 2018 were not wearing a seat belt and that 72 per cent of the British public wanted the introduction of penalty points for those caught not wearing a seat belt. We will continue to campaign with PACTS to increase the penalty for failing to wear a seat belt because it saves lives.

Our Community Fund

We immediately responded to the Covid-19 crisis by establishing our very own Community Fund targeting much needed resource to charities and local authorities where our main office sites are based. It was a small way of providing a helping hand to a variety of causes throughout the UK.

Phase 1:

£2 million of immediate support to the most vulnerable, directly assisting children and families in refuges, parents needing baby packs, food banks and community groups

Phase 2:

£500,000 for colleagues to nominate 180 local causes they cared passionately about with micro-donations

Phase 3:

£1 million directed towards recovery efforts focused on four pressing challenges: social mobility, marginalised groups, food poverty and public health

£2m
of immediate support to the most vulnerable

£500k
180 charities received donations of up to £5,000

£1m
directed towards recovery efforts

Community Fund 2021
We know that Covid-19 will continue to dominate our lives throughout 2021 and we have allocated £1.5 million to support charities across the coming year.

Computers for kids
Following our immediate crisis support to refuges, we funded 700 laptops for KidsOut to distribute to children in support of their education. Since then the first donation from our 2021 Community Fund has seen £125,000 go towards the Daily Mail's Computers for Kids campaign.

ABI Covid-19 Support Fund
We also donated £3.6 million to the ABI's Covid-19 Support Fund which has supported hundreds of charities across the UK.

Giving back to our communities
Colleagues have taken advantage of our popular Community Cashback initiative which awards £250 to chosen charities.

Planet

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

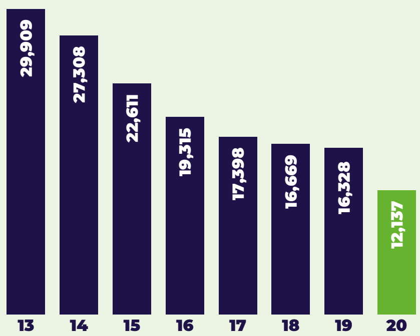
45%
reduction in energy consumption compared to 2013[1]

69%[2]
reduction in CO_2 emissions (Scope 1 and 2) compared to 2013[1]

Enabling and encouraging flexible working

The impact of climate change has far reaching implications for economies and societies around the world. We are determined to contribute to a long-term sustainable future and know that through our actions as a business we can contribute to climate risk mitigation and help to accelerate the transition to a low carbon future. There are three steps to our plan.

Greenhouse gas emissions (tCO_2e)[3]



Energy consumption (kWh)

	2020
Electricity	16,669,842
Gas	21,699,765
Total	**38,369,607**

Step one:

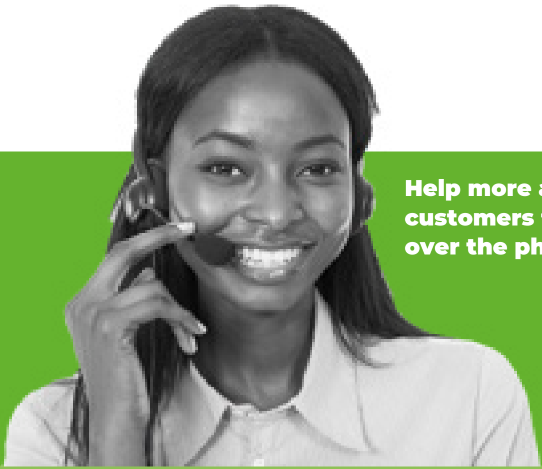
Disclose to track progress

We have always challenged ourselves to reduce emissions and energy consumption across the business through greater transparency. We exceeded our 2020 targets set in 2017 against a 2013 baseline and now intend to hold ourselves to account against a new 2019 baseline.

We comply with the applicable greenhouse gas reporting requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and apply the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) to calculate our emissions, which includes emissions associated with electricity consumption using both the Location-based Scope 2 and Market-based Scope 2 calculation methodologies. We monitor the intensity metric of emissions per £ million of net earned premium as a measure of how efficiently we provide our insurance products (see page 61). We also engage with the Carbon Disclosure Project ("**CDP**") and recently maintained a 'B' rating based on 2019 activity.

We have always published our Scope 1 and 2 emissions, but this year we wanted to go further by breaking down our emissions across our offices and our accident repair centres and by publishing our first TCFD report (see page 62).

We also began the process of evaluating our Scope 3 emissions starting with those under our direct control (such as waste disposal and business travel) and purchased goods and services. Plans are underway to evaluate the final part of our Scope 3 emissions, and our investment portfolio in 2021.



Help more and more customers fix cars over the phone

100%
carbon neutral business in 2020[4]

Aiming to be the most energy efficient repair network in the UK

100%
of office waste diverted from landfill

Step Two:

Commit to tangible actions

We have committed to set Science-Based Targets for Scope 1, 2 and 3 emissions within the two-years timeframe set out by the SBTi. On Scope 1 and 2 emissions, we intend to set a target that enables us to play our part in holding off some of the worst climate impacts by limiting the global temperature rise to no more than 1.5°C above pre-industrial levels.

Step Three:

Offset while we reduce

We know that it will take time to reduce our emissions so in the meantime we have made a long-term commitment to be a 100% carbon neutral business by offsetting Scope 1 and 2 emissions as well as the elements of our Scope 3 emissions which are under our direct control.

This year we achieved carbon neutrality by working with ClimateCare who has over 22 years of experience in project development, carbon asset development, and delivery of corporate carbon programmes.

Over the next three years we are funding carbon offsetting projects which will also deliver high social impact benefits in three countries.

Notes:

1. See page 66 for more information on reduction targets. All emission and energy use data reported are related to UK operations.
2. Scope 1 and 2 emissions are reported here on a like-for-like basis against a 2013 baseline and exclude emissions from additional vehicles used during repairs, courtesy car fuel usage and from vehicles that are Company-funded. For our full Scope 1 and Scope 2 results inclusive of these emissions please see page 61.
3. Total scope 1 and 2 emissions. The 2019 result of 16,328 tCO_2e differs from the reported result in the 2019 Annual Report and Accounts of 13,932 tCO_2e as it now includes the additional emissions cited in footnote 2. The 2020 result is inclusive of these emissions.
4. By offsetting Scope 1 and 2 emissions as well as the elements of our Scope 3 emissions under our direct control.

Our journey to net zero

Each year we will become less reliant on carbon offsetting to achieve net zero. Through our "Greener, Cleaner Action Plan" we aim to mitigate our impact on climate change:

- **Offices:** Reimagining the way we work by investing in energy-efficient features, encouraging flexible working, improving recycling rates, continuing to use 100% renewable electricity and ensuring 100% of office waste is diverted from landfill.
- **Accident repair centres:** Aiming to be the most energy-efficient repair network in the UK by investing in our estate and repair processes.
- **Green Flag:** Reducing mileage and supporting sustainable transport through efficiency initiatives, such as optimising our roadside fix rate to reduce our mileage and tow fewer vehicles.
- **Our supply chain:** Extending our reach by calculating and disclosing our Scope 3 purchased goods and services emissions and exploring how we can work with individual suppliers to drive lower emissions.
- **Our customers:** Supporting green choices by conducting customer market research to explore attitudes to insurance.

Our investments: moving climate up the agenda

- 100% of our portfolio will be net carbon neutral by 2050
- Corporate bond portfolios are committed to a 50% reduction in weighted average greenhouse gas emission intensity by 2030
- A preference for companies with carbon reduction targets approved by the Science Based Targets initiative
- A preference for companies with at least a 2°C carbon performance alignment with the Transition Pathway Initiative
- The exclusion of any companies with a carbon transition score indicating assets could be economically stranded
- The exclusion of any mining companies that generate >5% of revenues from thermal coal production and electricity generators that derive >5% of revenues from thermal coal power generation (unless, in either case, the company has an approved Science Based Targets initiative plan)
- The exclusion of any companies that are developing new thermal coal mines or coal burning power plants
- Ensuring all of our investment-grade corporate bond portfolios maintain an average MSCI ESG rating of 'A'

Continuing to invest in energy reduction measures

This year the Group continued to invest in energy efficient measures with over £2 million invested in our office estate including:

- New electric air conditioning systems in our Bromley office enabling a reduction in gas usage and better maintainability
- Installation of LED lighting and new power systems in our Birmingham and Glasgow offices which could lead to a 50% reduction in electricity use

This year the Group was also awarded the ISO 14001 accreditation by the Lloyds Register Quality Assurance body for our office management – an internationally agreed standard that helps organisations improve their environmental performance.

We have also continued to invest in our auto services sites catering for their individual energy efficiency needs:

- Installing a new air conditioning system in our Peterborough site allowing for more accurate temperature control, alongside a reduction in electricity usage compared to conventional units
- Training technicians in new repair techniques which reduce the need for repair materials and reliance on paint spray booths
- New LED lighting in our Weybridge site enabling energy savings of up to 60%, a reduction in maintenance costs over a projected lifespan of 10 to 20 years
- Two new dual electric car charging points in our Birmingham site preparing for the rise in electric vehicle usage

Our offsetting projects

Over the next three years, we will offset those emissions we can't yet avoid through projects that cut carbon emissions whilst also delivering tangible benefits to local communities and environments in three countries:

- **Rainforest protection, Brazil:** Our funding will support efforts to prevent unplanned deforestation across 350,000 hectares of the Portel micro region, through training and educating local communities in alternative agroforestry methods. By opening up new economic opportunities, the project is reducing slash and burn agriculture, which has been one of the largest contributors to deforestation. The project is also providing access to official land titles for native families and is protecting more than 30 vulnerable species.
- **Water filters, Kenya:** Our funding will support the distribution of safe water filters for families. As well as delivering health impacts, the project also reduces the need for people to boil water to make it safe to drink, which requires the burning of unsustainable energy sources such as wood or charcoal. This reduced reliance on fuel reduces family expenditure and reduces pressure on forests, as well as cutting carbon emissions.
- **Clean cookstoves, Bangladesh:** Less than 20% of Bangladeshi households have access to clean cooking, instead using traditional "three-stone" fires, contributing to approximately 49,000 premature deaths a year. Our funding will support entrepreneurs to produce, manufacture and distribute the "bondhu chula", a clean cookstove designed for an efficient burn to reduce fuel use.

Group emissions

Our 2020 progress against our new 2019 baseline represents our most transparent emission reporting to date. In 2020 we were able, for the first time, to break out our Scope 1 and Scope 2 emissions into separate performance figures across our office sites and accident repair centres, and disclose a Scope 3 footprint with greater clarity of the activities under our direct control. Emission results reported below are all related to UK operations.

Scope 1	**2020**		2019 baseline	
Office sites	**1,432**		1,881	
Auto services[1]	**6,819**		7,838	
Total (tCO_2e)[1,2]	**8,251**		9,719	
Scope 2	**2020**		2019 baseline	
	Location-based[3]	**Market-based[3]**	Location-based[3]	Market-based[3]
Office sites	**2,176**	**0**	4,516	0
Auto services	**1,710**	**0**	2,093	0
Total (tCO_2e)[4]	**3,886**		6,609	
Scope 3 emissions under our direct control	**2020**		2019 baseline	
Fuel and energy related activities	**2,332**		2,465	
Waste generated in operations	**413**		1,245	
Business travel – air travel	**198**		928	
Business travel – hotel night stays	**75**		469	
Business travel – rail	**63**		410	
Employee commuting[5]	**1,450**		4,599	
Upstream leased assets[1,6]	**63**		193	
Upstream transportation and distribution of auctioned vehicles	**625**		912	
Total (tCO_2e)[1]	**5,219**		11,221	
Direct Line Group carbon footprint (operational control)	**2020**		2019 baseline	
Office sites (Scope 1&2 tCO_2e)	**3,608**		6,397	
Auto services (Scope 1&2 tCO_2e)	**8,529**		9,931	
Total Scope 1&2 (tCO_2e)	**12,137**		16,328	
Total Scope 3 under our direct control (tCO_2e)	**5,219**		11,221	
Total (tCO_2e)	**17,356**		27,549	

In addition, we monitor the intensity metric of emissions per £ million annually of net earned premium. This is a measure of how efficiently we provide our insurance products and allows us to compare our performance year-on-year and against other insurance companies.

Intensity metric

Year	Emissions per £ million of net earned premium[7]
2020	**4.1**
2019	5.5
2018	5.4
2017	5.5
2016	6.4
2015	7.7
2014	9.1
2013	9.5

Notes:

1. The 2019 result differs from the Group's TCFD 2020 report published in December 2020 as a result of a reclassification of 320 tCO_2e from upstream leased assets (Scope 3 under our direct control) to Scope 1 auto services.
2. The 2019 Scope 1 total of 9,719 CO_2e differs from our previously reported figure of 7,365 CO_2e in the 2019 Annual Report and Accounts as it now includes emissions from additional vehicles used during repairs, courtesy car fuel usage and vehicles that are Company funded, which had not previously been tracked. The 2020 result includes these emissions.
3. Figures for Scope 2 use standard location-based methodology. We follow GHG Protocol to disclose both location and market-based figures; and as we have secured our energy from 100% renewable sources since 2014, our Scope 2 market-based results are nil.
4. The 2019 Scope 2 total of 6,609 CO_2e differs from our previously reported figure of 6,567 CO_2e in the 2019 Annual Report and Accounts following recalculation.
5. Employee commuting is based on UK national averages, not actual individual methods of transport of Direct Line Group employees commuting. This data is not currently tracked.
6. Upstream leased assets refer to leased office space locations where Direct Line Group does not directly control the energy provision as it is included in the service agreement.
7. Prior to 2019, the emissions used in the calculation of the intensity metric excluded emissions from additional vehicles used during repairs, courtesy car fuel usage and vehicles that are Company funded, as these were not previously tracked. The 2019 result has been re-presented accordingly (reported as 4.7 in the 2019 Annual Report and Accounts). The 2020 result includes these emissions.

Task Force on Climate-related Financial Disclosures

This year the Group published its first comprehensive climate disclosure reporting against the Task Force on Climate-related Financial Disclosures ("TCFD") framework. TCFD has enhanced our reporting and we are confident it will continue to do so as we strengthen our strategic response to one of the biggest challenges facing the world today. A summary of the Group's 2020 TCFD Report follows.

For access to the full report please go online at: www.directlinegroup.co.uk/2020_TCFD_Report

Governance

The Group prides itself on good sustainability governance underpinned by our Vision and Purpose and a clear commitment from the top to align sustainability goals and ensure relevant accountability across the business.

The Sustainability Steering Group, led by our CEO, drives the sustainability agenda through our sustainability pillars, each of which is sponsored by a member of our senior management team. Our five-pillar sustainability strategy, endorsed by the Board, aims to foster the highest standard of ESG practice and deliver long-term sustainability for all of our stakeholders. The Planet pillar takes the lead on climate-related issues and is sponsored by our Chief Risk Officer ("**CRO**").

Board and Committees

The potential impact of climate change on the business ("**inbound**"), as well as the Group's impact on the environment ("**outbound**"), are issues that have grown in importance and sit firmly within the Group's governance approach.

The Board has oversight on two key aspects of the Group's approach:

- the Board considers and approves the Group's strategic and financial plan ("**the Plan**") annually and monitors progress at each of its meetings during the year. In approving the Plan, the Board reviews and approves the Group's Own Risk and Solvency Assessment ("**ORSA**"), which includes an analysis of the climate change-related risks to the business; and
- the Board oversees the Group's sustainability activity through its Committees which scrutinise and provide appropriate challenge on the Group's five pillar sustainability strategy. The Chair of each Committee reports to the Board after each Committee meeting, including on sustainability activities when relevant.

The Board sets and monitors the Group's performance against its risk strategy, risk appetite and risk framework and has also established a risk management model that separates responsibilities into 'Three Lines of Defence'.

- The First Line of Defence is the Group's management roles with responsibility for owning and managing risks to achieve business objectives on a day-to-day basis.
- The Second Line of Defence is the Risk Function which is responsible for the design and implementation of the Enterprise Risk Management Strategy and Framework, and provides proportionate oversight of, and challenge to, the business's handling of risks, events and management actions.
- The Third Line of Defence is Group Audit, providing an independent and objective view of the adequacy and effectiveness of the Group's risk management, governance and internal control framework. The Group Audit Plan includes sustainability and climate change-specific reviews.

Management's role

There are three primary management roles designed to assign responsibility for the delivery of the Group's assessment and management of climate-related issues:

- the CEO has overall responsibility for climate change and environmental matters;
- the CRO is responsible for overseeing the management of climate change-related financial risk and sponsors the Planet pillar of the Group's sustainability framework. The CRO is also the senior manager with responsibility for assessing and monitoring climate change-related risk. In that capacity, the CRO oversees the work of the Risk function in analysing and stress testing the potential future impact of climate change on the business. The results of these stress tests are submitted to the Risk Management Committee, the Board Risk Committee and the Board, including as part of the ORSA; and

- the Chief Financial Officer ("**CFO**") is responsible for setting the Group's investment strategy and is advised by the Investment Committee on the application of ESG weightings, including those related to climate change, to the relevant portfolios. The CFO is a member of the Committee and the CEO, CRO and the Director of Investment Management & Treasury are attendees.

In addition, the Climate Change Working Group has been established to help assess the potential impacts of climate change on the Group. Members of this working group represent various teams from across the business with the aim of ensuring risks are identified and managed effectively.

Strategy

Our strategy is to drive change across our underwriting activity, our operations and our investments. The specific impacts of climate change on our business are diverse, and fall into three broad categories:

- **Physical risks and opportunities** resulting from the physical effects of climate change such as weather-related events. This is important to our business as it includes the potential for increased insurance claims, driven by both the frequency and severity of natural catastrophes and other weather-related events in the UK.
- **Transition risks and opportunities** arising from efforts to mitigate climate change, which are driving the transition to a lower-carbon economy. This is significant as we navigate this transition, ensuring our insurance products and operations continue to meet our customers' needs as a result of any changes in market dynamics and customer behaviour, for example a shift towards electric vehicle usage.
- **Liability risks** arising when parties who have suffered losses from climate change seek to recover them from those they believe may have been responsible. This is important to our business, because this includes exposure to liability risk through commercial liability insurance.

We have defined the following time horizons for these risks: Short (1-5 years), Medium (5-10 years), and Long (10+ years). In general, transition risks are likely to materialise more rapidly than physical risks, which are likely to be gradual and materialise in the longer term. The timing of liability risks is less certain due to the nature of the exposure.

Stress test

We participated in the PRA's 2019 insurance stress test which considered the impact of climate change on our business, based on three hypothetical climate change scenarios.

- **Scenario A**, a rapid, disorderly transition to a low-carbon economy.
- **Scenario B**, a slow, more orderly transition that keeps global temperatures well within the Paris Agreement target of 2°C of warming.
- **Scenario C**, a scenario with failed future improvements in climate policy, reaching a temperature increase in excess of 4°C (relative to pre-industrial levels) by 2100 assuming no transition and a continuation of current policy trends.

Whilst the transition scenarios saw material impacts on the investment portfolio, the most notable impacts on both investments and insurance liabilities arose from the physical effects of no transition, that is no additional actions beyond those already announced. Based on the PRA specifications, Scenario C, in which physical risk dominates, resulted in the most significant impact on the Group but did not breach risk appetite despite not allowing for reinsurance. This demonstrates the resilience of the Group's strategy to such a scenario. Furthermore, the projected time frame (2100) for this scenario is likely to allow the business to adapt.

Further disclosure on the outputs from the scenario analysis can be found in our full TCFD 2020 report, pages 11 to 13

Risk time horizons

Short (1 – 5 years)	Medium (5 – 10 years)	Long (10+ years)
Increasing frequency and severity of natural catastrophes and other weather-related events in the UK. As a general insurer we have the ability to re-price annually and transfer risk through reinsurance arrangements. This is likely to limit insurance liability impact in the short term.	Strategic and operational response to the transition towards a lower-carbon economy. This will include including changes to risk nature, opportunities and risks within our supply chain and repair processes and changes to, and opportunities in, our product offerings.	The impacts of risks and opportunities that need to be considered over the longer term include significant adjustments to weather-related modelling, a shift in dynamics within the markets we operate in and continued efforts towards net carbon neutrality in our investment portfolio.

Strategic approach

Our strategy focuses on the Group's underwriting activity, our operations and our investments where we assess the inbound and outbound risks and opportunities.

A full explanation of our strategic response can be found in our 2020 TCFD Report[1]

Underwriting

Climate change is a key risk facing the insurance industry. It has the potential to affect both the frequency and severity of natural catastrophes and other weather-related events in the UK which are key drivers in the Group's solvency capital requirements.

In our Motor business, the transition to electric-powered vehicles could affect strategic and operational considerations, including changes to the profile of accidents and changes to the nature of risks, supply chain and repair processes. Understanding this transition provides an opportunity to ensure optimum risk assessments influence pricing decisions and seek to ensure an efficient repair process in our accident repair centres.

Developing further insight into electric-powered vehicles for pricing considerations, the nature of the risks involved, developing efficient repair practices and strengthening technical expertise in our accident repair centres are therefore commercial opportunities. Failing to do this could have an adverse impact on market share if the Group fails to grasp the scale of the transition in the medium term.

Climate change also creates the opportunity to enhance our risk-modelling expertise that can strengthen our pricing decisions. Remaining active participants in developing solutions to influence the debate on weather-related events gives the Group an opportunity to enhance risk modelling and ensure commercial impacts are understood, particularly how claims and fulfilment operations function, for example flooding and resilient repairs in our Home business. Changes in building codes and standards could also impact the way the Group prices property underwriting risk.

Consumers and existing customers could gravitate in greater numbers to competitors as part of a desire for environmentally friendly products. This is a risk and opportunity in equal measure. Developing products that could encourage a reduction in emissions would highlight the Group's capability to customers, opening up a potential commercial opportunity, for example mileage refund propositions for motor customers.

The Group is now conducting market research on consumer attitudes to green products in the insurance industry in order to give the Group greater insight into their commercial viability.

Operations

Our operations are exposed to physical and transition risks. Climate change could disrupt our direct operations as it has the potential to affect both the frequency and severity of natural catastrophes and other weather-related events in the UK. We could also face increased operating costs due to potential carbon cost increases and regulatory requirements designed to limit carbon emissions. In seeking to mitigate such potential challenges the Group is setting reduction targets, improving the way individual business areas operate and the way we leverage our relationship with suppliers.

A failure to set long-term emission reduction targets for business operations could see energy consumption and costs increase. Targets, however, allow the Group to focus on energy reduction across its estate and be transparent about progress achieved.

We continue to invest in energy-efficient features and equipment across our office estate and accident repair centres providing the opportunity to reduce energy costs, which could otherwise increase. The Group is also improving operational efficiencies in order to save energy costs and mitigate environmental impact, for example, in our roadside rescue and recovery business where we are focused on lessening our impacts by reducing our mileage through attendance efficiency. More information can be found on page 20 of the Group's 2020 TCFD Report.

Our responsibilities extend far beyond our direct operations. Therefore, another key area of focus for us is to continually enhance our understanding of the risks and impacts in our supply chain and continue to drive improvements that are designed to minimise carbon and waste.

We recognise that total Scope 3 emissions could either increase or reduce as a result of how we manage our supply chain, particularly the goods and services we purchase. Once approved, our new Science-Based Targets will enable the Group to monitor its progress and the effectiveness by reducing emissions in our supply chain.

We will use our established relationships and purchasing power through procurement to mitigate our risks by seeking to reduce the emissions in our supply chain, while we support our supply chain partners to adapt to a low-carbon world. Once approved, our new Science-Based Targets will enable us to monitor our progress and the effectiveness of this approach.

Note:

1. For access to the full report please go online at: www.directlinegroup.co.uk/2020_TCFD_Report

Investments

In recent years we have started to integrate more ESG considerations into our investment strategy, recognising this is a long-term process which will require assessment and challenge to inform future decision making. We know that the impacts of potential physical and transition risks arising in the wider economy can have an impact on our investment portfolio, through their influence on the value of assets.

Our largest asset portfolios are focused on corporate bonds, and in early 2019 we introduced a significant new initiative. The Group's investment-grade portfolios, representing the bulk of its fixed income investments, now include a new investment objective: to achieve a minimum MSCI ESG rating of 'A' for the portfolio. Companies with higher ESG credentials have more sustainable practices, so this new objective has enabled us to better align our investment goals with our environmental and social goals. We are proud to have achieved the objective and, by the end of 2019, 100% of the investment-grade corporate bond portfolios had an average ESG rating of 'A'.

We are also actively encouraging our investment managers to invest in green bonds. Green bonds are designated bonds intended to encourage sustainability and to support climate-related or other environmental projects. All our relevant bond mandate guidelines direct the portfolio manager to purchase a green bond where the risk/return characteristics are similar to those of a non-green bond.

We hold an investment property portfolio, and all assets in this portfolio must have an Energy Performance Certificate of 'D' or better, or a plan and funds in place for achieving that level. This is one level above the Government-mandated efficiency level of 'E'. The property portfolio also has a tailored set of 2022 ESG targets covering, amongst other things, carbon, energy, water and waste.

Looking ahead, we intend to increase our efforts to develop a more focused climate-related investment approach with a long-term goal of ensuring our entire investment portfolio is net carbon neutral by 2050.

Our first steps on this path relate to our corporate bonds portfolio, the largest part of our investment portfolio. Across these portfolios we have committed to a 50% reduction in weighted-average GHG emissions intensity by 2030, benchmarked against 2020 levels.

We recognise the importance of avoiding investing in the companies least prepared for the transition to a low-carbon economy due to the risk of stranded assets. In response, we are working to increase allocations to those companies providing the solutions and those demonstrating a serious intent to decarbonise.

We also know that to meet the aims of the Paris Agreement, energy generation from fossil fuels will have to be drastically reduced in the coming decade. From 2021, asset managers will not be authorised to buy bonds in mining companies that generate more than 5% of revenues from thermal coal production, and electricity generators that derive more than 5% of revenues from thermal coal power generation. To encourage positive climate action, an exception will be made for companies which have either made commitments for emission reduction targets through the SBTi or assigned a '2 degree' or better Carbon Performance Alignment from the Transition Pathway Initiative. We also plan to exclude companies that are developing new thermal coal plants or mines, in a time frame consistent with our application to the global corporate renewable energy initiative, RE100. We will review the above exclusions annually and may, in the future, divest completely from companies with any involvement in coal or expand the list to include other types of fossil fuels.

Alongside these actions against our investment-grade bonds, we are committed to a wider framework which encompasses all asset classes to deliver our net carbon neutral long-term goal (see page 31 of the Group's 2020 TCFD Report).

Risk management

The predominant direct physical drivers of risk to the Group's capital position are UK floods and major UK windstorms. Whilst additional risks such as freezing weather and subsidence are less material to capital requirements, these are modelled within the Group's Internal Economic Capital Model and reviewed at least biennially.

The influence of climate change is difficult to isolate from the complex oceanic and atmospheric processes driving UK weather. The Group uses catastrophe models to capture these factors, and in turn these models are regularly reviewed against specific criteria including how they have considered latest scientific thinking, to ensure they appropriately capture the Group's risk profile. Responsibility for this work sits within the Capital Modelling function.

Our most exposed policies renew annually and are priced according to risk. Pricing algorithms use sophisticated rating engines to account for recent trends and are supplemented with views of catastrophic risk to seek to ensure sufficient pricing. These prices will evolve as climate change influences manifest themselves through changing loss patterns, and views of catastrophic risk develop because of rising sea levels, changes in precipitation rates and urban resilience.

Risk pricing models are built using historical data covering a multi-decadal time period for perils most likely to be influenced by climate change. This allows us to understand and incorporate long-term signals and past trends into our modelling.

These models benefit from considerable amounts of internal and externally purchased data. External data is reviewed and updated regularly, and we maintain a relationship with data suppliers to understand the methodologies and assumptions in their work. Nevertheless, the underlying trends can be difficult to measure as they emerge through infrequent one-off catastrophe events and may have additional contributory factors (for example, deforestation increasing the pace of rainwater run-off upstream of a flood). Furthermore, future trends are likely to differ from past projections. As such, we recognise a range of uncertainty as to current and future impacts.

Increases in frequency and severity of large catastrophe weather events are mitigated by the Group's use of catastrophe excess of loss reinsurance. This reinsurance covers property (Personal Lines and Commercial) and Motor physical damage losses; in addition to significant capital benefits, it transfers the volatility of low-frequency, high-severity natural perils events away from the Group. The reinsurance purchase decision is a combination of catastrophe modelling, capital analysis, the Group's risk appetite, cost of cover and the overall income statement impact. Cover is purchased with an upper limit equivalent to a 200-year modelled loss and the retention will be based upon the amount that the Group is willing to sustain from such a loss. This cover has benefited from two substantial improvements in recent years that provide additional climate change mitigation against multiple events:

- an increase in the number of reinstatement provisions. The reinsurance limit is purchased with a reinstatement provision where, in the event of a catastrophe loss, the limit of cover available is automatically reinstated to provide cover for the next event loss. Up until recently the cover was purchased with just a single reinstatement provision across the whole programme but this was increased to two in 2017 for a significant proportion of the reinsurance. This has resulted in more overall reinsurance cover being available for catastrophe losses; and
- an extension to the 'hours clause'. Catastrophe reinsurance covers are generally subject to an hours clause that defines a loss event by a number of hours. In practice, the Group can accumulate all losses within a number of hours to determine the reinsurance event for recovery purposes. In recent years, the amount of time available has been extended which means that the Group can capture more claims and longer duration events and have a greater level of protection for these losses.

In addition, we purchase risk covers to protect against large individual commercial losses.

For a full summary of how the Group approaches Risk management please go to page 24 of our full 2020 TCFD report

Metrics and targets

We take our environmental impact responsibilities seriously and recognise the value of target-setting and reporting in driving our emission reductions. We comply with the applicable greenhouse gas reporting requirements of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 and apply the GHG Protocol Corporate Accounting and Reporting Standard (revised edition) to calculate our emissions, which includes emissions associated with electricity consumption using both the Scope 2 location-based and Scope 2 market-based calculation methodologies. This year we also began the process of evaluating our Scope 3 emissions under our direct control and plans are underway to evaluate the final part of our Scope 3 emissions, and our investment portfolio in 2021.

Our 2020 emissions data can be found on page 61, which reflects reduced energy usage in 2020 due to the impact of Covid-19. This data includes our intensity metric of emissions per £ million annually of net earned premium. This is a measure of how efficiently we provide our insurance products and allows us to compare our performance year-on-year and against other insurance companies.

In addition, we have two Group-wide environmental impact targets:

- a 57% reduction in emissions (Scope 1 and 2) on a like-for-like basis by the end of 2020 against a 2013 baseline. We exceeded this target with a 69% reduction in energy related emissions in 2020, which takes into account the impact of Covid-19 where home working and lockdown measures altered our energy usage. Excluding the impact of Covid-19 we estimate energy related emissions would have been approximately 63% lower than 2013; and
- a 30% reduction in energy consumption on a like-for-like basis by the end of 2020 against a 2013 baseline. This year we again exceeded our target with a 45% reduction in energy consumption, which takes into account the impact of Covid-19 where the move to home working reduced energy use across our estate. Excluding the impact of Covid-19 we estimate that energy consumption in 2020 would have been approximately 34% lower than 2013.

Having met and exceeded these targets we will now benchmark the Group's environmental performance against a 2019 baseline and will set Science-Based Targets within the two-year timeframe set out by the SBTi.

We also have the following long-term goal for our investments:

– ensuring our entire investment portfolio is net carbon neutral by 2050 in line with the aims of the Paris Agreement.

To support this aim we have now set an interim target of a 50% reduction in weighted average GHG emissions intensity by 2030 within our corporate bonds portfolio, the largest part of our investment portfolio. We will use GHG emissions intensity[1] as the key metric of measurement as follows:

$$\text{GHG emissions intensity} = \frac{\text{Metric tonnes } CO_2e \text{ (}CO_2\text{ equivalent) GHG emissions}}{\text{Million \$ Sales}}$$

Normalising by sales as the denominator allows the investor to compare carbon efficiency of different sized firms within the same industry and has become the standard metric used in the investment industry. Our aim in 2021 is to be able to report the weighted average carbon intensity of our corporate bonds portfolio. Furthermore, in order to improve monitoring, management and future reporting in this area, we are working towards an improved picture of the emissions intensity of other significant portions of our investment portfolio, where appropriate data and methodologies exist.

Looking forward, we are working with the Carbon Trust to set Science-Based Targets across the full Scope 1, 2 and 3 of our operations. These targets will be submitted for approval and subject to the two-year time frame set out by the SBTi.

For a full breakdown of the Group's overall emissions, including our intensity metric and historical performance, see page 61.

Future Group activity

The Group has now set itself new priorities against the TCFD recommendations.

TCFD recommendation	Future Group activity
Governance	
Describe the Board's oversight of climate-related risks and opportunities.	The Group plans to maintain strong Board oversight, ensuring the Planet pillar, as part of its sustainability strategy, continues to take a strategic lead. Setting the Board's strategic debates in a climate change context will be supported by periodic debates on climate-related risks and opportunities, as well as inviting thought leaders to engage with Board meetings.
Describe management's role in assessing and managing climate-related risks and opportunities.	
Strategy	
Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term.	The Group intends to conduct more analysis in order to present more detailed impact assessments of climate-related risks across different time horizons.
Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.	The Group intends to strengthen how it systematically considers climate-related issues from a risk and opportunity perspective across business areas, strategic decision making and financial planning in order to be better able to describe impacts.
Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	Quantifying the impact of climate-related scenarios, including a 2°C or lower scenario, will strengthen the Group's ability to describe how resilient its strategy is, particularly placing monetary values on climate-related impacts.
Risk management	
Describe the organisation's processes for identifying and assessing climate-related risks.	The Group will continue its robust approach towards the management of physical risk and intends examining in more depth inbound and outbound impacts in order to be able to better describe transition and liability risks. The ambition is for risk management processes to support the Group in conducting detailed analysis on each risk and applying monetary values to support the Group's overall strategy.
Describe the organisation's processes for managing climate-related risks.	
Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	
Metrics and targets	
Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.	The Group plans to work towards establishing Science-Based Targets within the business to be approved by the SBTi which will strengthen our disclosures across Scope 1, Scope 2 and total Scope 3 GHG emissions.
Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 GHG emissions, and the related risks.	
Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	

Note:

1. GHG emissions intensity is used to account for greenhouse gases other than just carbon dioxide which contribute to global warming (such as methane and nitrous oxide). These other gases are converted into a CO_2 equivalent measure based on their warming potential.

Streamlined Energy and Carbon Reporting (SECR) regulations

The following table highlights where information can be found that supports the requirement to disclose how the Group manages its energy consumption and carbon emissions.

Requirement	Pages
Annual global GHG emissions (CO_2e)	
– from activities for which the Company is responsible	61
– from buying electricity, heat, steam or cooling by the Group for its own use	61
Annual global energy consumption in kWh, being the aggregate of:	
– energy consumed from activities for which the Company is responsible	58
– energy consumed resulting from buying electricity, heat, steam or cooling by the Group for its own use	58
The proportion of GHG emissions and energy consumed relating to the UK and offshore area[1]	59 and 61
Methodology used to calculate emissions and energy consumption	58
At least one intensity metric in relation to emissions	61
Description of energy efficiency actions taken	60

Note:

1. The offshore area is broadly defined as the sea adjacent to the UK, including the territorial sea, plus the sea in any designated area under section 1(7) of the Continental Shelf Act 1964 and section 41 (3) of the Marine and Coastal Access Act 2009.

Non-financial information statement

This Non-financial information statement highlights information necessary for an understanding of the Company's development, performance, position and impact of its activity, information relating to environmental, employee, social, respect for human rights, anti-corruption and anti-bribery matters.

Where possible, the following table states where additional information can be found that supports the requirements of sections 414CA and 414CB of the Companies Act 2006.

Reporting requirement	Information necessary to understand our business and its impact within the Annual Report & Accounts	Pages
Environmental	– Our sustainability pillars – Sustainable Development Goals – Greenhouse gas emissions – Climate-related risks – TCFD Report	44 to 61 46 58, 61 66 62
Employees	– Covid-19 response and people – Diversity and inclusion – Hampton-Alexander Review – Gender pay gap – Performance and pay	50, 102 50 , 92, 107, 110, 125 52, 93, 108 52 10, 15, 52, 86, 110
Social and community matters	– Social Mobility Employee Network – Prompt Payment Code – Our Community Fund	54 to 55 56, 142 57
Human rights	– Well-being strategy – My Life policies – Living wage – Ethical Code for Suppliers – Modern Slavery Statement	52 to 53 52, 53 52, 118 142 86, 109, 142
Anti-bribery and corruption	– Ethical matters – Sustainability Committee report – Code of Business Conduct	105, 110 109 to 110 77, 85, 88, 142
Innovation	– New products, channels and propositions – Digital customer journey	2 to 3, 12, 37 14, 16, 40, 43, 49
Business model	– Strategic report	1 to 75
Principal risks and impact on business activity	– Managing our risk – Risk management – Audit, risk and internal control – Board Risk Committee report	69 to 75, 95 to 96, 104 172 to 185 95 to 96 102 to 105
Non-financial KPIs	– Change delivery – Workforce engagement – Net promoter score – Customer complaints	13 to 14 19, 117, 118 19, 48, 124 19, 124

Risk management

Our aim is to make risk management simple, well understood and embedded. We will provide oversight which is pragmatic and commercial to help the business make good risk-based decisions and to move quickly whilst understanding the risks.

Managing risk in line with our strategy

Our management team, with oversight from the Board and Board Risk Committee, is responsible for developing our strategy. Our strategic planning process aims to ensure we have developed clear objectives and targets, and identified the actions needed to deliver them, including the management of risk.

A key aspect of any effective strategic planning process is to understand and manage those risks appropriately. To achieve this, the Risk Function works closely with the business to help it to identify and assess risks, which is done through setting and achieving targets as well as through its review and challenge of business plans in the strategic planning process.

The Group's risk strategy is aligned with the Group strategy and supports business decision-making through the proactive identification, assessment and management of risks.

Our risk governance framework

The Risk Function continues to lead transformation and cultural change to drive ownership of risks in the business, recognising the Group's changing risk profile and the maturing control and governance environment.

To begin with, the focus was on establishing standards and governance, articulating the Group's risk appetite and ensuring we had appropriate capability across its three lines of defence. We now have an embedded Enterprise Risk Management and Strategy Framework ("**Risk Management Framework**") with clear accountabilities and risk ownership designed to ensure that we identify, manage, mitigate and report on all key risks and controls through the three lines of defence model:

First line: Management is responsible for embedding risk management into business as usual and change processes whilst creating transparent reporting of risks and management actions.

Second line: The Risk Function is responsible for the design and recommendation to the Board Risk Committee of the Risk Management Framework, its implementation across the Group and the provision of proportionate oversight of risks, events and management actions throughout the Group.

Third line: Group Audit is responsible and accountable for providing an independent and objective view of the adequacy and effectiveness of the Group's risk management, governance and internal control framework.

See page 89 for governance structure

Risk appetite

Our risk appetite statements are an expression of the level of risk the Group is prepared to accept to achieve its business objectives. The statements are used to drive risk-aware decision-making by key business stakeholders.

Our risk appetite statements are documented in our policies and include:

- monitoring whether the business remains within risk appetite, among other information, using key risk indicators;
- deriving the key risk indicators from the risk appetite statements to drive and monitor risk-aware decision-making; and
- both qualitative and quantitative risk statements which are forward and backward-looking. We review our risk appetite statements and key risk indicators annually.

Our Risk Management Framework

The Risk Management Framework document sets out, at a high level, the Group's approach to setting risk strategy and managing risks to the strategic objectives and day-to-day operations of the business.

Aligned to the three lines of defence model, not only does the Risk Management Framework articulate the high-level principles and practices needed to achieve appropriate risk management standards, but it also demonstrates the inter-relationships between components of the Risk Management Framework.

Within this, the risk management process is a key element in the development and on-going maintenance of an accurate risk profile. The objective of the risk management process is to identify, assess, manage, monitor and report on the risks that the Group is exposed to. See page 66 for specific information on how the business identifies and assesses the risks associated with climate change.

Within the Risk Management Framework, policies address specific risk areas and are aligned to the Group's risk appetite. Policies, where appropriate, are supported by underlying minimum standards which interpret policies into a set of risk and control requirements to be implemented across the Group.

Risk appetite statement

Overarching risk objective

The Group recognises that its long-term sustainability is dependent on having sufficient economic capital to meet its liabilities as they fall due, thus protecting its reputation and the integrity of its relationship with policyholders and other stakeholders. As part of this, its appetite is for general insurance risk, focusing on personal lines retail and small and medium-sized enterprise insurance in the United Kingdom. The Group has appetite for non-insurance risks, as appropriate, to enable and assist it to undertake its primary activity of insurance.

Three strategic risk objectives

1. Maintain capital adequacy
The Group seeks to hold capital resources in the range of 140%-180% of its solvency capital requirement.

2. Stable/efficient access to funding and liquidity
The Group aims to meet both planned and unexpected cash outflow requirements, including those requirements that arise following a 1-in-200 year insurance, market or credit risk event.

3. Maintain stakeholder confidence
The Group has no appetite for material risks resulting in reputational damage, regulatory or legal censure, poor customer outcomes, fines or prosecutions and other types of non-budgeted operational risk losses associated with the Group's conduct and activities. The Group will maintain a robust and proportionate internal control environment.

Our risk culture

Our risk culture underpins our business and decision-making, and helps us embed a robust approach to managing risk. Our Risk Function drives ownership of risks in the business and ensures that risk consideration is integral to all decision-making. It also provides expert advice and guidance to business areas, whilst also challenging the effectiveness of controls to manage risk and compliance.

The Board is committed to promoting a culture of high standards of corporate governance, business integrity, ethics and professionalism in all our activities. An annual assessment of risk behaviours and attitudes is undertaken jointly by the Risk Function and Group Audit and considers a range of factors influencing risk culture.

We also have an annual Risk Communications Plan which features activity to reinforce the message that risk is everyone's responsibility. The Plan features staff awareness campaigns, articles on the intranet and the imaginative "Risk Heroes" campaign which enabled members of staff to harness social media and mobile phone photograph filters; and enabled Risk to engage with colleagues about the importance of risk management in a unique and conversational way.

Proactive risk management through Covid-19:
The Covid-19 pandemic created an unprecedented set of circumstances in the UK, as the country moved to national lockdowns. To minimise transmission of the Covid-19 virus, people across the UK were asked to remain at home, including working from home where possible and restricting any travel.

Within the Group, Covid-19 presented a series of challenges in seeking to protect its people, maintain customer operations, and safeguard the business.

In responding to the pandemic, management demonstrated strong proactive leadership, took accountability and showed a clear understanding of risk as they transitioned the business to a home working model. We transitioned our people to working from home prior to the national lockdown being called, while maintaining service continuity for our customers.

Throughout the pandemic, the Risk Function worked closely with business areas to perform key risk and control assessments to inform this decision making; including assessments of risks introduced through mass homeworking, which enabled us to take mitigating action where necessary. The results of this exercise informed management of our critical supply chain.

Collaboration took place across the business to manage other Group responses to the pandemic; such as, the management of the surge in customer claims related to Travel; the assessment of additional scenarios relating to operational resilience; and documenting how impacts of the pandemic may evolve, in order to identify and mitigate risk.

Throughout this challenging period, business functions have continued to work together proactively to ensure that our customers receive appropriate levels of service and support, whilst still delivering business performance.

Principal risks and uncertainties

We carefully assess the principal risks facing us. Principal risks are defined as having a residual risk impact of £40 million or more on a 1-in-200 years basis, taking into account customer, financial and reputational impacts.

Principal risk	Description	Risk commentary	
Insurance Risk Strategic Alignment 3 Relative size of risk Trend – increasing	The risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting.	Key drivers of the outlook for insurance risk across our business plan include reserve, underwriting, distribution, pricing and reinsurance risks. Issues relating to Covid-19 have been a key area of focus for the Group in 2020 and the main driver of the increasing trend in Insurance risk. Claims trends have been significantly impacted particularly during the lockdown period. This has led to uncertainty in claims reserving and pricing. In 2021 and beyond, Covid-19, Brexit and potential recession may have an impact on claims inflation together with market and customer behaviour.	We continue to monitor this closely. In response to this uncertainty we have used stress testing to understand the potential impacts of an economic downturn on frequency and severity of claims costs. Finally, climate change presents a risk of more frequent extreme events and key risk indicators are being continually enhanced to monitor related risks across Home, Motor and Commercial.
Market Risk Strategic Alignment 3 Relative size of risk Trend – stable	The risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments.	Key drivers of market risk are the sensitivity of the values of our assets and investments to changes in credit spreads, and our exposure to losses as a result of changes in interest rate term structure or volatility. Concerns about the Covid-19 pandemic and Brexit fallout could impact equity and credit markets within the global economy leading to credit spread increases, foreign exchange rate volatility, interest rate changes and devaluation of UK property assets.	To address this, we have an investment strategy which is approved by the Board and includes limiting exposure to individual asset classes and the number of illiquid investments we hold. We also use risk reduction techniques such as hedging foreign currency exposures with forward contracts.
Operational Risk Strategic Alignment 4 5 6 Relative size of risk Trend – decreasing	The risk of loss due to inadequate or failed internal processes or systems, human error or from external events. The key risks within this category are Cyber, Technology & Infrastructure, Operational Resilience, Change, People, Information Management, Outsourcing, Partnerships and Fraud.	Operational risks can arise within all areas of the business and can manifest themselves through inadequate or failed internal processes or systems, human error or from external events. Our approach is to manage our operational risks to proactively mitigate potential customer harm, regulatory or legal censure, financial and reputational impacts. The decreasing trend in operational risk is driven mainly by the good progress made by the business in delivering technology improvements. We have in place operational processes and systems, including prevention and detection measures. These include processes which seek to ensure we can absorb and/or adapt to internal or external events that could impact customer operations and the wider business. With the majority of staff now working from home, we continue to work to improve the performance of our IT systems, focusing on improving both system stability and capability.	With significant strategic investment we continue actively to strengthen our change implementation controls to further mitigate potential impacts from risk events. We continue to deliver sustainable improvements to the overall security control environment, designed to enable us to respond to malicious and unintended threats from both internal and external entities. Processes are also in place to automate controls to enhance risk monitoring. We operate a strong control environment through the delivery of the Procurement & Supply Chain target operating model, which is focused on delivering active monitoring and management of key suppliers. Our Risk Management Framework is designed to enable us to capture risk information in a complete and consistent way, enabling proactive trend analysis, root cause analysis and read across to facilitate early warnings and a 'learning' risk environment.

Link to strategy

1	Be best at direct
2	Win on price comparison websites
3	Extend our reach
4	Be nimble and cost efficient
5	Have technical edge
6	Empower Great people

Principal Risk	Description	Risk commentary	
Regulatory & Compliance Risk Strategic Alignment 1 2 3 5 Relative size of Risk Trend – stable	The risks leading to reputational damage, regulatory or legal censure, fines or prosecutions and other types of non-budgeted operational risk losses associated with the Group's conduct and activities.	We maintain a constructive and open relationship with our regulators and have a strong culture of delivering on our commitments to our customers (see pages 48 to 49). Pricing practices within the general insurance market is a key area of focus for the FCA and for the Group. We continue to devote a lot of attention to this area as we prepare for the implementation of the FCA's pricing practices remedies, expected in Q2 2021. Our existing conduct Risk Management Framework is designed to deliver fair outcomes to customers and minimise our risk exposure. The framework is supported by a set of conduct pricing principles designed to enable the fair pricing of business across our book. We continue to develop our approach to anticipate regulatory developments and to ensure that we can continue to provide good outcomes for our customers. We carry out planned risk-based monitoring of customer processes as well as more targeted thematic reviews to help us manage the risk of unfair customer outcomes.	We have maintained regular and open dialogue with both the FCA and PRA on our responses to Covid-19, outlining actions taken with the aim of ensuring that good customer outcomes are achieved and that the Group remains financially and operationally resilient. We have worked closely with UK regulators on our Brexit preparations, and with the Central Bank of Ireland to establish an Irish Branch in preparation for the end of the Brexit transition period. Finally, we have put in place a strong governance and accountability framework as part of the Senior Managers and Certification Regime, and carry out an annual declaration process to ensure the ongoing fitness and propriety of the Group's Senior Managers and Certified Functions.
Credit Risk Strategic Alignment 3 Relative size of risk Trend – stable	The risk of loss resulting from default in obligations due from and/or changes in the credit standing of issuers of securities, counterparties or any debtors to which the Group is exposed.	To manage credit risk, we set credit limits for each counterparty and actively monitor credit exposures. In addition, we only purchase reinsurance from reinsurers with at least an A- rating and, for liabilities with a relatively long period of time to settlement, this rating is at least A+.	Finally, we also have well defined criteria to determine which customers are offered and granted credit.
Strategic Risk Strategic Alignment 2 3 4 5 6 Relative size of risk Trend – stable	The risk of direct or indirect adverse effects resulting from strategies not being optimally chosen, implemented or adapted to changing conditions.	Strategic risk is influenced by internal and external developments such as the Covid-19 pandemic, Brexit and the FCA's Pricing Practices Review. In addition, the adoption of agile ways of working is designed to allow the business to more quickly identify and react to risks to the implementation of the Group's strategic goals. To manage our risks, we have taken the following steps: – we agree, monitor and manage performance against the Board-approved plan and targets;	– the Board leads an annual strategy and five-year planning process which considers our performance, competitor positioning and strategic opportunities; – as part of the timetable for the Strategic Plan, the Risk Function carries out a risk review of the Plan which is documented in the Group's Own Risk and Solvency Assessment and presented to the Board; and – we identify and manage emerging risks using established governance processes and forums.

Link to strategy

1	Be best at direct
2	Win on price comparison websites
3	Extend our reach
4	Be nimble and cost efficient
5	Have technical edge
6	Empower Great people

UK recession and global financial instability

The risk of a further UK-wide recession and global financial instability is ongoing. The economic uncertainty is expected to remain high throughout H1 2021, as a result of the Covid-19 pandemic, and the Group continues to monitor the worst-case impact.

As a result of the Covid-19 pandemic, the UK Government has acted to support UK employees and prevent lasting damage to the economy. However, the uncertainty surrounding the pandemic makes the overall impact and recovery progress unclear.

The disruption to global trade and supply-chains caused by the pandemic could increase the risk of inflation in the long-term.

For the Group, the investment portfolio is positioned relatively defensively; however, if the UK recession were to worsen significantly, additional steps could be taken such as further shifting the portfolio towards 'defensive' sectors or increasing more allocation to cash.

Globally, the economic shock caused by the Covid-19 pandemic initially resulted in credit spreads in Europe and the US moving to levels last seen in the 2008/09 credit crisis, and equity markets posted extremely steep percentage falls. Whilst markets have recovered to a degree, there still remains uncertainty over the duration and continued impact of the pandemic.

The Group portfolio contains a proportion of short-maturity bonds which could be sold relatively quickly if necessary. Recent stress and scenario testing has highlighted that the largest impacts would be on the Group's asset portfolio. The Group believes that the risks from global financial instability are being appropriately monitored.

Potential effects of Brexit

The Brexit transition period following the UK leaving the EU ended at 11pm on 31 December 2020. A trade and co-operation agreement had been agreed, tariffs on goods entering the UK from the EU were avoided and the more severe risks identified in connection with a so-called 'no-deal' Brexit have not materialised.

Key risks identified as potentially arising in the context of disruption following the end of the transition period included financial impacts (for example, if credit spreads widened) and operational impacts (for example, if goods were delayed at the EU/UK border). Other risks identified included risks of changes to the value of sterling, inflation, recession, recruitment and retention of people, impacts on travel, and potential changes to tax and regulation.

Some of these risks could still occur to some degree and we continue to monitor developments.

The Group has a small amount of business in the Republic of Ireland, servicing a small Irish part of a UK partner's wider business. Accordingly, following approval from the Central Bank of Ireland the Group established an Irish branch in the Republic of Ireland with effect from the end of the transition period.

Emerging risks

Emerging risks are defined in the Group as newly developing risks that are often difficult to quantify but may materially affect the Group. Emerging risks are usually highly uncertain risks which are external to the Group. The Group has in place an emerging risks process which enables it to:

- have a proactive approach to emerging risk management;
- identify, manage and monitor a broad range of potential emerging risks; and
- mitigate the impact of emerging risks which could impact the delivery of the Group's Strategic Plan.

The Group records emerging risks within an Emerging Risk Register. An update on emerging risk is presented to the Board Risk Committee annually and is supplemented by deep dives into selected emerging risks. During 2020, the Group Risk function worked with first line of defence subject matter experts to enhance the quality and detail of emerging risk updates.

The Covid-19 pandemic was not included within the Emerging Risk Register as an emerging risk, as it has emerged and is impacting and is reflected in our current Group risk profile. However, 'Global Pandemic' remains on the Emerging Risk Watchlist for monitoring, which focuses on the potential for a similar type of outbreak in years to come. Many of the lessons from the Covid-19 situation can be applied to how the Group would respond to another global pandemic.

The Covid-19 pandemic continues to challenge the way the industry operates, both now and in the future. Second line of defence and first line of defence subject matter experts continue to monitor potential threats and opportunities which may impact the Group and the wider industry, as the 'new normal' becomes clearer.

The most notable emerging risks are outlined on the following page.

Climate change

The Group recognises that climate change potentially poses material long-term financial risks to the business and is receiving increased scrutiny from regulators and investors. Climate change risks can be divided into three categories: physical, transition and liability risks. All three of these categories can manifest themselves through a range of existing risks within the material risk register, including insurance, market, operational, strategic and reputational risks.

Following the issue of the PRA's Supervisory Statement SS3/19, the Group has appointed the CRO as the Senior Management Function holder for Climate Change and put an initial plan in place to address the expectations set out in the supervisory statement.

The Group has updated risk policies and minimum standards explicitly to reference the risks from climate change, and we reviewed climate-related key performance indicators for energy usage and emissions across the business throughout H2 2020, to help inform future climate-related financial disclosures.

The risks and impacts of climate change are wide ranging; the Group is focusing increasingly on climate change, with related risk management activity which includes monitoring climate change through the emerging risk process, forming a Climate Change Working Group and continuing its journey to implement the recommendations of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures ("**TCFD**").

As part of embedding the management of these climate-related financial risks in 2021, the Group will take part in the Bank of England's Climate Biennial Exploratory Scenarios exercise. This stress testing exercise aims to understand the impact on the Group of future climate scenarios incorporating physical and transition risks.

Ethical use of data

The Group identified the 'failure to establish an ethical way to use data' as an emerging risk in H2 2019, with activity underway to mitigate against associated risks. The industry and policymakers' view of this risk is still emerging, as legislation and regulation in this area is yet to mature; however, it is a growing area of focus for the Group's regulators and for the Group itself.

A group of stakeholders including the Chief Data Officer and the Privacy & Information Management team has been established to provide visibility of the challenge for the Group, and a working group has been established to gather external views and create visibility for the required timelines, and to provide the focus required to move development of a data ethics framework at an appropriate pace.

The Group has been outlining a proposed approach for the management and governance of data ethics. Work will continue in 2021 to confirm and embed the proposed principles-based approach. In addition, we have commenced work to determine how the Group could best incorporate emerging data ethics considerations into current customer conduct processes and forums.

Viability statement

In accordance with Provision 31 of the 2018 UK Corporate Governance Code, the Directors have assessed the prospects of the Group for a period longer than the minimum 12 months required by the going concern statement.

The Strategic report, on pages 1 to 75, sets out the Group's financial performance, business environment, outlook and financial management strategies. It covers how the Group measures its regulatory and economic capital needs and deploys capital. You can find discussion about the Group's principal risks and risk management on pages 69 to 74. Note 3 to the consolidated financial statements starts on page 172 and sets out financial disclosures relating to the Group's principal risks. This covers insurance, market and credit risk; and the Group's approach to monitoring, managing and mitigating exposures to these risks.

Every year, the Board considers the Strategic Plan and an Own Risk and Solvency Assessment ("**ORSA**") for the Group. The Plan makes certain assumptions in respect of the competitive markets in which the Group operates, and the delivery and implementation of the new customer systems. Appropriate aspects of the Strategic Plan are stress-tested to understand and help set capital and other requirements.

When reviewing the Strategic Plan, the Board considered the Group's prospects over the period that the plan covered and the conclusions of the ORSA, based on the Group's anticipated activities as set out in the strategic plan. This review includes reviews of solvency, liquidity, assessment of principal risks and risk management over a three-year period from 2020 to 2022 with a further two years of indicative planning from 2023 to 2024. The first year following approval of the business plan has greater certainty, so it was used to set detailed budgets across the Group. Outcomes for the subsequent years in the plan are less certain. However, the plan provides a robust planning tool for strategic decisions. The Board recognises that, in a strategic plan, uncertainty increases over time and, therefore, future outcomes cannot be guaranteed or accurately predicted.

The Board has assessed the principal risks of the Group over the duration of the planning cycle. The assessment included considering the possible challenging market conditions due to the impact of Covid-19 on the economy and customer behaviour, the possible adverse implications of Brexit, the implementation of the FCA's Pricing Practices Review and change risk. The 2020 Plan modelled a number of different scenarios which were directly and indirectly influenced by the Covid-19 pandemic. 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.

Covid-19 pandemic

- The Plan has been stress tested for the impact of a deep UK recession triggered by the end of furlough and extended lockdown throughout the first half of 2021. This is a severe but plausible scenario that we have used to challenge our contingent management actions.

Brexit

- Following the Brexit deal announced in December 2020 the likelihood and severity of impacts relating to a disorderly Brexit have significantly reduced. However, the Plan has been stress tested for the potential impact of adverse consequences on investment values.

FCA General Insurance Pricing Practices Review ("PPR")

- The FCA's consultation period ended in January 2021 and the final report has not yet been published. The Group's Plan includes a scenario for the impact of the PPR from 2022 onwards based upon the differential between new business and renewal prices. The Group considered a spectrum between two potential outcomes. A series of management actions have been identified to mitigate the impact of this scenario.

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. In both cases, the Group remained within its risk appetite range for its solvency capital ratio and did not breach the Group's solvency capital requirement after contingent management actions in any of the years covered by the plan (2020 to 2024).

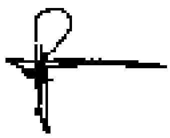
A reverse stress test was also performed to identify the most probable combination of stresses that would result in capital loss and thus threaten the viability of the Group, i.e. a reduction of own funds to below the solvency capital requirement. The test combined a number of independent events and concluded that the Group's solvency capital requirement would not be breached after management actions.

Based on the results of these reviews, the Board has a reasonable expectation that the Company and the Group can continue in operation, meet liabilities as they fall due and provide the appropriate degree of protection to those who are, or may become, policyholders or claimants in the period to 31 December 2024.

Statement of the Directors in respect of the Strategic report

The Board reviewed and approved the Strategic report on pages 1 to 75 on 5 March 2021.

By order of the Board



Penny James
Chief Executive Officer

5 March 2021