Direct Line Group

Annual Report and Accounts 2021

Innovating for the future

Financial highlights

Profit before tax
£446.0m
(2020: £451.4m)

Return on tangible equity[1]
23.6%
(2020: 19.9%)

Combined operating ratio[1,2]
90.1%
(2020: 91.0%)

Solvency capital ratio[1,3]
176%
(2020: 191%)

Operating profit[1]
£581.8m
(2020: £522.1m)

Dividends and capital returns[4]
£401.3m
(2020: £595.2m)[5]

MSCI's ESG rating for the Group increased from 'A' to 'AA'

13th on the Inclusive Top 50 UK Employers List

Notes:

1. See glossary on pages 248 to 250 for definitions and Appendix A – Alternative performance measures on pages 251 to 255 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 248 for definitions.
3. Estimates based on the Group's Solvency II partial internal model.
4. See pages 38 to 39 for the dividend policy.
5. Includes £195.5m special dividend in 2020 to replace the cancelled 2019 final dividend.

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

Innovating for the future

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.

In 2021 we continued transforming our business by using technology, data and digital tools to deliver more for our customers, backed by powerful brands, great service and market-leading claims capabilities.

As we build an insurance company of the future we are putting sustainability at the heart of how we do business because it allows great people to thrive, creates a better corporate culture, drives competitiveness and provides a foundation for long-term rewards for our shareholders.

Innovating for the future

Our core strengths

Our core strengths, combined with new technology are designed to deliver sustainable growth.

Insurance customers value strong brands, great service and a claims operation that delivers what it promises. These are the core strengths of Direct Line Group.

> For more information, see page 21 for the CEO's review

In an increasingly digital world, future success requires a relentless focus on customer needs, efficiency and innovation, combined with pricing and claims expertise to deliver an exceptional insurance experience.

Our diversified business model ensures that we remain focused on reaching customers through the four main routes to market: direct, price comparison websites, partnerships and brokers. To read more on our channels and powerful brands, see our business model on page 16.

Customer focus

With customers at the heart of all we do, we are passionate about offering great service, unique customer propositions and a highly efficient claims operation. Our powerful brands enable our customers to choose the right cover for their circumstances in order to protect their homes, cars, holidays, businesses and pets. It's why our customer retention rates are high and our net promoter scores (NPS) are strong.

Pricing sophistication

We are transforming our competitiveness with our new tech platforms enabling greater accuracy in pricing in our chosen markets. Our pricing and underwriting teams now have the systems and sophisticated data techniques designed to get products to market faster and target a broader pool of potential customers.

and capabilities

£581.8m
Operating profit

+1.0%
Direct own brands portfolio growth

2.5%
Reduction in operating expenses before restructuring and one-offs

Claims expertise

Our vertically integrated claims model differentiates us and adds value giving the business a competitive advantage. We are fully focused on data, artificial intelligence ("**AI**") and digital as these are the key capabilities needed to get results. As we further digitalise our claims journey we are aiming for increased simplicity and speed to give our customers peace of mind when they make an insurance claim and need us most.

Efficient cost base

The implementation of our transformation programme is already reducing our cost to serve customers, while at the same time improving customer outcomes. As the business increasingly utilises the new technology we are becoming more efficient, pricing with greater speed and responding to changing market dynamics with greater agility.

Innovating for success

We're innovating across our business – be it offering attractive customer propositions, introducing green solutions to achieve our net zero ambitions or creating our flagship Motor technology centre that puts us at the forefront of repairing advanced car technology. Customers are already benefiting from our technology transformation, receiving enhanced self-service options.

Innovating for the future

During 2021 Direct Line Group (the "Group") delivered a strong financial performance and completed the main elements of its technology build to deliver greater pricing and data capability across the business.

Financially, our combined operating ratio figure for the year was 90.1% and we have launched a new share buyback programme of up to £100 million. We have also declared a final dividend of 15.1 pence per share, a 2.7% increase over 2020, highlighting our long track record of delivering strong returns to shareholders.

Due to our technology transformation we are deploying pricing with greater accuracy, bringing new offers to market and digitalising our claims operations to better serve our customers at the point when they need us most and by being clearsighted about our sustainability priorities, we are implementing solutions to better position the Group for the long term.

As we embed our tech capability it leaves the Group well positioned to build on our strong 2021 performance to deliver successful outcomes through 2022 and beyond.

Our Stechford accident repair centre

We continued to expand our claims capabilities with the acquisition of our 22nd centre this year supporting our competitive advantage in vehicle repair.

Innovating for the future

Deploying our new Motor platform

Enhancing our pricing capability

The successful launch of a new Motor platform for our biggest brands – Direct Line, Churchill and Privilege – has improved customer experience and allows greater pricing sophistication. Being cloud-based enables the platform to connect to a greater variety of data sources, enabling us to update our pricing engines at speed.

Delivering customer benefits

With the major elements of our Motor tech transformation complete, the new platform means:

- choice and efficiency for customers with month-on-month growth in the number of own brand customers using the greater self-service opportunities
- more tasks are now automated, freeing up time for our consultants to focus on customers
- new products get to market faster, books of business can be onboarded quickly and we can focus on new commercial opportunities

Customers are already rating our new platform positively.

100%

of Motor claims can now be registered online

72%

of all Motor sales are now completed directly online

92%

of customers who responded score our new Motor platform 9 or 10 out of 10 when rating their customer service experience on a sales or renewal interaction

Strengthening Partnerships

Major motor partnership win

In July the Group was delighted to announce a 10-year partnership, from H2 2023, with Motability Operations to provide insurance to customers on the Motability Scheme. The Scheme serves over 640,000 people and is forecast to increase Motor gross written premium by around £500 million each year. The partnership will provide us with extra insight into their fleet of modern vehicles and build further scale to our expert claims management service.

£500m

Motor gross written premium forecast each year from H2 2023

Giving our travel customers flexibility

We extended our Aquarium travel platform this year to reach an extra 1.7 million customers through our partnership with Nationwide. Customers can now manage their insurance digitally and register some claims whilst still abroad, without having to speak to an adviser.

1.7m

travel customers can now manage their insurance digitally

NatWest Group home insurance contract

We have extended our long-term home insurance partnership with NatWest Group to 2027. Building on the success of our existing partnership, we will continue to look after close to half a million of their customers' home insurance needs.

2027

home insurance contract with NatWest Group extended until 2027

Supporting Metro Bank's small and medium-sized enterprises ("SME") customers

In February 2021 Metro Bank announced they would be partnering with Churchill Expert to launch the Bank's first ever insurance offering, a suite of products for their SME customers. Metro Bank said they had chosen to partner with us because of our excellent track record on customer service, as well as our offering of a wide range of 4 and 5 star Defaqto rated products.

SME partner

Metro Bank's partnership with Churchill Expert offers a suite of products for their SME customers

Improving online customer experience

Commercial lines success

Our diversified business model means we aim to reach customers however and wherever they shop. We pride ourselves on offering SMEs tailored insurance so they have the insurance cover they need. This year:

- We continued the rollout of a new pricing and underwriting system across Commercial combined and Fleet, alongside the launch of machine learning pricing models, improving pricing accuracy
- Direct Line for Business continued to deliver double-digit growth within the SME market, supported by 64% growth in Churchill for business
- NIG delivered the highest gross written premium growth in the last 10 years

Overall, during 2021 our Commercial business grew gross written premium by 15%.

15%

gross written premium growth for our Commercial business

Digital support for our customers

We are increasingly using digital tools to interact with customers. This year we resolved 30% of over 2 million online enquiries with our virtual assistant and our webchat channel dealt with around 1.3 million interactions.

30%

of online enquiries resolved via our virtual assistant

Start-up success

Our insurance start-up motor brand Darwin has gone from strength to strength, growing its policy count to over 135,000 by the end of 2021, an increase of over 150% in just a year. Part of its success is based on machine learning which enables competitive pricing to be deployed into the market at speed. It is live on four PCWs and Darwin is already one of the highest-rated motor insurers in the UK on Trustpilot.

+150%

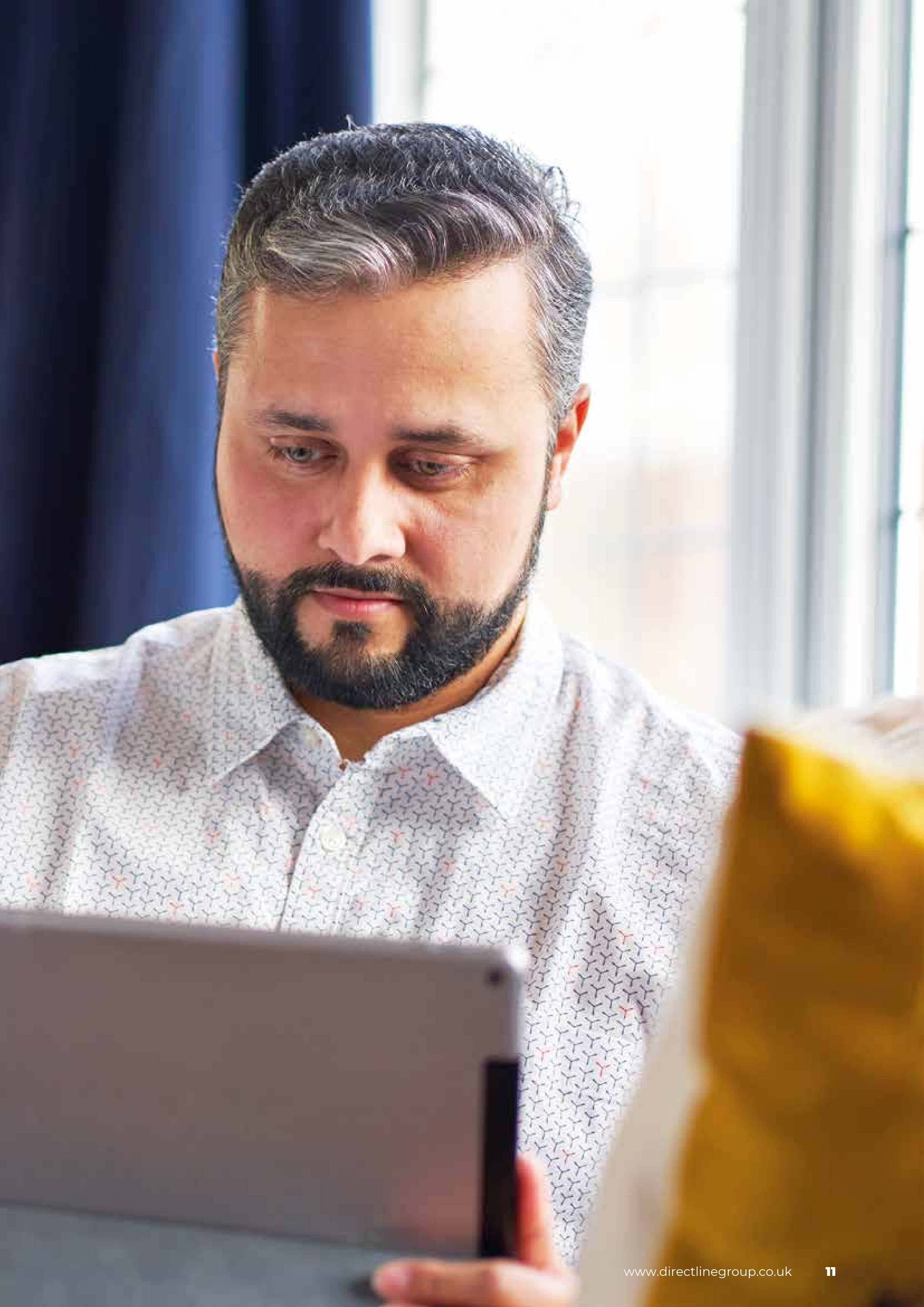
Darwin in-force policy count up by over 150% compared to 2020

Motor claims efficiency

Using our unique damage evaluation calculator we can quickly assess if a customer's vehicle can be repaired before it arrives at one of our garages, by utilising customer supplied images we can order the necessary parts to start repairs immediately. Additionally we have the option to deploy our AI technology that has been trained to use a database of over 2 million images to identify repair issues, which has helped our engineers to settle total loss cases faster, providing certainty for customers on what will happen with their vehicle.

2m+

our AI technology has been trained to use a database of over 2 million images to identify motor repair issues



Building a sustainable business

Going green

The Group joined the Race to Zero campaign, committing to set Science-Based Targets, to achieve net zero emissions by 2050. This year we started:

- Testing hydrogenated vegetable fuel oil (“**HVO**”) in our recovery trucks
- Trialling electric spray paint booths
- A new Supply Chain Sustainability Programme

Race To Zero

we joined the Race To Zero campaign to achieve net zero emissions by 2050

Electric made easy

The future of UK motoring is electric and in November we were delighted to launch a new electric vehicle (“**EV**”) offer for our Direct Line brand, aimed at making the transition to electric easy for our Motor insurance customers. It offers all new business customers access to a bundle of electric vehicle charging essentials, as well as an EV concierge service and insurance that covers batteries and charging cables. Using our agile working model, it took less than eight weeks to take the concept off the drawing board and into the market.

22nd

we continue to invest in our capability to repair more advanced and electric vehicles with the acquisition of our 22nd accident repair centre this year

New flagship car technology centre

To prepare for a world of rapidly changing car technology, the Group completed the build of its new tech centre in Stechford, Birmingham. The facility will develop the tools, skills and training to benefit its network, including the ability to test various ADAS (Advanced Driver Assistance Systems) calibration tools and electric vehicle repair methods. As we have the largest insurer-owned garage network in the UK, it will enable the Group to meet evolving customer repair needs particularly as the UK transitions to a green future.

£2m

investment in new car technology centre

Promoting Diversity and Inclusion

In 2021 our Executive Committee has been transformed; for the first time ever a majority of its members are women and two members are from a minority ethnic background. Across the business we are working to drive diversity and inclusion, including this year our first ever social mobility action plan and Black Inclusion report. We know there is much more to do, and were proud to be named 13th most inclusive employer in the UK.

Over 50%

of our ExCo are now women

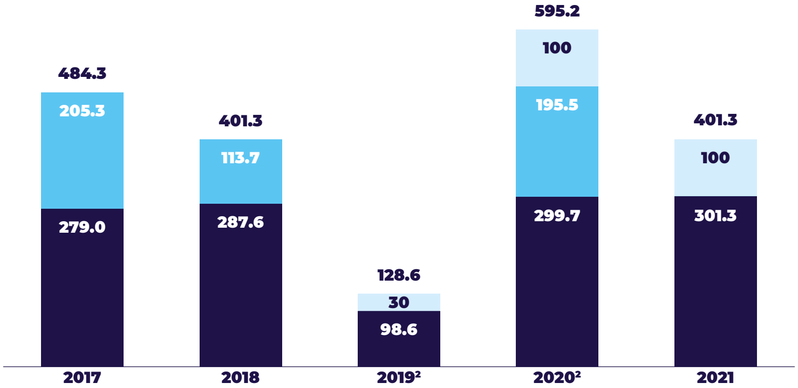
Investment case

Improving our competitiveness while delivering strong shareholder returns

Delivering strong shareholder returns

We have a track record of delivering strong returns to shareholders, having distributed £2.1 billion[1] over the past five years. In early 2020, we took the difficult decision to cancel the 2019 final ordinary dividend due to the impact of the Covid-19 pandemic at that time; however, this was subsequently paid to shareholders as a special interim dividend in the second half of 2020.

Capital returns (£m)



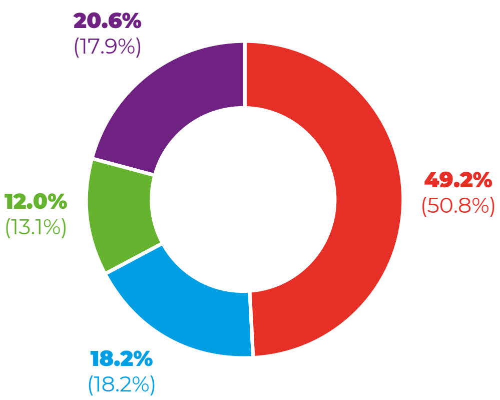
£2.1bn[1]

capital returns in the last five years

Buyback programmes
Special dividends
Ordinary dividends

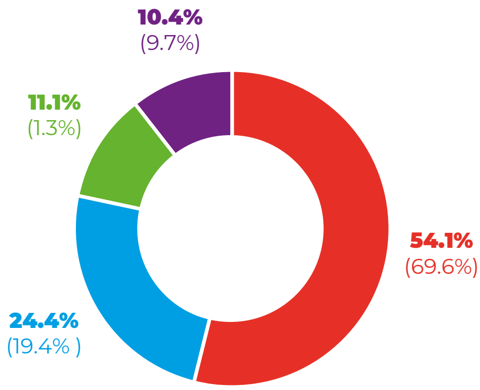
Gross written premiums (£m)

2021: £3,171.6m (2020: £3,180.4m)



Operating profit (£m)

2021: £581.8m (2020: £522.1m)



Motor
Home
Rescue and other personal lines
Commercial

Notes:

1. Represents capital returns paid and proposed as at the date of publication. Includes 2016 final dividend paid in May 2017.
2. The 2019 dividends and capital returns have been adjusted to remove the cancelled 14.4 pence per share final dividend and £120 million of the share buyback programme as announced in March/April 2020. (The reported number was dividends and capital returns of £447.0 million.) The cancelled 14.4 pence per share dividend was paid as an special interim dividend in the second half of 2020.

Transformation has enabled us to improve the quality of our earnings

Over the last few years we have been transforming our technology and changing the way we work to increase the competitiveness of our business.

This has helped us improve the quality of our earnings and, in 2021, over 50% of our operating profit[1,2] was from current-year business, in line with the target we set out in 2019, with older reserving years no longer such a significant part or our annual profits.

We are driving to achieve this through our six strategic objectives

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.

Our financial targets

Costs

Expense ratio[1,3] of 20% in 2023

2021 actual:

23.9%

Normalised current-year operating profit[1,2]

At least 50% contribution to total operating profit by 2021

2021 actual:

53.3%

Normalised combined operating ratio[1,4]

Between 93-95% throughout the medium term

2021 actual:

91.1%

Return on tangible equity (RoTE)[1]

At least 15% per annum over the long term

2021 actual:

23.6%

Notes:

1. See glossary on pages 248 to 250 for definitions and Appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.
2. Normalised for weather. Reported contribution 55.6%.
3. Applies to operating expenses excluding restructuring and one-off costs.
4. Normalised for weather. Reported COR 90.1%.

Business model

Delivering for all our stakeholders

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 its heart.

> Read more about our business segments on pages 46 to 53

Motor
Britain's leading private motor insurer represented through our well-known brands Direct Line, Churchill, Privilege and Darwin and also through our partners[1].

Home
One of Britain's leading personal home insurers, represented through our well-known brands Direct Line, Churchill and Privilege, and our partners, including NatWest Group[1].

Giving customers a choice of brands and channels

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

This is how we create value

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

Diversified model

Our diversified model enables us to generate premiums from a range of brands, products and distribution channels.

Investment return

The premiums we collect from customers are invested in a diversified investment portfolio whilst also ensuring we can support our long-term claim commitments.

> See page 43

A triple win

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

A win for customers

100%

of Motor and Home claims can now be registered online

Notes:

1. © Ipsos 2022, Financial Research Survey (FRS), 6 months ended Jan 2022. 14,218 adults (aged 16+) surveyed across Great Britain with motor insurance, 13,280 with home insurance. Interviews were conducted online and telephone, and weighted to reflect the overall profile of the adult population. Includes Direct Line, Churchill, Privilege, Darwin and partner brands: NatWest, RBS.
2. Mintel Vehicle Recovery – September 2021.
3. Mintel Pet Insurance – 2021.

Rescue and other personal lines
We are one of the leading providers of rescue and pet insurance in the UK. Green Flag is the third largest roadside recovery provider[2] and we are the fourth largest pet insurer[3].

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

Darwin. Privilege. GREEN FLAG COMMON SENSE TO THE RESCUE NIG DLG PARTNERSHIPS

Accident repair centres
We own 22 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 advanced counter-fraud capability.

Costs
We're improving our efficiency through greater use of digital processes and by targeting cost reduction measures to increase our competitiveness.

Tax
We manage our tax obligations responsibly and contributed, either directly or indirectly, £885.1 million in tax to the Exchequer this year.

> See page 45

A win for our people and shareholders

£3.8m
Invested in free shares for our people

£2.1bn
Capital returns in the last five years

A win for society and the planet

£1.5m
Donated to charities and good causes from our Community Fund

Race to Zero
Joined the Race to Zero campaign to achieve net zero emissions by 2050

Chair's statement

Working for all our stakeholders

Dear Shareholder,

I am pleased to report that 2021 saw Direct Line Group make significant progress on its strategic transformation at the same time as delivering strong operating profit. We achieved profit before tax of £446.0 million (2020: £451.4 million) and a combined operating ratio of 90.1% (2020: 91.0%).

The work we undertook in 2020 to adapt our operations and evolve the way we do business in response to the Covid-19 pandemic meant that we were well positioned to continue to provide our customers with excellent service, support our people, and push ahead with key strategic initiatives despite entering 2021 in another lockdown and seeing a continuation of pandemic-related restrictions during the year. The Board oversaw the business's preparations for the implementation of the FCA's new general insurance Pricing Practices Review regulations, which came into force on 1 January 2022, which involved a large-scale programme of activity and the deployment of considerable resources to meet the requirements of the new regulations within an ambitious timeframe during 2021. We believe that our multi-brand, multi-channel strategy places the Group in a strong position to deliver sustainable growth under the new pricing rules.

Danuta Gray
Chair of the Board

We have also made good progress on key sustainability initiatives, details of which are set out in this report, that we believe will contribute to the long-term sustainability of the business and its ability to deliver for our many stakeholders.

Dividend and capital management

The Board has recommended a final ordinary dividend of 15.1 pence per share, making a total of 22.7 pence per share, an increase of 2.7% over the 2020 total ordinary dividend.

Following the £100 million share buyback programme in 2021 and reflecting the strength of our capital position, we intend to commence a further share buyback programme of up to £100 million split into two tranches of up to £50 million each, the first in H1 and the second scheduled for H2.

After the proposed final dividend and £100 million share buyback programme, the estimated solvency capital ratio was 176% as at 31 December 2021. We have outstanding Tier 2 debt issued in 2012 with nominal value of £250 million which can first be called from 27 April 2022. Excluding this debt, the adjusted solvency ratio after the proposed final dividend and share buyback would be 160% which is in the middle of our stated risk appetite range of 140% to 180% of solvency capital requirement.

We have a track record of returning capital to shareholders, with £2.1 billion returned over the last five years, whilst also improving our capital structure with issues of Restricted Tier 1 and Tier 2 debt. Furthermore, over the last two Motor reinsurance renewals we have reduced the amount of excess of loss reinsurance purchased as increasing reinsurance prices has made it less effective economically. Looking forward, we have a strong balance sheet with further opportunities to reduce capital intensity and increase flexibility.

Board and leadership changes

There have been several changes in our Board and leadership teams since the time of our last Annual Report. In May, we announced that Tim Harris had decided to retire as Chief Financial Officer ("**CFO**") in order to prioritise supporting a family member who was undergoing medical treatment. On behalf of the Board and all our colleagues, I would like to thank Tim for the exceptional contribution he made as CFO since 2019 and to wish him and his family the very best. Following Tim's decision, Neil Manser (who had performed the role of Acting CFO since January 2021) was appointed as CFO on a permanent basis. Neil has a proven track record in the business, previously having held the roles of Chief Strategy Officer, Managing Director of our commercial business, NIG, and Director of Investor Relations. I am pleased that our strong internal talent pipeline and succession planning enabled a smooth transition of the finance leadership to such a high-calibre, capable candidate and am delighted by the invaluable contribution that Neil has already made to the Board during the year.

In November, we were also delighted to welcome Tracy Corrigan to the Board as a Non-Executive Director. Tracy's broad understanding of capital markets and the digital economy, and first-hand experience of driving digital transformation, cultural change and customer-focused innovation, has put her in a strong position to support the Board and our executive team in delivering our ambitious strategy.

There were also some exciting appointments to our Executive Committee. Promotion of internal talent resulted in the appointment of Jessie Burrows as Managing Director, Customer Sales, Service & Claims and Jazz Gakhal as Managing Director, Motor. In addition, Aurore Lecanon joined us as Chief Risk Officer and Ash Jokhoo as Chief Information Officer. These appointments strengthen our capabilities in the key areas of data, customer and technology and support our drive to increase the diversity of our workforce at all levels.

More information about leadership changes in 2021 can be found on page 96.

Sustainability and culture

Our vision is to create a world where insurance is personal, inclusive and a force for good. This means we want to do business in a way that benefits all our stakeholders and has a positive impact on society. We have lots of exciting and ambitious initiatives in place to help us achieve this, but just as importantly, we have a culture that places huge value on "doing the right thing" and encourages and empowers our people to do so. The Sustainability section of the Strategic report shows how we are embedding sustainability into our business with greater confidence, in a way that underpins our strategy and is reflected in the way we behave. In the Corporate Governance report, we show how the Board has engaged with our stakeholders, including our shareholders, and how it has adapted its own ways of working to support and sustain the Group's culture and connect with our wider management team.

Our customers

During the year, our strategic technology transformation delivered some material improvements to the way we interact with our customers. We successfully rolled out our new Motor platform to our biggest brands (Direct Line and Churchill) and we continued to find new opportunities for innovation, including an online customer claims portal, which enables digital claims management, and a new cloud-based telephony system in Green Flag, which enables enhanced customer service and more efficient claims handling.

2021 also saw us announce a new partnership with Motability, made possible by our investment in business and technology transformation, which has created the capability for us to be a service provider of scale. We will provide insurance and vehicle repairs to the Motability scheme, supporting its more than 640,000 customers. The scheme helps people with disabilities achieve greater independence by leasing a new car, scooter or powered wheelchair in exchange for their mobility allowance. This partnership aligns with our purpose of helping people carry on with their lives, giving them peace of mind now and in the future, and I look forward to seeing how Motability's customers can benefit from our investments in vehicle repair and customer service.

Planet

During 2021, we continued to make good progress in respect of the "planet" pillar of our sustainability strategy. Our Sustainability report and Climate Change Action report for 2021 are available on the Group's corporate website. Highlights during 2021 included joining the "Race to Zero" Campaign and the launch of our first electric vehicle bundle for new Direct Line customers. More information about these initiatives can be found on pages 70 to 75.

In this report we also publish our second Task Force on Climate-related Financial Disclosures report, which sets out the progress the Group has made in setting Science-Based Targets, which will strengthen our disclosures across Scope 1, Scope 2 and Scope 3 emissions.

Society

We aim to use our expertise to improve outcomes for society and the communities we serve. One of the key ways we see that we can make a positive impact on society is through promoting social mobility through the Opportunity Action Plan that we have launched in partnership with the Social Mobility Pledge. This year, we have looked to harness the benefits of remote working by targeting recruitment in social mobility cold spots and holding insight days for bright students from less-advantaged backgrounds. We have continued to use our Community Fund to prioritise social causes, including marginalised groups and loneliness, mental health and wellbeing and food poverty. More information on this work can be found on page 67.

People

In 2021 we continued to support our people through the pandemic and look for ways to support our colleagues' wellbeing and safety in the new hybrid working environment. Our flexible approach to remote working has proven valuable in enabling us to access a wider and more diverse talent pool. We have listened to our colleagues' views, expressed through our regular engagement surveys and our Employee Representative Body, and taken action where we have seen opportunities to make things better (see pages 64 and 111). We continued to show strong commitment to our diversity and inclusion agenda, publishing our first Black Inclusion report and committing that from 2022 we will voluntarily publish our ethnicity pay gap. We hope this transparency will lead us to understand better where to focus future diversity and inclusion initiatives, because we know there is always much more to do.

I would like to end my statement by thanking our people for their continued commitment and dedication to our business. It is through their hard work that we enter 2022 with a sustainable business, ready to compete under new pricing rules and poised to use our new data and technology capabilities to grow the business, deliver great outcomes for customers and achieve our purpose of helping people carry on with their lives, giving them peace of mind now and in the future.

DANUTA GRAY
Chair of the Board

Section 172(1) statement

The Board of Direct Line Insurance Group plc ("**Direct Line**") confirms that during the year under review, it has acted in the way it considers would be most likely to promote the long-term success of the Company for the benefit of its members as a whole, whilst having regard to the matters set out in Section 172(1)(a)-(f) of the Companies Act 2006 ("**Section 172(1)**").

Purpose and Vision

The matters set out in Section 172(1) underpin Direct Line's purpose and vision and form the foundation for the Board's considerations and decision making. Our purpose – to help people carry on with their lives, giving them peace of mind now and in the future – is centred on customers and their long-term interests. Our vision – to create a world where insurance is personal, inclusive and a force for good – reflects our desire to do business in a way that benefits all stakeholders, the environment and wider society.

Stakeholders

Information on Direct Line's key stakeholders is set out in the Sustainability section of the Strategic report on the following pages: Customers, 58 to 60; People, 61 to 65; Society, 66 to 69 and Environmental, 70 to 75. The diagram on page 55 sets out factors that we have assessed as being important to our stakeholders.

Engagement

The Board recognises that our stakeholders have diverse and sometimes competing interests that need to be finely balanced, and that these interests need to be heard and understood in order for them to be effectively reflected in decision making. Information about how the Board has engaged with stakeholders during the year and outcomes of that engagement can be found on pages 109 to 110 in the table titled "How the Board engages with stakeholders".

Board decisions and oversight

Examples of how stakeholder engagement and Section 172(1) matters have influenced Board discussion and decision making during the year can be found in the table titled "Consideration of Section 172(1) factors by the Board" on page 108. The table covers a number of key topics including: the return of capital to shareholders; the future of Direct Line's workplace and culture; and the implementation of rules resulting from the FCA's Pricing Practices Review. The metrics and processes which the Board looks at to ensure that business practices and behaviours reflect the Company's culture, purposes and values, including the impact of decisions on key stakeholders, are set out under "Culture and purpose" on page 105. Information about Board oversight of environmental matters can be found on page 76 in the TCFD Report.

The below table sets out where key disclosures in respect of each of the Section 172(1) matters can be found.

	Section 172(1) factor	Relevant disclosures
a	the likely consequences of any decision in the long term	Innovating for the future (pages 1 to 13) Vision, purpose, strategic objectives (page 23) Consideration of Section 172(1) factors by the Board (page 108)
b	the interests of the company's employees	Key Performance Indicators – Colleague engagement scores (page 31) Outcome of employee engagement surveys (page 65) Diversity and Inclusion (pages 61 to 64) Employee Representative Body (page 111) How the Board engages with stakeholders (pages 109 to 110)
c	the need to foster the company's business relationships with suppliers, customers and others	Key Performance Indicators – NPS and customer complaints metrics (page 31) Supporting customers (pages 58 to 60) Supply Chain Sustainability Programme (page 82) How the Board engages with stakeholders (pages 109 to 110)
d	the impact of the company's operations on the community and the environment	External ratings, memberships and benchmarks (page 57) Social Mobility Action Plan (page 67) Community Fund 2021 (page 68) Science-Based Targets setting (page 86) TCFD disclosures (pages 76 to 87) How the Board engages with stakeholders (pages 109 to 110) Sustainability Committee Report (pages 130 to 131)
e	the desirability of the company maintaining a reputation for high standards of business conduct	Our values (page 62) Internal controls (pages 117 to 118) The role of the Board – Culture and Purpose (page 105)
f	the need to act fairly between members of the company	Capital returns (page 14) How the Board engages with stakeholders (pages 109 to 110) Annual General Meeting (page 97) Shareholder voting rights (pages 161 to 162)

An exciting point for the business

As I reflect on 2021, I am delighted by the Group's strong performance. I feel proud of the way we have navigated the complexities and uncertainties of a challenging market, impacted by the pandemic. Commercial, Home own brands and Rescue have grown, benefiting from the investments we have made in recent years in technology and pricing, whilst in Motor we have prepared for future growth while steering a smart path through a period of falling premium and uncertain claims frequency as the market seeks to predict the shape of the pandemic and its effect on customer driving behaviour.

Penny James
Chief Executive Officer

At the same time we have made brilliant strategic progress. After several years replacing the technology across the business, introducing agile ways of working and building our data foundations, we are nearing the completion of our technology transformation phase.

Through that transformation we have improved the profitability of the business we write, with releases from older reserve years no longer such a significant part of our annual profits. We have delivered performance across the business, including the quality of claims management, pricing and improvements in our cost efficiency. We anticipate further progress in all these areas through 2022 and 2023.

So, as I look ahead, I see 2022 as the year we pivot to focusing on driving the business forward. 2021 has been dominated by delivering the transformation to enable future growth and preparing for one of the biggest changes the market has seen with the introduction of the FCA's new Pricing Practices Review regulations. As we tune and embed the systems we have built and plan for Home to join Motor on them, we also look ahead with excitement as we are able to focus on driving our performance in this new market.

As we look to make this shift, I have focused on making sure we have the right leadership to make us successful. Several members of our executive team have changed and we now have a team brimming with the customer and insurance experience that has driven our past success, but also the technology, digital and data skills we want to become the data- and technology-driven insurance company of the future.

We start from a position of strength, of course, with a track record of strong returns, having delivered a return on tangible equity of over 19% for each of the last five years and having returned over £2.1 billion of capital to shareholders over the same period, including the final dividend and share buyback programme announced today. This is possible due to our scale and expertise across our diversified business model, with market-leading brands across multi-products and multi-channels. These sustained returns, combined with our new tech capability, give us a platform for future success.

Chief Executive Officer's review *continued*

Our customer-obsessive mindset is intent on delivering long-term sustainable growth. We are a business that puts data at the heart of what it does and we are working to have it at everyone's fingertips – with the agility to create and tailor innovative solutions and give customers the flexible, modular and on-demand insurance products that give them control. It is why I am so excited by the progress we have made, having now rolled out our largest brands, Direct Line and Churchill, onto our new Motor platform.

This transformation builds on our existing core strengths of great customer service, strong brands and expert claims capability which look to harness the best of technology to make every customer interaction effortless, instant and transparent, however customers come to us. Our diversified business model gives us the platform to be the best at direct and win through price comparison websites ("**PCWs**"), partners and brokers. The technology transformation enables a step change in our pricing capability and operational efficiency which is designed to further increase our competitiveness.

As we move to embed and leverage what we have built, we believe there is plenty more to come:

- Step changes in our use of pricing and data, which are already beginning to improve our competitiveness in Motor, and we will continue to refine and enhance our pricing models and capabilities as we move through the year.
- The next sweep of our brand advertising, building on the success of the 'superheroes' and Churchill campaigns.
- Improvements in our customer service and costs efficiency through material increases in straight-through processing.
- Over 640,000 Motability Operations customers who are scheduled to join us in 2023 in a deal focused on providing brilliant customer service and claims in a capital-efficient manner with 80% reinsured.
- And we are delighted to have extended our contract with NatWest Group to continue looking after their customers' Home insurance needs, a contract built on our ability to deliver great service for their customers through brilliant use of digital and data capability.

So, as we enter 2022, we are initially focused on understanding the new dynamics in the marketplace, where renewal and new business pricing are linked. It's early days but the market appears to be responding rationally and we are taking time to understand how customers will behave in the new pricing practices world and how to balance product, pricing and distribution to the best effect. The next phase is optimising for growth as we embed and tune the technology we've built.

We believe passionately that delivering sustainable growth in the long run means our customers, society and the planet need to thrive and we have a role to play in helping to ensure that is the case. In essence we need to do the right thing for our customers, our people and the planet. We are making our business an inclusive and rewarding place to work, where brilliant, skilled people can deliver in a high-performance culture. We are investing in the skills that our business will need for its future success and are offering training programmes to enable people who want to reskill to do so.

We have also made further strides to embed sustainability initiatives by prioritising actions which are good for the long-term interests of the business and which bring wider societal benefits. You can see this most strongly in the steps we are taking to protect our business from the impact of climate change and to give back more to the planet than we take out. Our decision this year to join the Race to Zero – committing to set Science-Based Targets to reduce emissions based on a 1.5°C pathway – reflects that ambition. But we also recognise our role in supporting customers to go green and delivering our new Direct Line electric vehicle proposition is another sign of our ability to innovate in an agile way.

This is a business I love, brimming with people who share my view and go the extra mile to support customers and one another. 2021 has been far from an easy year. Change is never comfortable and is rarely predictable. The results and progress are the outcome of the sheer dedication of our amazing people and their determination to succeed despite the challenges and strains of a pandemic. So, the most important thing I can do here is thank each one of them for sharing this journey with me.

Forging ahead with our strategy

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

Our values

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

Our strategic objectives

- Best at direct
- Win on price comparison websites
- Extend our reach
- Technical edge
- Nimble and cost efficient
- Great people

> See pages 15 and 26 for further information

Our sustainability pillars

Customers People Society Planet Governance

> See page 54 for further information

Our brands

Direct Line
Darwin.
Privilege.
NIG
churchill
GREEN FLAG COMMON SENSE TO THE RESCUE
DLG PARTNERSHIPS

Chief Executive Officer's review *continued*

Preparing for the future

As one of the largest motor insurers in the UK we have 22 garages. As car technology rapidly changes, we are continuing to invest in our repair capability so we can meet future customer needs with the aim of achieving efficient repair.

This is why we possess the ability to test and calibrate ADAS (Advanced Driver Assistance Systems) and are training more of our technicians in electric vehicle repair, as this is expected to be a growing market and we need to be ready. Our new technology centre is a further sign of our repair capability and is designed to help build in-house knowledge and inspire the next generation.

New Motor insight

We are delighted to announce a new 10-year Motor partnership with Motability Operations from 2023.

It is expected to give the Group further insight on a fleet of modern vehicles as the scheme serves some 640,000 people, and is further evidence of the quality of our customer service, vehicle repair expertise and digital claims capability.

New car technology centre

As the largest insurer-owned garage networks in the UK we pride ourselves in efficient repair. To strengthen the Group's repair capability further we have invested in a new car technology centre in Birmingham.

£2m

investment in new car technology centre

Business performance

We are already beginning to see some financial benefits of our transformation, with another strong financial performance in 2021, growing our own brand policy count, delivering a combined operating ratio of 90.1% and increasing operating profit year on year by 11.4% to £581.8 million. This has enabled us to declare a final dividend of 15.1 pence, a 2.7% increase over 2020, and announce a share buyback programme of up to £100 million.

We grew direct own brand in-force policies by 1.0% driven by Commercial direct and Green Flag Rescue, our two divisions furthest through their transformation, and Home where we traded well in a buoyant new business market.

We continued to make progress on our cost agenda, with operating expenses reducing £18 million to £706 million and the expense ratio falling 0.6 percentage points to 23.9%. Whilst we saw levies increase by 11% during 2021, alongside heightened inflation in wage costs, these impacts were more than offset by lower technology costs, savings from our property strategy and a 9% reduction in headcount. We also incurred lower Covid-19 related costs.

The combined operating ratio at 90.1%, normalised for weather at 91.1%, was better than our medium-term target of 93% to 95% and in line with our mid-year stated revised expectation of between 90% and 92%. We achieved an excellent underwriting profit for the year with increased prior-year reserve releases and Motor claims frequency remaining below pre-pandemic levels in H1 2021.

This, together with a strong investment result, meant operating profit increased from £522.1 million in 2020 to £581.8 million in 2021. We have been focusing on improving the amount of our operating profit that comes from the current year and in 2021 met our target of at least 50%.

Impact of Covid-19

Whilst in 2020 we saw a modest indirect economic benefit from the Covid-19 pandemic in our results, during 2021 the impact was less marked. Within Motor we saw similarly low levels of claims frequency across the first half of 2020 and 2021 and with restrictions easing across H2 2021 we saw claims frequency increase back to expected levels. Throughout 2021 motor market premiums reduced, in part reflecting this trend and offsetting the financial impact.

Outside of Motor the impact of Covid-19 was even less significant. Rescue saw lower new business shopping during lockdown restrictions, whilst claims experience in Home and Commercial was not significantly affected.

In our Travel business, lower customer travel levels continued to reduce gross written premium below pre-pandemic levels and claims volumes reduced in 2021 following the non-repeat of Covid-19 related claims in 2020.

Strategy update

Valuable customer relationships

Following the implementation of the FCA Pricing Practices regulatory changes at the start of 2022, the importance of strong customer relationships has never been higher.

Strong brands and great customer service have always been core strengths of our business and that has been consistently demonstrated by our high Net Promoter Scores and retention rates across both Home and Motor.

Throughout our technology transformation, we have always started with the customer. Our new technology architecture has delivered a step change in our digital capabilities, enabling our customers to deal with us however they wish. We have seen customer use of our digital channels increasing month on month throughout 2021, with 100% of Motor and Home claims now able to be registered online.

Our diversified business model also means that customers can deal with us through a range of recognised brands across a number of products. This enables us to support a real breadth of different customers.

Darwin, a new brand we set up in 2019, is a great example of our diversified approach. It uses machine learning to leverage our existing data resource and counter-fraud expertise to offer customers a low-cost digital product. In just two years it has increased to over 135,000 policies, is ranked in the top 10 on TrustPilot and provides us another powerful brand in the PCW channel.

Finally, our transformation has enabled us to improve our competitiveness through increased accuracy and agility in our pricing, as well as increasing the breadth of propositions that we can offer. During 2021 we rolled out our new electric vehicle proposition, building on our expertise in this growing market and helping our customers make the switch to electric vehicles.

“Our diversified business model also means that customers can not only deal with us through whichever channel they wish, but also via a range of recognised brands across a number of products.”

Growing the portfolio

Commercial and Green Flag Rescue are the areas of our business that are furthest through their transformation and they demonstrate what can be achieved when we combine our existing strengths in claims management, customer service and strong brands, with a new technology infrastructure and agile ways of working.

Between them they drove strong gross written premium growth of 13.9% in 2021 and gained share in their respective markets. We are adopting similar approaches in Motor and Home and are seeking to grow our share over time.

Longer term, we believe our brand strength enables us to extend into broader products and services to meet customers' needs. Direct Line has recently launched a standalone cyclist product to take advantage of this growing market and to attract new customers to other more established products; our electric vehicle proposition is designed to help customers transition to electric vehicles and is only one part of a wider ecosystem; and Green Flag, by changing its operating model, can now offer more assistance to customers during a vehicle recovery. These are all examples of how we are broadening our propositions and products to deliver for more customers.

Chief Executive Officer's review *continued*

Strategic objectives

Overall, in 2021, we made great progress on our path to building the insurance company of the future – technology and data led but with a customer-obsessive mindset. We not only completed the main elements of our technology build but have also made great progress against our six strategic objectives;

Objective	Progress to date
Best at direct	– Launched a new Direct Line proposition helping to make the transition to electric vehicles easier for customers by providing free access to a bundle of electric vehicle-related services, including discounted home charging installation. – Green Flag delivered a new cloud-based policy platform for online sales and relaunched the way it operates, enabling it to offer more services alongside roadside recovery. – Launch of Direct Line cyclist product as we extend our products and services in order to meet broader customer needs.
Win on PCWs	– Successfully rolled out our new Motor platform, which delivers greater pricing sophistication using third-party data and speed to market. We saw the benefits of this in improved Motor competitiveness in the second half of the year. – Continued to deliver strong growth in Darwin as we enhanced pricing across the four main PCWs, growing policy count to over 135,000, an increase of over 150% compared to the end of 2020. – Churchill business delivered 64% growth in gross written premiums in 2021.
Extend our reach	– We announced our new partnership with Motability Operations, demonstrating our core strengths in delivering great customer service and efficient car repairs. The partnership is anticipated to increase Motor gross written premiums by around £500 million each year from H2 2023. – Agreed a long-term extension to our Home partnership with NatWest Group. – U K Insurance Business Services Limited expanded into subscription insurance with a new partnership with Cazoo. – Green Flag renewed partnerships with Caravan and Motorhome Club, Zurich and Virgin Money.
Nimble and cost efficient	– Progressed our site strategy, purchasing our head office and rationalising our footprint at two regional offices, overall reducing our site footprint by 30% since 2019 and delivering savings in excess of £10 million per year. – Expanded digital customer journeys, including 100% of all Home and Motor claims now able to be registered online and with end-to-end digital journeys for certain claims types, delivering reduced demand into our contact centres. – Technology transformation reducing ongoing run costs through rationalisation of legacy systems, including the decommissioning of two data centres and reducing system support costs.
Technical edge	– We continued to expand our claims capabilities through the acquisition of our 22nd DLG Auto Services accident repair centre. This acquisition supports our competitive advantage in vehicle repairs and we continued to invest in capability to repair more advanced and electric vehicles. – Commercial continued the rollout of its new pricing and underwriting system across Commercial combined and Fleet, alongside the launch of machine learning pricing models, dramatically improving pricing accuracy. – Integration of digital journeys into our new fraud decision engine.
Great people	– We have refreshed our leadership, with an Executive Committee team which has the brilliant mix of digital, customer, data, insurance and agile skills we need to grow our business, leveraging the technology we have built. – The Group ranked 13th in The Inclusive Top 50 UK Employers list for 2021/22. – Published our Black Inclusion report and signed up to 10,000 Black interns programme. – Continued to embed Agile operating models across our trading and technology teams, enabling increased pace and efficiency of change.

"We take our environmental obligations seriously and this year joined the Race to Zero – committing to set Science-Based Targets to reduce emissions based on a 1.5°C pathway."

Sustainability strategy progress

We have continued to make progress on our sustainability strategy this year, improving our MSCI ESG rating from an 'A' to 'AA', and have published our second Task Force on Climate-related Financial Disclosures ("**TCFD**") report outlining our strategic response to climate change in this Annual Report. We have also participated in the Bank of England's Climate Biennial Exploratory Scenario ("**CBES**"), providing a clearer assessment of climate-related implications for the Group. We take our environmental targets seriously and this year joined the Race to Zero – committing to set Science-Based Targets to reduce emissions based on a 1.5°C pathway. While we finalise our submission to the Science Based Target Initiative ("**SBTi**") for approval, we are clear-sighted that setting ambitious targets requires practical measures to help reduce our emissions.

Colleagues have been innovating and trialling solutions to guide our emission reduction strategy, including launching a Supply Chain Sustainability Programme and piloting measures in our garage network because these are some of our most carbon-intensive operations. Part of our strategic response also means helping to make it easy for our customers to go green so that we can both contribute to and benefit from accelerating the transition. As a major motor insurer we are determined to make it easy for customers to insure electric vehicles, while aiming to fix them in the most energy-efficient repair network in the UK. That's why our new electric vehicle proposition for Direct Line customers is such an exciting development and a sign of how we can take long-term sustainable decisions which are good for the planet and our business.

UK weather

During February 2022, the UK experienced three significant storms: Dudley, Eunice and Franklin. To date, we have already helped over 10,000 customers across Home and Commercial and estimate claims to be between £30 million and £40 million. This is an early estimate and is within our annual weather budget assumption for 2022.

Ukraine conflict

We are deeply saddened and shocked by the conflict in Ukraine and have made an immediate donation from the Group's Community Fund to the UK's DEC Ukraine Humanitarian Appeal. As a UK-based business, there has been no direct impact from the conflict in Ukraine that started in February 2022. The investment portfolio has no direct exposure to Russia or Ukraine.

Outlook

Our strong strategic progress and disciplined approach to trading throughout 2021 meant we were well placed as we entered 2022 and began the implementation of the FCA Pricing Practices regulatory changes.

These are early days but we have seen positive new business premium inflation across the Home and Motor markets in January and February 2022, with search volumes higher but with switching reduced when compared to the same period in 2021. Our retention levels in Motor and Home have remained strong. These movements are within the range of outcomes we had projected and prepared for.

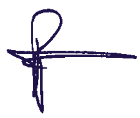
Our initial focus was on aiming to safely land the changes compliantly, while seeking to understand both market and consumer behaviour in the new environment. Our multi-brand portfolio sets us up well as it enables us to both protect value and be competitive in new business. This will enable us, as we move through the year, to optimise for growth and shareholder value whilst all the time delivering great outcomes for customers.

There are a range of inflationary pressures currently being seen within our market. Our claims expertise, including our repair cost advantage in Motor, puts us in a good position to manage these. Elsewhere, we have delivered absolute reductions in our overall cost base and we plan to reduce costs further during 2022.

Reflecting this, as well as our long-term confidence underpinned by our strategic transformation, we reiterate our combined operating ratio target range of 93% to 95%, normalised for weather, in 2022 and over the medium term. We also reiterate our expense ratio target of 20% for 2023, assuming modest premium growth, and our ongoing target of achieving at least a 15% return on tangible equity each year.

Having completed the main elements of our technology build we have complemented our strengths in strong brands, fantastic customer service and market-leading claims capabilities with a step change in our pricing capability, greater digitalisation and improved efficiency.

Whilst we are already seeing some of the benefits of this new capability coming through, the full benefits are yet to be realised, which leaves us well positioned to build on this strong performance through 2022 and beyond.



Penny James
Chief Executive Officer

Market overview

Consumer trends

In 2021 we witnessed consumer trends further align with our strategy, consistent with our technology transformation:

- More customers taking advantage of our digital capability where we are providing greater flexibility for people to manage their insurance how they want, whether it is amending policy cover or making a claim. It is part of our aim to use the best technology to make every customer interaction effortless, instant and transparent however customers come to us.
- A desire for trusted, famous brands offering distinctive customer offers and insurance propositions. We want to create and tailor solutions and give customers the flexible, modular and on-demand products that give them control. We were delighted to launch our new electric vehicle proposition for our Direct Line brand in 2021.
- Car technology is increasingly sophisticated and as the green transition picks up pace, electric vehicles are becoming more popular in the UK. Owning our garage network gives us beneficial commercial insights on vehicle technology, alongside upskilling our technicians in electric vehicle repair.
- The Covid-19 pandemic has changed consumer travel patterns, as more people work from home meaning fewer people are using cars in peak commuting hours, impacting claims behaviour. Insurers will need to adapt to this new environment and our ability to deploy more sophisticated pricing, as a result of our new motor platform, gives the Group greater competitiveness as the UK emerges from the pandemic.
- Increasingly people are taking advantage of partnerships where they can access insurance products. We are aiming to be the insurance partner of choice because it allows us to reach new sets of customers, which is why we are delighted to be partnering with Motability. Our new Direct Line electric vehicle proposition offers a free bundle of services from our partner, Zoom EV, and our Commercial business is working with Cazoo, providing motor insurance to customers within their monthly car subscription.

Financial Conduct Authority Pricing Practices Review

In May 2021 the FCA published its General Insurance Pricing Practices Final Policy Statement outlining the implementation timetable for the reforms. Following the Final Policy Statement, the Group successfully met the product governance deadline at the end of September 2021, as well as implementing the pricing reforms which came into effect on 1 January 2022.

We have been supportive of the reforms since the FCA announced its intention for firms to equalise customer prices by offering a renewal price no higher than the equivalent new business price through the same sales channel for motor and home policies.

For several years, before the FCA announced its intention to reform the market, we have taken a proactive approach to reduce the pricing differential between new business and renewal customers, including reviewing customers' renewal prices when they reach their five-year anniversary.

As the market rebalances, in line with the FCA's rule changes, we believe customers will continue to look for both value for money and trusted brands, especially those with a reputation for excellent customer service, market-leading customer offers in terms of what people receive with their cover and a strong track record in claims handling, which are where we have fundamental strengths. We remain confident that our core strengths will assist in helping the Group to navigate this new market with the aim of delivering the right outcomes for our customers and shareholders.

"We have been supportive of the reforms since the FCA announced its intention for firms to equalise customer prices by offering a renewal price no higher than the equivalent new business price through the same sales channel for motor and home policies."

Inflation

The Group is not immune from global inflationary pressures which became more pronounced in the UK during the second half of 2021. Like other insurers, heightened inflation in construction materials such as concrete and lumber has impacted home claims. Meanwhile, motor claims inflation has trended upwards largely due to the limited global supply of new vehicles increasing costs for second-hand vehicles, impacting total loss settlements. In Motor we continued to focus on maintaining the quality of our book and continued to price for claims inflation at a time when we believe market pricing was not reflective of observed claims inflation.

While inflation is expected to persist throughout 2022 we believe the Group has strengths which can help navigate an increasingly inflationary environment. Owning the largest garage network of any insurer allows us to repair vehicles effectively and economically, enabling us to mitigate some inflationary pressures. Whilst we have a large home business, construction materials only make up a small amount of our claims costs, with a greater proportion relating to labour costs and decorating materials meaning we are insulated from certain inflationary pressures partially caused by supply chain disruption. If supply chain delays reverse as a result of a relaxation of Covid-19 restrictions we could see some of these impacts unwind.

“While inflation is expected to persist throughout 2022 we believe the Group has strengths which can help navigate an increasingly inflationary environment.”

Climate

Climate change affects the Group in several ways and, like other companies, the Group is focusing its efforts on how to manage the transition to a low-carbon future. In October 2021 the Chancellor published the ‘Greening Finance’ roadmap, setting out plans for new Sustainability Disclosure Requirements to create a framework for sustainability disclosures across the economy, building on TCFD to integrate global standards.

The Group has taken a number of steps in recent years to publish its energy usage and emissions transparently. It continues to develop risk-mitigation measures to reduce operational emissions and has enhanced its assessments of climate-related risks to our business.

This year the Group has published its second TCFD-aligned disclosure (see page 76) which sets out our strategic response to climate change. We have also continued to publish our Scope 1 and 2 emissions as well as Scope 3 emissions[1] with greater clarity of the activities under our direct control. We are now also publishing our Scope 3 supply chain emissions as well as, for the first time, our homeworking emissions following the Group's adoption of a mixed (remote and site-based) working model (see page 64).

In 2021 the Group joined the Race to Zero committing to set Science-Based Targets to reduce our emissions based on a 1.5°C pathway. We are in the process of setting Science-Based Targets, which will guide the Group to reduce our emissions as part of the Science Based Target initiative (“**SBTi**”), where we are aiming for a validated set of targets in 2022. This will cover our operational emissions (Scope 1 and 2 emissions), as well as our Scope 3 emissions including our supply chain and investments. In recognition that our carbon reduction strategy will take time we remain a carbon neutral business through offsetting.

“Alongside our climate change scenario analysis we are focused on supporting customers to make sustainable choices.”

Understanding climate-related risks is important because we manage insurance risks presented by weather-related events, such as flooding and storm damage. The Group continues to evaluate the risks presented by climate change and last year we participated in the Bank of England’s Climate Biennial Exploratory Scenario (“**CBES**”).

Alongside our climate change scenario analysis we are focused on supporting customers to make sustainable choices. In 2021 we launched our electric vehicle offer for our Direct Line brand and our commercial business partnerships are offering customers the flexibility to try electric vehicles.

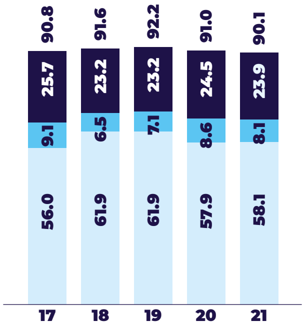
UK economy and Brexit

The UK's new international trading relationships may have had an impact on claims inflation and may still do so, although the Covid-19 pandemic continues to mask the effects of these relationships. Certain risks related to Brexit could still occur or be exacerbated and we continue to be alert to possible developments.

1. Excluding investments

Our key performance indicators

Combined operating ratio[1] ("COR") (%)



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.

Expense ratio
Commission ratio
Loss ratio

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.

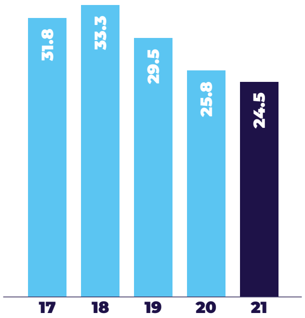
> For additional performance information see page 35

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 135 and 141

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.

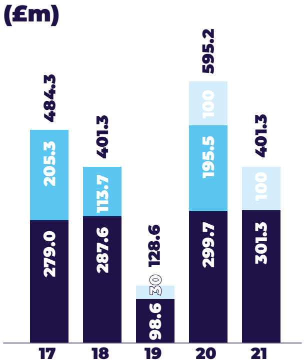
We have not set a target. However, growing earnings per share is considered an indicator of a healthy business.

> For additional performance information see page 38

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 pages 135 and 141

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 213 for dividend breakdown).

Buybacks
Special
Ordinary

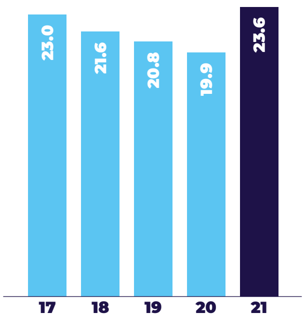
We aim to grow the regular dividend in line with business growth. Additionally, we look to return any capital to shareholders which is expected to be surplus to our requirements for a prolonged period.

> For additional performance information see page 38

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 135 and 145

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 38

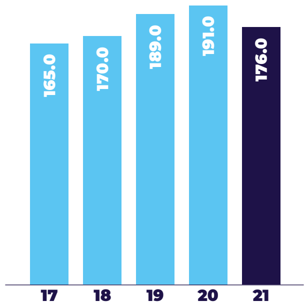
We base the LTIP awards partly on adjusted RoTE over a three-year performance period.

> For additional information see pages 135 and 145

Notes:

1. See glossary on pages 248 to 250 and Appendix A – Alternative performance measures on pages 251 to 255 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 represented 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%.

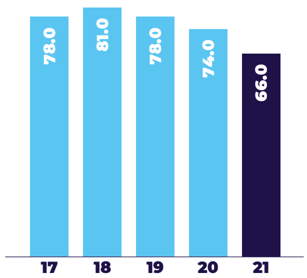
> For additional performance information see page 39

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 page 135

Colleague engagement (%)



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

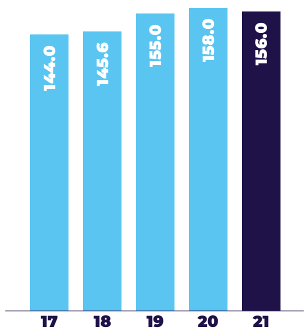
To make the Group best for our customers and best for our colleagues. We gauge employee engagement through our colleague opinion surveys and we aim for high colleague engagement scores each year.

> For additional performance information see page 61

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

> For additional information see pages 135 and 143

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.

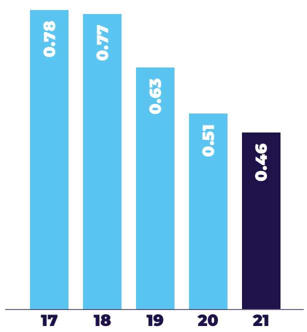
We aim to increase our NPS over time.

> For additional performance information see page 58

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

> For additional information see pages 135 and 142

Customer complaints[6] (%)



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 135 and 142

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.

Finance review

A strong financial performance

Financial highlights

Direct own brands in-force policies grew 1.0% with growth across Commercial direct (7.5%), Green Flag Rescue (5.8%) and Home (2.3%). Motor direct own brands in-force policies were stable in H2 2021 with a reduction of 1.9% over the year. Direct own brands gross written premium was 0.8% lower and grew 0.7% in H2 2021.

Operating profit increased to £581.8 million (2020: £522.1 million) driven by an increase in underwriting profit and a strong investment return result. Current-year contribution to operating profit, normalised for weather, was 53% (2020: 65%), in line with the Group's 2021 target of at least 50%.

Combined operating ratio improved to 90.1% (2020: 91.0%). Normalised for weather, the combined operating ratio was 91.1%, ahead of our medium-term target of 93% to 95% and in line with the expectation of between 90% and 92% for 2021 we stated at half year.

Profit before tax of £446.0 million was £5.4 million lower than 2020 as the increase in operating profit was offset by a £62.1 million increase in restructuring and one-off costs primarily reflecting restructuring of the property portfolio, including the purchase of the Bromley office in early 2021 as previously announced.

Proposed final ordinary dividend of 15.1 pence per share, making a total of 22.7 pence per share, an increase of 2.7% over the 2020 total ordinary dividend, and announcing a £100.0 million share buyback programme. Strong capital position with an adjusted solvency capital ratio of 160%.

Neil Manser
Chief Financial Officer

Financial summary

	FY 2021 £m	FY 2020 £m
In-force policies (thousands)	**14,565**	14,615
Of which: direct own brands (thousands)	**7,529**	7,454
Gross written premium	**3,171.6**	3,180.4
Of which: direct own brands	**2,207.6**	2,225.6
Net earned premium	**2,957.4**	2,960.5
Underwriting profit	**291.5**	267.8
Instalment and other operating income	**144.0**	159.2
Investment return	**146.3**	95.1
Operating profit	**581.8**	522.1
Restructuring and one-off costs	**(101.5)**	(39.4)
Operating profit after restructuring and one-off costs	**480.3**	482.7
Finance costs	**(34.3)**	(31.3)
Profit before tax	**446.0**	451.4
Tax	**(102.3)**	(84.2)
Profit after tax	**343.7**	367.2
Key metrics		
Current-year attritional loss ratio[1,2]	**65.5%**	62.3%
Loss ratio[1,2]	**58.1%**	57.9%
Commission ratio[1,2]	**8.1%**	8.6%
Expense ratio[1,2]	**23.9%**	24.5%
Combined operating ratio[1,2]	**90.1%**	91.0%
Return on tangible equity[2]	**23.6%**	19.9%
Investment income yield[2]	**1.9%**	2.1%
Net investment income yield[2]	**1.7%**	1.8%
Investment return yield[2]	**2.4%**	1.6%
Basic earnings per share (pence)	**24.5**	25.8
Diluted earnings per share (pence)	**24.1**	25.5
Return on equity	**12.5%**	13.1%
Dividend per share – interim (pence)	**7.6**	7.4
– final (pence)	**15.1**	14.7
– total ordinary (pence)	**22.7**	22.1
– special (pence)[3]	**–**	14.4
Share buyback	**100.0**	100.0
	FY 2021	FY 2020
Net asset value per share (pence)	**193.6**	199.7
Tangible net asset value per share (pence)	**131.2**	141.5
Solvency capital ratio post-dividends and share buyback[4]	**176%**	191%
Adjusted solvency capital ratio[5]	**160%**	172%

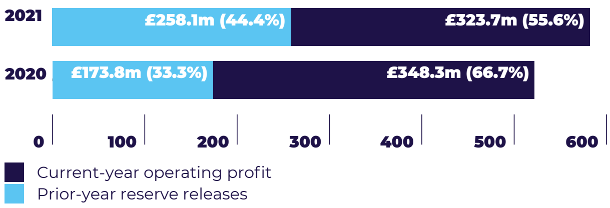
Notes:

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. See glossary on pages 248 to 250 for definitions.
2. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.
3. 2020 special dividend paid in lieu of the cancelled 2019 final dividend.
4. Estimates based on the Group's Solvency II partial internal model.
5. Adjusted solvency capital ratio excluding Tier 2 debt which can first be called from 27 April 2022. See appendix A – Alternative performance measures on page 251 for definition and on page 255 for reconciliation to financial statement line items.

Performance

Operating profit

	FY 2021 £m	FY 2020 £m
Underwriting profit	**291.5**	267.8
Instalment and other operating income	**144.0**	159.2
Investment return	**146.3**	95.1
Operating profit[1]	**581.8**	522.1



Note:

1. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

In 2021 we delivered a strong financial performance, growing our own brand policy count, delivering a combined operating ratio of 90.1% and increasing operating profit year on year by 11.4%. This enabled us to declare a final dividend of 15.1 pence, a 2.7% increase over 2020, and announce a further share buyback programme of up to £100 million.

We delivered operating profit of £581.8 million, an increase of £59.7 million over 2020, driven by increased underwriting profit and a strong investment return, partially offset by lower instalment and other operating income. Current-year contribution to operating profit, normalised for weather, was 53% (2020: 65%), in line with our target of at least 50%.

Underwriting profit increased by £23.7 million, with increases in prior-year reserve releases and lower operating costs being partially offset by higher claims frequency in Motor. Increases in prior-year reserve releases benefited from favourable development across several perils in Home and large bodily injury reserves development in Motor as uncertainty arising from Covid-19 and Brexit reduced. The combined operating ratio at 90.1%, normalised for weather at 91.1%, was better than our medium-term target of 93% to 95% and in line with our stated mid-year revised expectation for 2021 of between 90% and 92%.

Lower average premiums in Motor and lower claims volumes across the whole year drove a reduction in instalment and other income to £144.0 million (2020: £159.2 million).

Investment return increased by £51.2 million in 2021 following £43.6 million of realised and unrealised gains across our investment property and credit portfolios (2020: £11.7 million of net realised and unrealised losses).

During 2021, the impact of Covid-19 was less significant than in the previous year where it caused a modest overall indirect economic benefit. Whilst Motor claims frequency remained below pre-pandemic levels in H1, it increased back to expected levels during H2 and Motor saw elevated severity inflation in damage claims throughout the year.

In-force policies and gross written premium

In-force policies (thousands)

	31 Dec 2021	31 Dec 2020
Direct own brands	**3,869**	3,943
Partnerships	**102**	118
Motor	**3,971**	4,061
Direct own brands	**1,879**	1,837
Partnerships	**788**	801
Home	**2,667**	2,638
Rescue	**3,417**	3,400
Travel	**3,445**	3,499
Pet	**138**	145
Other personal lines	**56**	61
Rescue and other personal lines	**7,056**	7,105
Of which: Green Flag direct	**1,179**	1,114
Direct own brands	**602**	560
NIG and other	**269**	251
Commercial	**871**	811
Total in-force policies	**14,565**	14,615
Of which: direct own brands	**7,529**	7,454

Direct own brand policies grew 1.0% to 7.5 million with growth in Commercial, Green Flag Rescue and Home offsetting declines in Motor. Total in-force policies were broadly stable at 14.6 million (31 December 2020: 14.6 million) as the increases in direct own brand and Commercial NIG in-force policies were offset by lower partnership and Travel volumes.

Gross written premium

	FY 2021 £m	FY 2020 £m
Direct own brands	**1,515.2**	1,567.6
Partnerships	**45.6**	49.3
Motor	**1,560.8**	1,616.9
Direct own brands	**416.7**	411.6
Partnerships	**161.1**	166.3
Home	**577.8**	577.9
Rescue	**170.0**	166.7
Travel	**92.3**	134.0
Pet	**71.4**	72.8
Other personal lines	**46.3**	44.3
Rescue and other personal lines	**380.0**	417.8
Of which: Green Flag direct	**88.3**	83.1
Direct own brands	**187.4**	163.3
NIG and other	**465.6**	404.5
Commercial	**653.0**	567.8
Total gross written premium	**3,171.6**	3,180.4
Of which: direct own brands	**2,207.6**	2,225.6

Direct own brands gross written premium reduced by 0.8% to £2,207.6 million (2020: £2,225.6 million) where strong growth in Commercial and Green Flag Rescue was offset by lower volumes and lower average premiums in Motor. Total gross written premium of £3,171.6 million (2020: £3,180.4 million) reduced by 0.3% with strong growth in Commercial NIG offset by the small reduction in own brands and a reduction in Travel.

Underwriting profit and combined operating ratio[1]

	FY 2021	FY 2020
Underwriting profit (£ million)	**291.5**	267.8
Loss ratio	**58.1%**	57.9%
Commission ratio	**8.1%**	8.6%
Expense ratio	**23.9%**	24.5%
Combined operating ratio	**90.1%**	91.0%

Note:

1. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

Overall underwriting profit increased to £291.5 million (2020: £267.8 million) with an improvement in the combined operating ratio to 90.1% (2020: 91.0%).

The loss ratio edged up slightly to 58.1% (2020: 57.9%) driven by increases across Motor and Commercial more than offsetting improvements in Home and Rescue and other personal lines.

The small deterioration in the loss ratio was more than offset by a lower commission ratio. The commission ratio reduced primarily due to reduced profit share payments, particularly on packaged bank accounts and Home partnerships, partially offset by increased commission payments in Commercial.

The expense ratio reduced by 0.6 percentage points to 23.9% as operating expenses reduced following progress on our cost saving initiatives, partially offset by increased levies and depreciation and amortisation charges relating to the launch of our new technology platforms.

Ratio analysis by division

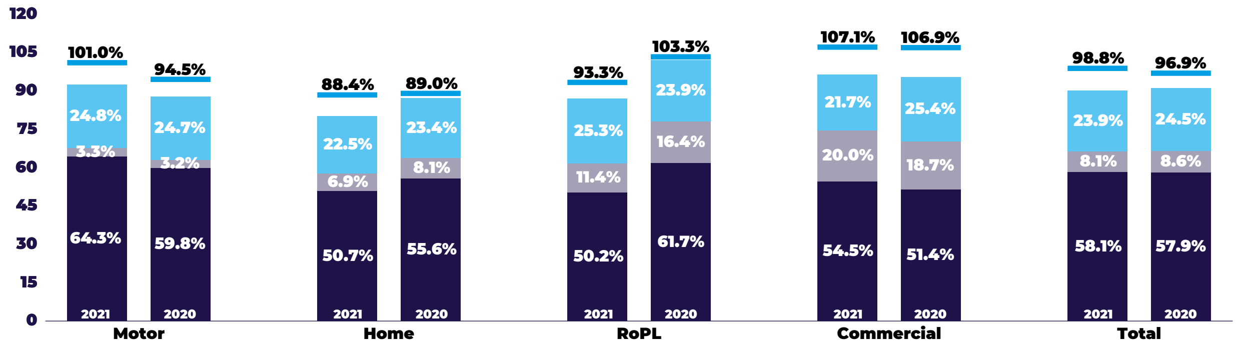
	Notes	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
For the year ended 31 December 2021						
Net earned premium	4	**1,473.3**	**553.4**	**369.5**	**561.2**	**2,957.4**
Net insurance claims	4	**947.0**	**280.4**	**185.3**	**306.0**	**1,718.7**
Prior-year reserve releases	35	**127.1**	**45.8**	**23.8**	**61.4**	**258.1**
Major weather events		**n/a**	**(18.3)**	**n/a**	**(19.2)**	**(37.5)**
Attritional net insurance claims		**1,074.1**	**307.9**	**209.1**	**348.2**	**1,939.3**
Loss ratio – current-year attritional		**72.9%**	**55.7%**	**56.5%**	**62.0%**	**65.5%**
Loss ratio – prior-year reserve releases		**(8.6%)**	**(8.3%)**	**(6.4%)**	**(10.9%)**	**(8.7%)**
Loss ratio – major weather events[1]		**n/a**	**3.3%**	**n/a**	**3.4%**	**1.3%**
Loss ratio – reported	4	**64.3%**	**50.7%**	**50.2%**	**54.5%**	**58.1%**
Commission ratio	4	**3.3%**	**6.9%**	**11.4%**	**20.0%**	**8.1%**
Expense ratio	4	**24.8%**	**22.5%**	**25.3%**	**21.7%**	**23.9%**
Combined operating ratio[2]	4	**92.4%**	**80.1%**	**86.9%**	**96.2%**	**90.1%**
Current-year combined operating ratio[2]		**101.0%**	**88.4%**	**93.3%**	**107.1%**	**98.8%**
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	35	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[2]	4	87.7%	87.1%	102.0%	95.5%	91.0%
Current-year combined operating ratio[2]		94.5%	89.0%	103.3%	106.9%	96.9%

Notes:

1. Home and Commercial claims for major weather events, including inland and coastal flooding and storms.
2. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

Finance review *continued*

Ratio analysis by division (%)



The current-year attritional loss ratio excludes prior-year reserve releases and claims costs from major weather events and is therefore an indicator of underlying accident year performance. Our current-year attritional loss ratio of 65.5% increased by 3.2 percentage points compared to 2020, with increases in loss ratio in Motor, Home and Commercial partially offset by a reduction in Rescue and other personal lines.

Prior-year reserve releases increased in 2021 to £258.1 million (2020: £173.8 million), equivalent to 8.7% of net earned premium (2020: 5.9%) and were concentrated towards more recent accident years. Prior-year reserve releases were higher across all categories, including in Home, which benefited from favourable experience across several perils, in line with expectations, and Motor, which benefited mainly from large bodily injury reserve development as uncertainty arising from Covid-19 and Brexit reduced.

Our current-year combined operating ratio increased by 1.9 percentage points to 98.8% (2020: 96.9%) as a 3.2 percentage point increase in the current-year attritional loss ratio was partially offset by a 0.6 percentage point improvement in the expense ratio, a 0.5 percentage point decrease in the commission ratio and a 0.2 percentage point reduction in claims due to major weather.

Operating expenses before restructuring and one-off costs

	Note	FY 2021 £m	FY 2020 £m
Staff costs[1]		**261.0**	255.6
IT and other operating expenses[1,2]		**147.7**	196.0
Marketing	10	**112.0**	106.6
Sub-total		**520.7**	558.2
Insurance levies	10	**89.0**	80.4
Depreciation and amortisation[3,4]	10	**96.6**	85.8
Total operating expenses before restructuring and one-off costs		**706.3**	724.4

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. For the year ended 31 December 2021, depreciation and amortisation includes a £2.1 million impairment charge (2020: £6.6 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to the development of new systems. and a £0.5 million impairment charge (2020: £nil), which relates to ROU property assets.
4. Includes depreciation on right-of-use assets of £10.8 million (2020: £14.8 million).

We continued to reduce our operating expenses as we move towards our target of a 20% expense ratio in 2023. Overall operating expenses before restructuring and one-off costs reduced by £18.1 million to £706.3 million (2020: £724.4 million) and resulted in a decrease in the expense ratio of 0.6 percentage points to 23.9% (2020: 24.5%).

Costs before insurance levies, depreciation and amortisation were 6.7% (£37.5 million) lower at £520.7 million reflecting lower costs in relation to the Covid-19 response and reductions arising from the Group's cost-saving initiatives. We have also made good progress on our property strategy, completing the acquisition of our Bromley office and we have disposed of a further property in 2022.

Instalment and other operating income

	Note	FY 2021 £m	FY 2020 £m
Instalment income		**97.3**	109.3
Other operating income:			
Revenue from vehicle recovery and repair services	7	**19.7**	24.0
Vehicle replacement referral income	7	**13.1**	12.2
Legal services income	7	**7.2**	8.8
Other income[1]	7	**6.7**	4.9
Other operating income		**46.7**	49.9
Total instalment and other operating income		**144.0**	159.2

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 £15.2 million to £144.0 million. Instalment income fell primarily due to lower Motor gross written premium, whereas other operating income reduced due primarily to a reduction in external Motor repair income and lower recovery after accident volumes.

Investment return

	Note	FY 2021 £m	FY 2020 £m
Investment income		**116.0**	127.1
Hedging to a sterling floating rate basis		**(13.3)**	(20.3)
Net investment income		**102.7**	106.8
Net realised and unrealised gains/(losses) excluding hedging		**43.6**	(11.7)
Total investment return	6	**146.3**	95.1

Investment yields

	FY 2021	FY 2020
Investment income yield[1]	**1.9%**	2.1%
Net investment income yield[1]	**1.7%**	1.8%
Investment return yield[1]	**2.4%**	1.6%

Note:

1. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

Total investment return increased by £51.2 million to £146.3 million (2020: £95.1 million) primarily reflecting positive fair value adjustments in investment properties in 2021 versus write downs in 2020, as well as increasing the gains from debt security disposals year on year. Lower investment rates, driven by central banks' policy actions in 2020, led to a lower net investment income yield of 1.7% (2020: 1.8%).

In 2021 net investment income has been modestly ahead of expectations mainly due to good performance on the high yield portfolio and rising risk-free rates. For 2022 we expect net investment income yield to be in the region of 1.7%, increasing to between 1.8% and 1.9% in 2023, based on current yield curves.

Our 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 (“**PPO**”) and non-PPO liabilities in an optimal manner; and
- to deliver a suitable risk-adjusted investment return commensurate with our risk appetite.

Reconciliation of operating profit

	Note	FY 2021 £m	FY 2020 £m
Motor	4	**314.8**	363.5
Home	4	**141.8**	101.4
Rescue and other personal lines	4	**64.8**	6.8
Commercial	4	**60.4**	50.4
Operating profit	4	**581.8**	522.1
Restructuring and one-off costs	4	**(101.5)**	(39.4)
Finance costs	11	**(34.3)**	(31.3)
Profit before tax	4	**446.0**	451.4
Tax	12	**(102.3)**	(84.2)
Profit for the year attributable to the owners of the Company		**343.7**	367.2

Operating profit by segment

All divisions contributed significant profit in 2021, demonstrating the diversity of our multi-product, multi-brand and multi-channel portfolio. Motor operating profit decreased as claims frequency increased back to expected levels as Covid-19 lockdown measures have been progressively relaxed across H2 2021, partially offset by an increase in prior-year reserve releases following favourable development of large bodily injury reserves as uncertainty arising from Covid-19 and Brexit reduced. Home operating profit increased primarily due to lower weather-related costs and higher prior-year reserve releases on escape of water, flood and fire perils. Rescue and other personal lines profit increased significantly following the non-repeat of the 2020 impact of the Covid-19 pandemic on Travel. Commercial operating profit increased due to improvements in underlying motor and liability claims costs, offsetting higher property claims costs, and increased gross written premium. Rescue operating profit of £55.0 million (2020: £51.2 million) is included in the Rescue and other personal lines result.

Restructuring and one-off costs

We incurred £101.5 million of restructuring and one-off costs in 2021, with £89 million of these costs relating to our site strategy, including £83.9 million in relation to the purchase of the lease of our Bromley office. The remainder are in respect of redundancy programmes and one-off costs. The Group may incur additional costs in 2022 if further opportunities are found as part of the Group's site strategy.

Finance costs

Finance costs increased to £34.3 million (2020: £31.3 million) primarily due to the full-year effect of interest payments on the £260 million Tier 2 subordinated debt issued in June 2020 included in the 2021 figure, partially offset by reductions of lease interest payable following the purchase of the lease of our Bromley office.

Effective corporation tax rate

The effective tax rate for 2021 was 22.9% (2020: 18.7%), higher than the standard UK corporation tax rate of 19.0% (2020: 19.0%) driven primarily by the non-deductible payment to terminate the lease on the Bromley property, and other disallowable expenses partly offset by tax relief for the Tier 1 coupon payments. The Effective Tax Rate is higher than for 2020 due to the Bromley lease payment and is expected to return to a more normal level in future years, subject to any future one-off disallowable items.

Finance review *continued*

Profit for the year and return on tangible equity[1]

Profit before tax of £446.0 million was £5.4 million lower than for 2020 as the increase in operating profit was offset by a £62.1 million increase in restructuring and one-off costs as we continued to make progress in our property site strategy.

Profit for the year ended 31 December 2021 decreased by £23.5 million to £343.7 million (2020: £367.2 million) as an increase in operating profit was partially offset by a £62.1 million increase in restructuring and one-off costs and finance costs.

Return on tangible equity increased to 23.6% (2020: 19.9%) due primarily to the higher operating profit. 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 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

Earnings per share

Basic earnings per share decreased by 5.0% to 24.5 pence (2020: 25.8 pence). Diluted earnings per share decreased by 5.5% to 24.1 pence (2020: 25.5 pence) mainly reflecting a reduction in profit after tax.

Cash flow

The Group's cash and cash equivalents reduced by £271.7 million during the year (2020: £271.9 million increase) to £896.5 million.

The Group generated operating cash flows before movements in working capital of £435.9 million (2020: £394.5 million), an increase of £41.4 million; a reduction in profit for the year was more than offset by an increase in adjustments for non-cash movements. After taking into account movements in working capital, the Group generated £390.1 million (2020: £402.6 million), a decrease of £12.5 million. The Group has considerable assets under management; the cash generated from these reduced by £148.7 million to £167.2 million following reductions in the Group's assets under management, as a result of dividend payments. Net cash generated from operating activities was £439.0 million (2020: £584.7 million).

Net cash used in investing activities of £138.7 million reflected the Group's continuing investment in its major IT programmes (2021: £109.4 million, 2020: £140.7 million).

Net cash used in financing activities of £572.0 million included £317.4 million (2020: £312.5 million) in dividends and Tier 1 capital coupon payments in the year, £101.0 million in share buybacks (2020: £30.0 million) and £101.9 million (2020: £12.5 million) lease principal payments. The amount in 2020 included net proceeds of £257.2 million relating to Tier 2 subordinated debt issued in June 2020. Dividends paid in the year comprised the 7.6 pence first interim dividend announced in the half-year results in 2021 and the 14.7 pence per share final dividend announced in March 2021.

Net cash used in financing and investing activities more than offset the £439.0 million generated from operating activities and resulted in a net decrease in cash and cash equivalents of £271.7 million (2020: £271.9 million increase) to £896.5 million (2020: £1,168.2 million). The levels of cash and other highly liquid sources of funding that the Group holds to cover its claims obligations are continually monitored to ensure that the levels remain within the Group's risk appetite.

Net asset value

At 31 December	Note	**2021 £m**	2020 £m
Net assets[1]	16	**2,550.2**	2,699.7
Goodwill and other intangible assets	16	**(822.5)**	(786.8)
Tangible net assets	16	**1,727.7**	1,912.9
Closing number of Ordinary Shares (millions)	16	**1,317.3**	1,351.8
Net asset value per share (pence)	16	**193.6**	199.7
Tangible net asset value per share (pence)	16	**131.2**	141.5

Note:

1. See glossary on pages 248 to 250 for definitions and appendix A – Alternative performance measures on pages 251 to 255 for reconciliation to financial statement line items.

Net assets at 31 December 2021 decreased by £149.5 million to £2,550.2 million (31 December 2020: £2,699.7 million) and tangible net assets decreased to £1,727.7 million (31 December 2020: £1,912.9 million) following the payment of the 2020 final dividend, 2021 interim dividend and the completion of the share buyback programme, a reduction in available-for-sale reserves and additional expenditure on intangible assets as we 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 intends 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 15.1 pence per share (2020: 14.7 pence), an increase of 0.4 pence per share (2.7%). This reflects the Board's continued confidence in the Group's capital position and the sustainability of its earnings.

After the dividend and proposed share buyback programme, the estimated solvency capital ratio was 176% as at 31 December 2021. The Group has outstanding Tier 2 debt issued in 2012 with nominal value of £250 million which can first be called from 27 April 2022. Excluding this debt, the Group's adjusted solvency ratio would have been 160% as at 31 December 2021.

The final dividend will be paid on 17 May 2022 to shareholders on the register on 8 April 2022. The ex-dividend date will be 7 April 2022.

The Group uses reinsurance extensively to mitigate the impact of individual large claims and the aggregation of claims. At the 1 January 2022 renewal for its Motor excess of loss reinsurance, the Group chose to retain additional risk and increased the retention for each individual claim to £5 million (2021: £1 million with 75% placement).

Looking forward, we have a strong balance sheet with further opportunities to reduce capital intensity and increase flexibility.

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 2021.

Capital position

At 31 December 2021, the Group held a Solvency II capital surplus of £1.03 billion above its regulatory capital requirements, which was equivalent to an estimated solvency capital ratio of 176%, after the proposed final dividend and share buyback programme. Excluding the Group's outstanding Tier 2 debt the Group would have had a Solvency II capital surplus of £0.81 billion, equivalent to a solvency capital ratio of 160%.

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

At 31 December	2021	2020
Solvency capital requirement (£ billion)	**1.35**	1.34
Capital surplus above solvency capital requirement (£ billion)	**1.03**	1.22
Solvency capital ratio after proposed final dividend and share buyback	**176%**	191%
Adjusted solvency capital ratio[1]	**160%**	172%

Note:

1. Adjusted solvency capital ratio excluding Tier 2 debt which can first be called from 27 April 2022.

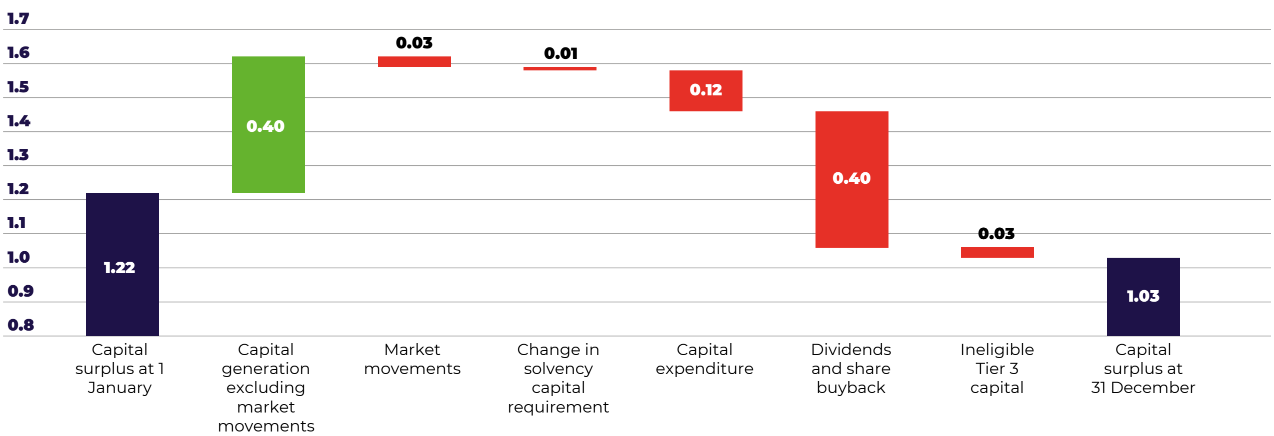
Movement in capital surplus

	2021 £bn	2020 £bn
Capital surplus at 1 January	**1.22**	0.85
Capital generation excluding market movements	**0.40**	0.59
Market movements	**(0.03)**	(0.02)
Capital generation	**0.37**	0.57
Change in solvency capital requirement	**(0.01)**	(0.02)
Surplus generation	**0.36**	0.55
Capital expenditure	**(0.12)**	(0.16)
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)**	(0.10)
Ineligible Tier 3 capital[3]	**(0.03)**	–
Net surplus movement	**(0.19)**	0.37
Capital surplus at 31 December	**1.03**	1.22

Notes:

1. Relates to the cancellation of the 2019 cash dividend (£197 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.
3. The amount of Tier 2 and Tier 3 capital permitted under the Solvency II regulations is 50% of the Group's SCR.

Movement in capital surplus (£bn)



In 2021, the Group generated £0.37 billion of Solvency II capital, of which £0.06 billion related to a change in the Group's deferred tax rate, following the change to the UK corporation tax rate from 19% to 25% with effect from 1 April 2023. Restructuring costs in relation to the purchase of the Bromley office lease reduced capital generation by £83.9 million. This was offset by a £0.01 billion change in the SCR, £0.12 billion of capital expenditure, dividends of £0.30 billion and share buybacks of £0.10 billion. At 31 December 2021 there was £0.03 billion of ineligible capital relating to deferred tax assets. Capital expenditure levels are expected to remain around £120 million in 2022.

Change in solvency capital requirement

	2021 £bn
Solvency capital requirement at 1 January	1.34
Model and parameter changes	(0.05)
Exposure changes	0.06
Solvency capital requirement at 31 December	1.35

The Group's SCR has increased by £0.01 billion in the year. Exposure changes resulted in a £0.06 billion increase, which was partially offset by a decrease of £0.05 billion relating to model and parameter changes.

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 2021. The impact on the Group's solvency capital ratio arises from movements in both the Group's SCR and own funds.

	Impact on solvency capital ratio[1]	
Scenario	31 Dec 2021	31 Dec 2020
Deterioration of small bodily injury motor claims equivalent to that experienced in 2008/09	(5pts)	(6pts)
One-off catastrophe loss equivalent to the 1990 storm "Daria"	(9pts)	(8pts)
One-off catastrophe loss based on extensive flooding of the River Thames	(9pts)	(8pts)
Increase in Solvency II inflation assumption for PPOs by 100 basis points[2]	(9pts)	(10pts)
100bps increase in credit spreads[3]	(8pts)	(9pts)
100bps decrease in interest rates with no change in the PPO real discount rate	(2pts)	(2pts)

Notes:

1. 2021 figures exclude from own funds the value of the £250 million Tier 2 subordinated debt which can first be called from 27 April 2022. The comparative period has been represented on this basis, with the only change being the interest rate sensitivity which was reported as (3pts) at 31 December 2020.
2. The PPO inflation assumption used is an actuarial judgement which is reviewed annually based on a range of factors including the economic outlook for wage inflation relative to the PRA discount rate curve.
3. Only includes the impact on 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 eligible own funds by tier on a Solvency II basis.

At 31 December	2021 £bn	2020 £bn
Tier 1 capital before foreseeable distributions	1.66	1.84
Foreseeable dividend and share buyback	(0.30)	(0.30)
Tier 1 capital – unrestricted	1.36	1.54
Tier 1 capital – restricted	0.36	0.38
Less reclassified restricted Tier 1 debt[1]	(0.02)	–
Tier 1 capital	1.70	1.92
Tier 2 capital – reclassified restricted Tier 1 debt and Tier 2 subordinated debt[1]	0.53	0.53
Tier 3 capital – deferred tax	0.18	0.11
Ineligible Tier 3 capital[2]	(0.03)	–
Total eligible own funds	2.38	2.56

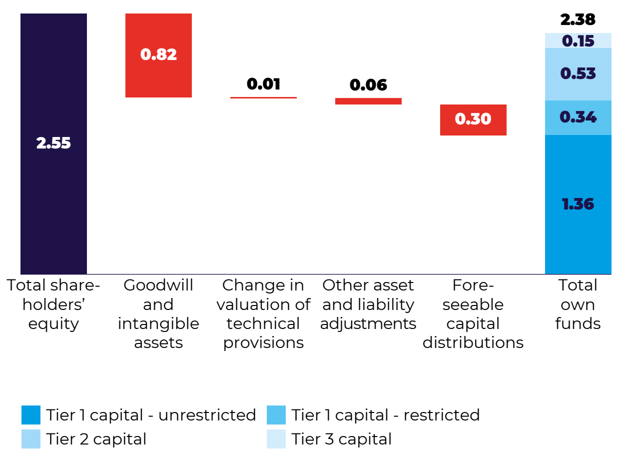
Notes:

1. As at 31 December 2021 £19 million (2020: £nil) of the Group's restricted Tier 1 capital was reclassified as Tier 2 due to Solvency II tiering restrictions.
2. The amount of Tier 2 and Tier 3 capital permitted under the Solvency II regulations is 50% of the Group's SCR.

During 2021, the Group's eligible own funds reduced from £2.56 billion to £2.38 billion. Eligible Tier 1 capital after foreseeable distributions represents 71% of own funds and 126% of the estimated SCR. Tier 2 capital relates to the Group's £0.51 billion subordinated debt and £0.02 billion of ineligible Tier 1 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.

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%. The Group has Tier 2 plus Tier 3 ineligible own funds of £0.03 billion.

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



Reconciliation of IFRS shareholders' equity to Solvency II eligible own funds

At 31 December	2021 £bn	2020 £bn
Total shareholders' equity	**2.55**	2.70
Goodwill and intangible assets	**(0.82)**	(0.79)
Change in valuation of technical provisions	**(0.01)**	0.04
Other asset and liability adjustments	**(0.06)**	(0.11)
Foreseeable dividend and share buyback	**(0.30)**	(0.30)
Tier 1 capital – unrestricted	**1.36**	1.54
Tier 1 capital – restricted	**0.36**	0.38
Less reclassified restricted Tier 1 debt[1]	**(0.02)**	–
Tier 1 capital	**1.70**	1.92
Tier 2 capital – reclassified restricted Tier 1 debt and Tier 2 subordinated debt[1]	**0.53**	0.53
Eligible Tier 3 capital – deferred tax	**0.18**	0.11
Ineligible Tier 3 capital[2]	**(0.03)**	–
Total eligible own funds	**2.38**	2.56

Notes:

1. As at 31 December 2021 £19 million (2020: £nil) of the Group's restricted Tier 1 capital was reclassified as Tier 2 due to Solvency II tiering restrictions.
2. The amount of Tier 2 and Tier 3 capital permitted under the Solvency II regulations is 50% of the Group's SCR which resulted in ineligible capital of £31 million.

Leverage

The Group's financial leverage increased by 1.0 percentage point to 25.2% (2020: 24.2%). The increase was primarily due to a decrease in shareholder's equity following the payment of the 2020 final dividend, 2021 interim dividend and the Group's £100 million share buyback programme, partially offset by 2021 profits.

At 31 December	2021 £m	2020 £m
Shareholders' equity	**2,550.2**	2,699.7
Tier 1 notes	**346.5**	346.5
Financial debt – subordinated debt	**513.6**	516.6
Total capital employed	**3,410.3**	3,562.8
Financial-leverage ratio[1]	**25.2%**	24.2%

Note:

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

Credit ratings

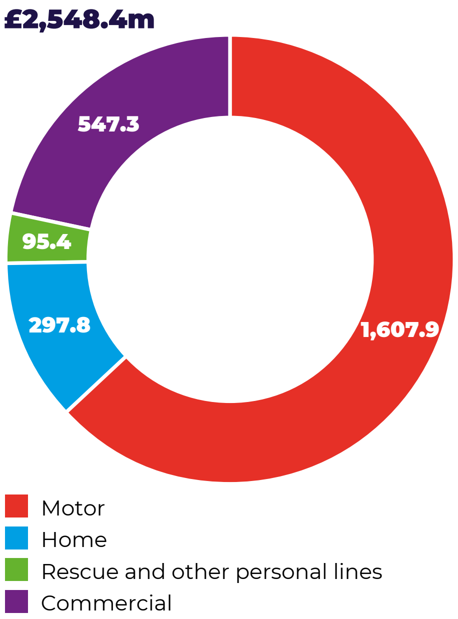
Moody's Investors Service provides insurance financial-strength ratings for U K Insurance Limited, our principal underwriter. Moody's rates U K Insurance Limited as 'A1' for insurance financial strength (strong) with a stable outlook.

Reserving

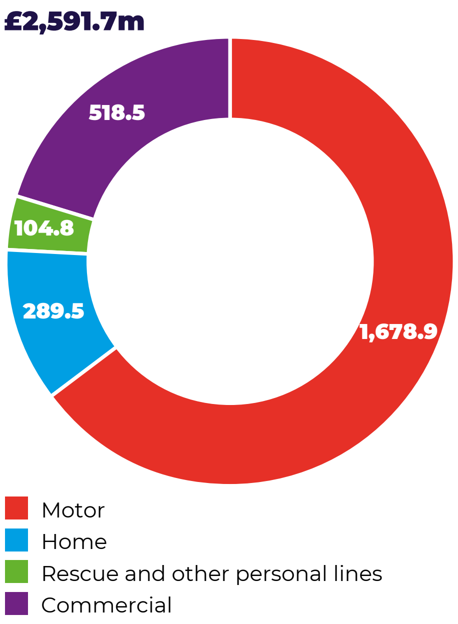
We make provision for the full cost of outstanding claims from the general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and associated claims handling costs. We consider the class of business, the length of time to notify 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.

We seek 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.

Claims reserves net of reinsurance 2021 (£m)



Claims reserves net of reinsurance 2020 (£m)



Finance review *continued*

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 minus 0.75% in Northern Ireland.

We reserve our large bodily injury claims at the relevant discount rate for each jurisdiction, with the overwhelming majority now case 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 for the 2014 to 2020 underwriting years. We have reduced the level of Motor reinsurance purchased from 2021 which will have an impact on future reserving.

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 we make assumptions about the likelihood that claimants will opt for a PPO. This is known as the PPO propensity.

Higher claims inflation remains a risk, given the continuing rise in consumer prices and wage inflation. Consumer prices inflation is at its highest level for the past decade and is not expected to decline until 2023. Pressure is likely to remain strong on wages, with potential implications for the cost of care. Global supply chain issues remain problematic, resulting in a risk of price increases for products and components in short supply. A range of general and specific claims inflation scenarios for goods and services have therefore been considered in the reserving process.

Prior-year reserve releases were £258.1 million (2020: £173.8 million) concentrated towards more recent accident years, with good experience in Home and with Motor large bodily injury claims in later accident years also being a key contributor as uncertainty arising from Covid-19 and Brexit reduced.

Looking forward, we expect to continue setting our 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.

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.

	Increase / (decrease) in profit before tax[1,2]	
At 31 December	**2021 £m**	2020 £m
PPOs[3]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	**43.0**	45.9
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	**(58.9)**	(62.7)
Ogden discount rate[4]		
Impact of the Group reserving at a discount rate of 0.75% compared to minus 0.25% (2020: 0.75% compared to minus 0.25%)	**42.5**	43.7
Impact of the Group reserving at a discount rate of minus 1.25% compared to minus 0.25% (2020: minus 1.25% compared to minus 0.25%)	**(59.4)**	(61.1)
Claims inflation		
Impact of a decrease in claims inflation by 100 basis points for two consecutive years	**37.3**	32.4
Impact of an increase in claims inflation by 100 basis points for two consecutive years	**(37.6)**	(32.2)

Notes:

1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at the balance sheet date and should not be interpreted as predictions.
3. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0% for reserving. The PPO sensitivity has been calculated on the direct impact of the change in the real internal discount rate with all other factors remaining unchanged.
4. Ogden discount rate sensitivity has been calculated on the direct impact of a permanent change in the discount rate in England and Wales with all other factors remaining unchanged. We will consider the statutory discount rate when setting the 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 2021. 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 £150 million and cover is placed annually on 1 July up to a modelled 1-in-200 year loss event of £1,150 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 £5 million per claim 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 2022.
- Commercial property risk reinsurance to protect against large individual claims with a retained deductible of £4 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; and
- 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 benchmarks for U K Insurance Limited are detailed in the following table:

	Benchmark holding 2021	**Actual holding 2021**	Benchmark holding 2020	Actual holding 2020
Investment-grade credit[1]	**66.0%**	**65.7%**	66.0%	63.8%
High yield	**3.0%**	**1.7%**	6.0%	6.0%
Investment-grade private placements	**6.0%**	**6.1%**	3.0%	1.8%
Credit	**75.0%**	**73.5%**	75.0%	71.6%
Sovereign	**3.0%**	**0.6%**	3.0%	0.4%
Total debt securities	**78.0%**	**74.1%**	78.0%	72.0%
Infrastructure debt	**4.0%**	**4.5%**	4.0%	4.5%
Commercial real estate loans	**6.5%**	**3.6%**	6.5%	3.5%
Cash and cash equivalents	**6.0%**	**12.1%**	6.0%	15.0%
Investment property	**5.5%**	**5.7%**	5.5%	5.0%
Total investment holdings	**100.0%**	**100.0%**	100.0%	100.0%

Finance review *continued*

Investment holdings and yields

	2021			2020		
	Allocation (£m)	Income (£m)	Yield (%)	Allocation (£m)	Income (£m)	Yield (%)
Investment-grade credit[1]	**3,721.1**	**70.9**	**1.9%**	3,736.6	76.2	2.1%
High yield	**342.1**	**17.5**	**5.1%**	349.0	18.7	5.1%
Investment-grade private placements	**91.2**	**2.4**	**2.5%**	103.9	2.7	2.6%
Credit	**4,154.4**	**90.8**	**2.2%**	4,189.5	97.6	2.3%
Sovereign	**35.7**	**0.1**	**0.2%**	25.5	0.7	1.1%
Total debt securities	**4,190.1**	**90.9**	**2.2%**	4,215.0	98.3	2.3%
Infrastructure debt	**250.8**	**4.4**	**1.7%**	264.5	5.8	2.1%
Commercial real estate loans	**200.8**	**6.1**	**2.9%**	206.7	6.7	3.3%
Cash and cash equivalents[2]	**896.5**	**0.1**	**0.0%**	1,168.2	2.6	0.2%
Investment property	**317.0**	**14.5**	**4.8%**	292.1	13.7	4.7%
Equity investments[3]	**6.2**	**–**	**0.0%**	3.2	–	0.0%
Total Group	**5,861.4**	**116.0**	**1.9%**	6,149.7	127.1	2.1%

Notes:

1. Asset allocation at 31 December 2021 includes investment portfolio derivatives, which have a mark-to-market asset value of £14.2 million included in investment-grade credit and £0.1 million in sovereign debt (31 December 2020: mark-to-market asset value of £7.7 million and £0.3 million 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. An insurtech-focused equity fund which is valued based on external valuation reports received from a third-party fund manager.

At 31 December 2021, total investment holdings of £5,861.4 million were 4.7% lower than at the start of the year. Total debt securities were £4,190.1 million (31 December 2020: £4,215.0 million), of which 2.1% were rated as 'AAA' and a further 54.7% were rated as 'AA' or 'A'. The average duration at 31 December 2021 of total debt securities was 2.5 years (31 December 2020: 2.8 years).

At 31 December 2021, total unrealised gains, net of tax, on available-for-sale ("**AFS**") investments were £9.0 million (31 December 2020: £83.9 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:

www.directlinegroup.co.uk/en/sustainability/reports-policies-and-statements.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 2021, the sum of taxes either paid or collected across the Group was £885.1 million. The composition of this between the various taxes borne and collected by the Group is shown below.

Total taxes borne

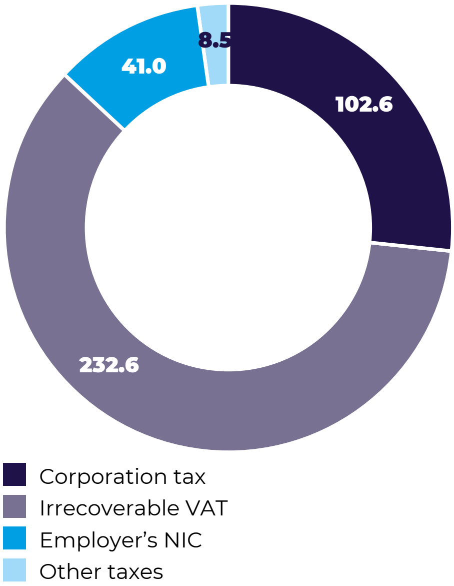
At 31 December	2021 £m
Current-year Corporation Tax charge	102.6
Irrecoverable Value Added Tax incurred on overheads	83.5
Irrecoverable Value Added Tax embedded within claims spend	149.1
Employers' National Insurance contributions	41.0
Other taxes	8.5
Total	384.7

Total taxes collected

At 31 December	2021 £m
Insurance Premium Tax	391.1
Value Added Tax	10.1
Employees' Pay As You Earn and National Insurance contributions	99.2
Total	500.4

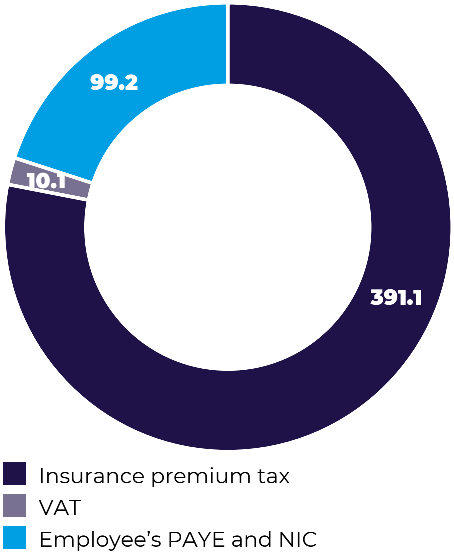
Total taxes borne by tax type (£m)

£384.7m



Total taxes collected by tax type (£m)

£500.4m



Neil Manser
Chief Financial Officer

Motor

“I've got an electric vehicle and need an insurer who will continue to offer a good deal.”

Jane, Motor customer

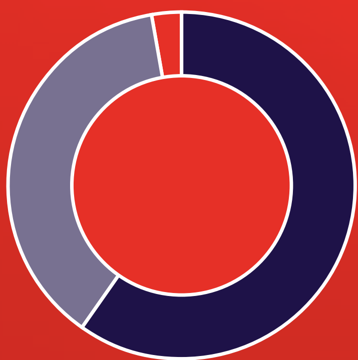
Motor: key highlights

Own brand in-force policies reduced by 1.9% with an overall reduction in in-force policies of 2.2% to 4.0 million.

Own brand gross written premium reduced by 3.3%, overall gross written premium reduced by 3.5%.

Operating profit of £314.8 million was £48.7 million lower than the prior year, as claims frequency increased to more normal levels, partially offset by stronger prior-year reserve releases.

Gross written premium by channel



- **59.8%** Direct
- **37.5%** Price comparison websites
- **2.7%** Partnerships

	2021	2020
In-force policies (thousands)	3,971	4,061
Of which direct own brands	3,869	3,943
Gross written premium	£1,560.8m	£1,616.9m
Of which direct own brands	£1,515.2m	£1,567.6m
Loss ratio	64.3%	59.8%
Commission ratio	3.3%	3.2%
Expense ratio	24.8%	24.7%
Combined operating ratio	92.4%	87.7%
Operating profit	£314.8m	£363.5m

Overview

In 2021 the UK motor market continued to experience disruption driven by Covid-19 lockdowns. Claims frequency remained below pre-pandemic levels and there were fewer new drivers entering the market. Alongside the implementation of the Government's Whiplash reform in May 2021, these trends resulted in deflationary market conditions. According to the ABI[1], average motor premiums fell by 7% in 2021.

New car registrations were relatively flat year-on-year, with vehicle manufacture being impacted by a global shortage of semiconductors. However, there was an acceleration in registrations of plug-in hybrid and fully electric vehicles which is good for the industry, the consumer, and the environment.

Claims severity inflation increased in 2021, particularly for damage claims, reflecting the increasing sophistication of car technology as well as the UK's new international trading relationships and Covid-19 related effects, such as second-hand car prices and additional cleaning costs.

Note:

1. https://www.abi.org.uk/news/news-articles/2022/02/2021-motor-premium-tracker/

Motability: Strengthening our Motor capabilities

We are planning for providing insurance to customers of the Motability scheme from H2 2023. The scheme provides mobility to over 640,000 disabled people and their families allowing them to lease a new car, powered wheelchair or scooter. Our digital capabilities and strength in vehicle repair, particularly our focus on being able to repair electric vehicles and future motor technologies, are a great fit for Motability Operations' fleet of around 625,000 modern vehicles.

Performance

Motor in-force policies reduced by 2.2% to 4.0 million compared to 2020, with own brand in-force policies down by 1.9% at 3.9 million. Gross written premium reduced by 3.5% to £1,560.8 million in the same period, with Motor own brand average premium reducing 2.5% during 2021.

There were two major trends in the motor market during 2021. Firstly, against the backdrop of deflationary market conditions driven by claims frequency remaining below pre-pandemic levels and the impact of the Whiplash reforms, we remained disciplined and focused on maintaining target loss ratios. Secondly, following the implementation of the Motor platform we saw improved competitiveness, enabling us to hold policy count flat across H2 despite our average premiums[2] reducing 2.5% in 2021 compared to the market reducing 7%.

We offered premium refunds to customers where miles driven were expected to be lower than anticipated at policy inception. In particular, we continued our "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.

Motor's current-year attritional loss ratio rose 6.3 percentage points to 72.9% (2020: 66.6%) driven predominantly by a reduction in the severity of lockdowns in 2021 compared to 2020. Whilst the Motor current-year loss ratio in H1 2021 was modestly higher than for H1 2020, it increased in H2 as lockdown restrictions were eased and claims frequency increased back to expected levels. In addition, claims severity inflation was slightly above our medium-term 3% to 5% per year inflation expectations during 2021, due to high levels of inflation in second-hand vehicles and additional Covid-19 related cleaning costs. Our vertically integrated business, including the largest insurer-owned networks of vehicle repair centres, has continued to provide us with a competitive advantage and mitigate some of this inflationary pressure.

In total, prior-year reserve releases were £26.5 million higher year-on-year at £127.1 million reflecting, primarily, favourable development of large bodily injury claims reserves as uncertainty arising from Covid-19 and Brexit reduced.

Overall, Motor's reported combined operating ratio increased by 4.7 percentage points to 92.4% (2020: 87.7%). A 1.8 percentage point increase in prior-year reserve releases was offset by a 6.3 percentage point increase in the current-year attritional loss ratio. There were marginal increases in the expense ratio and the commission ratio.

Note:

2. Average incepted written premium excluding IPT for Motor direct own brands for the year ending 31 December 2021.

Home

"Policy was a great price and website very easy to follow."

Michelle, Home customer

Home: key highlights

Total in-force policies 1.1% higher at 2.7 million. Own brand policies were 2.3% higher at 1.9 million, as retention remained high whilst new business grew across both direct and PCW channels.

Total gross written premium was stable at £578 million. Own brand gross written premium was 1.2% higher.

Total operating profit was £40.4 million higher than 2020, following a reduction in claims from weather events and an increase in prior-year reserve releases.

Gross written premium by channel

- **55.0%** Direct
- **17.8%** Price comparison websites
- **27.2%** Partnerships

	2021	2020
In-force policies (thousands)	2,667	2,638
Of which direct own brands	1,879	1,837
Gross written premium	£577.8m	£577.9m
Of which direct own brands	£416.7m	£411.6m
Loss ratio	50.7%	55.6%
Commission ratio	6.9%	8.1%
Expense ratio	22.5%	23.4%
Combined operating ratio	80.1%	87.1%
Operating profit	£141.8m	£101.4m

Overview

In the first half of 2021, the stamp duty holiday on property sales led to a buoyant new business market in home insurance. The shift towards buying home insurance through price comparison websites continued.

Towards the end of 2021, the market became increasingly competitive in advance of the implementation of the new FCA Pricing Practices Review regulations. This led to premium deflation as many insurers attempted to grow policy count ahead of the new rules coming into force on 1 January 2022.

According to the ABI[1] the average premium for combined, buildings only and contents only cover were stable in 2021.

There were a couple of named weather events in 2021. Storm Christoph brought exceptionally wet weather to North Wales and Northern England in January. In November a windstorm, Storm Arwen, affected thousands of homes across Scotland, Northern England and parts of Wales, leaving many homes without power.

Note:

1. https://www.abi.org.uk/news/news-articles/2022/02/2021-motorpremium-tracker/

Performance

In-force policies for Home's own brands increased by 2.3% compared to 2020 to 1.9 million policies. Retention levels remained high, whilst new business sales grew across our direct channels reflecting improved competitiveness in a strong new business market in H1. The market became increasingly competitive across H2 as we approached the implementation of the Pricing Practices Review regulations. Against this deflationary backdrop, we maintained our discipline in relation to new business particularly in the PCW channel.

Own brands gross written premium increased by 1.2%, whilst overall gross written premium remained stable between 2020 and 2021. Partnership volumes reduced by 1.6%; Prudential and Sainsbury's partnerships are closed to new business and continued to run off in line with expectations.

Own brands average premium[1] reduced by 1.6% compared to 2020, reflecting a change in mix towards lower risk policies, alongside risk-adjusted prices reducing by 1.0%. This followed pricing actions earlier in the year to capitalise on a buoyant new business market and to support retention, more than offsetting underlying inflationary price increases.

The current-year attritional loss ratio, excluding major weather event claims, was 3.0 percentage points higher than prior year at 55.7% as we took pricing actions to support retention and to capitalise on a buoyant new business market in H1, alongside some large fire claims and freeze events. The reported loss ratio was 4.9 percentage points better than 2020, with increases in prior-year reserve releases, following favourable experience on escape of water, flood, storm and fire perils, and a reduction in major weather claims more than offsetting the increase in attritional loss ratio. Claims severity inflation remained within our 3% to 5% medium-term expectations and claims frequency remained within normal levels.

The commission ratio of 6.9% was 1.2 percentage points lower than in 2020 due to lower profit share payments to partners.

Home's combined operating ratio improved by 7.0 percentage points to 80.1% (2020: 87.1%). This was driven primarily by a 6.4 percentage point improvement as a result of higher prior-year reserve releases and a 1.5 percentage point improvement resulting from fewer major weather events, as well as improvements in commission and expense ratios, offset in part by an increase in the current-year attritional loss ratio. Normalised for weather, the combined operating ratio was 5.1 percentage points better than for 2020 at 85.2% (2020: 90.3%).

For 2022, it is expected that the normalised combined operating ratio will return to levels similar to the 2020 normalised performance.

Note:

1. Average incepted written premium excluding IPT for Home own brands for the year ending 31 December 2021.

Supporting customers during Storm Arwen

Storm Arwen brought widespread disruption across the UK at the end of 2021 and we responded to those who needed assistance, increasing the number of call centre agents available and on one day during this period answering close to 3,500 calls, which was eight times as many as the number of calls usually received.

Rescue and other personal lines

“Once I reported the breakdown I was frequently kept updated. A mechanic arrived in a short time and sorted the problem.”

Geoffrey, Rescue customer

Rescue and other personal lines: key highlights

The Group’s direct Rescue brand, Green Flag, grew in-force policies by 5.8% and gross written premiums by 6.3% in the year.

Total in-force policies and gross written premium reduced by 0.7% and 9.0% respectively, primarily reflecting lower premium from Travel, offset by higher premium in Green Flag.

Operating profit of £64.8 million included £55.0 million (2020: £51.2 million) profit for Rescue.

Gross written premium by product

- **44.7%** Rescue
- **24.3%** Travel
- **18.8%** Pet
- **12.2%** Other personal lines

	2021	2020
In-force policies (thousands)	7,056	7,105
Of which Green Flag direct	1,179	1,114
Gross written premium	£380.0m	£417.8m
Of which Green Flag direct	£88.3m	£83.1m
Loss ratio	50.2%	61.7%
Commission ratio	11.4%	16.4%
Expense ratio	25.3%	23.9%
Combined operating ratio	86.9%	102.0%
Operating profit	£64.8m	£6.8m

Overview

Rescue

The new business market remained below pre-pandemic levels throughout 2021, in part due to Covid-19 related lockdowns.

Claims frequency also remained below pre-pandemic levels, benefiting from benign weather and was broadly in line with 2020.

Travel

As a result of the Covid-19 pandemic, non-essential international travel from the UK was illegal between January and May 2021. However, the demand for travel insurance increased during the second half of 2021 as travel restrictions were eased, although the volume of travel remained below pre-pandemic levels.

Pet

It has been reported that at least 3.2 million households[1] have acquired a pet since the start of the pandemic, with around 12 million dogs and 12 million cats[1] now living in UK homes. This has driven increased demand in the Pet Insurance market.

Note:

1. https://www.bbc.co.uk/news/business-56362987

Performance

The combined operating ratio for Rescue and Other personal lines improved by 15.1 percentage points to 86.9% (2020: 102.0%) due to the non-repeat of the 2020 Covid-19 related claims in Travel and to improvements in Rescue.

Rescue

Rescue in-force policies increased by 0.5% to 3.4 million and gross written premium increased by 2.0% to £170.0 million compared to 2020.

Green Flag Rescue continued to grow its higher average premium direct business during 2021, increasing in-force policies by 5.8% to 1.2 million and gross written premium by 6.3% to £88.3 million compared to 2020. 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 2.1% and 2.3% respectively.

In 2022, Green Flag is developing its customer proposition. As a result, the amount new customers pay will be split between premium and a service fee, which could result in up to approximately £10 million being recognised as other income instead of premium.

Making travel insurance digital

Since March an additional 1.7 million of our travel customers have been offered the convenience of managing their insurance digitally as our partner Nationwide was switched over to our Aquarium travel system. Amongst the advantages offered to those choosing to upgrade their policy is the ability to make a claim for items such as a lost bag whilst still abroad without having to speak to an adviser.

The combined operating ratio for Rescue of 74.8% was 1.7 percentage points better than 2020's ratio of 76.5%. This reflected an improved expense ratio, due predominantly to reduced marketing expenditure, and a lower commission ratio following lower profit shares with partners.

Other personal lines

Other personal lines (comprising Travel, Pet and other) in-force policies reduced by 1.8% to 3.6 million compared to 2020 primarily due to reductions in travel partnerships volumes. Gross written premium for Other personal lines decreased by 16.4% with reductions across all lines except policies tailored to mid- to high-net worth customers, where premium levels grew by 7.0%. In Travel, gross written premium was down 31.1% reflecting lower upgrade premium, lower partnership volumes and reduced partnership pricing that reflected lower claim expectations in 2021.

Other personal lines combined operating ratio improved by 21.7 percentage points compared to 2020 to 96.8%. The improvement is primarily due to the non-repeat of 2020 Covid-19 related claims in Travel.

Commercial

"The main reason I renewed my policy was the way my claim was dealt with."

Peter, Commercial customer

Commercial: key highlights

Total gross written premium increased by 15.0%, with direct own brands increasing by 14.8%.

Strong performance in both Direct Line for Business and Churchill as they continued to focus on micro business tailored propositions.

NIG and other gross written premium grew by 15.1%, continuing to benefit from improvements arising from re-platforming of its products, including Vans, on its electronic trading platform.

Gross written premium by channel

28.7% Direct

71.3% NIG & other

	2021	2020
In-force policies (thousands)	871	811
Of which direct own brands	602	560
Gross written premium	£653.0m	£567.8m
Of which direct own brands	£187.4m	£163.3m
Loss ratio	54.5%	51.4%
Commission ratio	20.0%	18.7%
Expense ratio	21.7%	25.4%
Combined operating ratio	96.2%	95.5%
Operating profit	£60.4m	£50.4m

Overview

The SME commercial market saw premium increases across all property and casualty products, with significant increases in certain sectors, while motor rates stayed low. There was an increase in risk sharing between insurers as they sought to limit exposures alongside strong market conditions and high inflation. Consolidation in the broker market showed no signs of abating and brokers continued to seek out good service and efficiencies from key partners.

Small, entrepreneurial businesses were more aware of the need for insurance following the disruption caused by the Covid-19 pandemic. Insurance demand from tradespeople began to grow as pandemic-related restrictions were lifted.

There was a marked increase in home-based start-ups and the continued move towards buying insurance online, which helped to drive growth in the direct channel.

The commercial market was also impacted by the storms that swept across the UK during 2021 (see Home section for more details).

Performance

Commercial in-force policies of 871,000 increased by 7.4% compared with 2020, reflecting strong growth in both Commercial direct own brands and NIG and other. Commercial gross written premium grew by 15.0% to £653.0 million (2020: £567.8 million).

Commercial direct own brands grew in-force policies by 7.5% and gross written premium increased by 14.8% to £187.4 million, with increases across all Commercial direct product lines. We continued to see the benefits of our technology transformation driving growth in SME trading on both the Direct Line for Business platform and Commercial's Churchill brand.

NIG and other in-force policy numbers were 7.2% higher than in 2020 and gross written premium grew by 15.1% to £465.6 million. This reflected growth across all major categories as the book continued to benefit from improvements arising from the re-platforming of its products, improved pricing sophistication and growth on its award-winning electronic trading platform.

The current-year attritional loss ratio in Commercial increased by 2.4 percentage points to 62.0% in 2021 due, predominantly, to elevated large fire claims partially offset by an improvement in underlying loss ratio in motor and liability.

Commercial growth

Our Commercial business has introduced new systems architecture delivering a step change in the way our business performs. Our data and modelling teams have reduced the amount of time spent on data collation and preparation, focusing more on pricing analysis and insight.

We have increased the suite of models available from 15 to over 90, improving pricing accuracy and driving the growth seen in 2021.

Total prior-year reserve releases increased by 8.1% to £61.4 million (2020: £56.8 million).

Overall, the combined operating ratio for Commercial increased by 0.7 percentage points to 96.2% (2020: 95.5%), with the 3.1 percentage point increase in reported loss ratio and a 1.3 percentage point increase in commission ratio partially offset by a 3.7 percentage point decrease in expense ratio reflecting good cost control.

Sustainability

Building a sustainable business

In 2021 we continued to embed initiatives with greater confidence across our five-pillar sustainability strategy. We are aiming to take the long-term decisions that deliver benefits for our business and wider society. Looking after customers, employing great people and ensuring they flourish, tackling climate change, operating within a strong society and having a reputation for high standards of governance are not nice-to-haves, they are foundations of our future success.

Sustainability pillars

Customers	People	Society	Planet	Governance
Earn our customers' trust by demonstrating how we are acting in their interests.	Encourage a culture that celebrates difference and empowers people so that they can thrive.	Use our expertise to improve outcomes for society and the communities we serve.	Protect our business from the impact of climate change and give back more to the planet than we take out.	Look to the long term for our stakeholders, build a reputation for high standards of business conduct and a sustainable business.
Our customers are at the heart of everything we do. Our reputation for excellent customer service contributes to winning new business, and delivering on that customer service year-on-year is why we have high rates of customer retention. Ensuring we continue to see the high levels of customer satisfaction in the interactions they have with us is critical to our future success.	Our business depends on having the best people delivering the best service for customers. Our increasingly diverse workforce gives us insights and perspectives that allow us to understand and serve our diverse customer base. Having a reputation for excellence as an employer, that is matched by the experience of working for the Group, allows us to attract, recruit and retain the people we need.	As a business, we benefit from strong local communities where people and businesses flourish. Our stakeholders want us to make a positive contribution to the society around us. Our vision is to be a force for good; the ways in which we deliver on this area include the tax contribution we make, the charitable donations we give, the volunteering we undertake and the campaigns and policy debates to which we lend our expertise.	Tackling climate change requires everyone to play their part. As an insurer we are passionate about our role, whether it is reducing our carbon footprint as the UK economy transitions to a net zero future, providing insight on weather-related events such as flooding and storm damage, or developing products that make it easier for customers to go green.	Being able to demonstrate exemplary governance is of increasing importance in attracting both customers and investors. In the future, maintaining our reputation for high standards of business conduct, meeting our legal obligations and behaving ethically will be essential to doing business successfully.

Transforming our business for the better

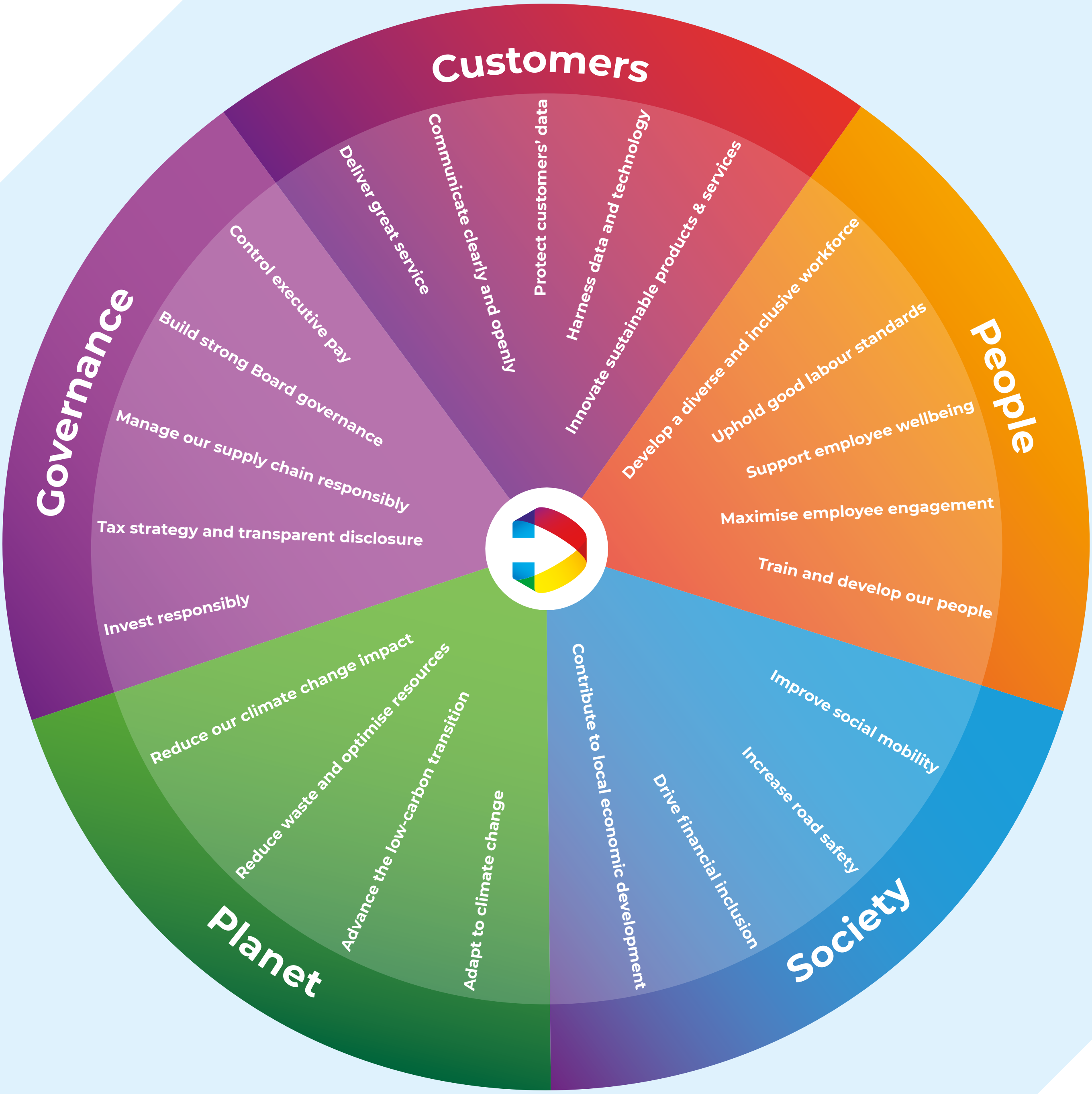
We are very proud to have produced our second ever Sustainability Report in 2021, highlighting the progress made across our five sustainability pillars.

> **Read our 2021 Sustainability Report at https://www.directlinegroup.co.uk/2021_Sustainability_Report**

The sustainability priorities of our stakeholders and business

When we created our sustainability strategy two years ago, our work was informed by an analysis of the issues affecting our business and a survey of our stakeholders' opinions as to the relative importance of each of those issues. The stakeholders included customers, suppliers, investors, commercial partners, non-governmental organisations and policymakers. The diagram below highlights the priorities identified within each sustainability pillar.

Our sustainability strategy is always evolving to meet future challenges and we are committed to enhancing our approach, so that we take into account the expectations of external stakeholders and the needs of the business.



United Nations Sustainable Development Goals

The United Nations created a number of Sustainable Development Goals ("**SDGs**") in 2015 focused on achieving a better and more sustainable future for all. The goals address numerous global issues such as fighting inequality, helping to end poverty and tackling climate change.

Aligned with our sustainability pillars, we contribute to several of the SDGs through our work across the Group.

Customers	People	Society	Planet	Governance
3 GOOD HEALTH AND WELL-BEING	3 GOOD HEALTH AND WELL-BEING	3 GOOD HEALTH AND WELL-BEING	7 AFFORDABLE AND CLEAN ENERGY	3 GOOD HEALTH AND WELL-BEING
8 DECENT WORK AND ECONOMIC GROWTH	5 GENDER EQUALITY	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	8 DECENT WORK AND ECONOMIC GROWTH
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	8 DECENT WORK AND ECONOMIC GROWTH	10 REDUCED INEQUALITIES	13 CLIMATE ACTION	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
13 CLIMATE ACTION	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	13 CLIMATE ACTION	15 LIFE ON LAND	13 CLIMATE ACTION

External ratings, memberships and benchmarks

We support various initiatives aligned to our five pillar sustainability strategy, including a range of external partnerships where we play an active role and also receive performance ratings.

CDP
DISCLOSURE INSIGHT ACTION

The Carbon Disclosure Project is a globally recognised platform measuring reporting performance and this year the Group achieved a B- rating based on 2021 activity.

SUSTAINALYTICS

We were again ranked as an ESG leader out of all companies assessed in the Property and Casualty insurance sector and maintained our top decile position in the broader insurance industry group of 261 companies.

MSCI ESG RATINGS AA

Our rating was upgraded from 'A' to 'AA' in 2021. We were recognised for our improvement in underwriting practices, our focus on climate change as an emerging risk and climate risk modelling, our efforts to integrate ESG principles into our investment decisions, alongside some of our HR initiatives.

GOLD 2021 ecovadis Sustainability Rating

We were awarded the EcoVadis Gold medal for Sustainability Performance in 2021. The Group is in the top 10% of companies rated by EcoVadis in the Insurance, reinsurance and pension funding (except compulsory social security) industry.

Get Nature Positive

We support the Get Nature Positive campaign, focused on restoring nature and biodiversity. In line with this aim, we announced a partnership with the nature recovery charity Heal, providing a £3 million loan facility that can support the purchase of two initial sites.

Sustainable Markets Initiative

As part of HRH The Prince of Wales's Sustainable Markets Initiative, we signed up to the Terra Carta Charter, supporting a roadmap towards a sustainable future, harnessing the power of nature, innovation and resources of the private sector. We are an active participant in the Sustainable Markets Initiative Insurance Taskforce.

RACE TO ZERO

We support the UN-backed Race To Zero campaign and are committed to tackling climate change by setting Science-Based Targets to a 1.5°C emissions scenario.

Social Mobility Pledge

We are a supporter of the Social Mobility Pledge which encourages organisations to support social mobility through access, outreach and recruitment initiatives.

We are a signatory to HM Treasury's Women in Finance Charter. We are proud that the majority of our Executive Committee are women.

Customers

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

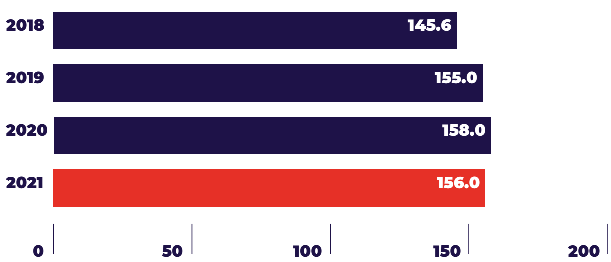
We are one of the UK's leading insurers, providing general insurance products to millions of customers through our well-known brands, including Direct Line, Churchill, Privilege and Green Flag.

Our aim has always been to understand customer expectations, anticipate future trends and deliver exceptional service, underpinned by a quality claims service, because this is how we hope to earn trust and customer loyalty. It is one part of how we are striving to make a sustainable business.

Net Promoter Score

We maintained a strong Net Promoter Score in 2021 and our performance over the last few years has shown that customers are willing to recommend our Direct Line brand to others.

Net Promoter Score[1] – Direct Line brand



Customer Pillars

Expectations
Manage and exceed my expectations

Ease
Make it as effortless as possible for me

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

Trust
Earn my trust

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

Empathy
Understand me and work hard to build a relationship

Note:
1. Please see Net Promoter Score KPI on page 31 for further information.

Mileage refunds

From the start of Covid-19 we have been clear we wanted to do right by our customers, so we have taken a number of steps in response to the changes we've seen in driving behaviour.

During the first lockdown in 2020 we offered refunds to all Motor customers, recognising significantly reduced driving levels due to the restrictions and in 2021 we did the same again.

Our Direct Line customers continue to benefit from our Mileage MoneyBack offer, where they can get money back if they drive less than the expected mileage they registered when taking out the policy[1].

For our other Motor brands, Churchill, Privilege and Darwin, customers have been offered refunds which could either be paid to them or donated to charity. Our customers were outstandingly generous and their combined donations led to significant sums being donated to NSPCC, Mind and UK Sepsis Trust.

£411k
NSPCC

£381k
Mind

£167k
Sepsis Trust

Supporting customers

CONNECT training

We have an established training programme called CONNECT to help our consultants respond with empathy to differing customer needs, while also taking responsibility and accountability. This is particularly important for customers who may be experiencing issues such as illness, bereavement or vulnerability. Based on the CONNECT training, those people who successfully demonstrate high levels of customer service receive a certificate of accreditation from the Institute of Customer Service. In 2021, over 1,700 of our customer-facing and support staff have received new additional training to recognise, engage and support our vulnerable customers.

"In 2021, over 1,700 of our customer-facing and support staff have received new additional training to recognise, engage and support our vulnerable customers."

Bereavement team

We are proud of our established team of consultants who are skilled in dealing with queries when someone loses a loved one because we know that managing financial matters can be the last thing on people's minds following a death. All queries are dealt with sensitively and in one place, to provide peace of mind at a difficult time for customers.

Recognising differing customer needs

We know some customers find it difficult, upsetting or simply time consuming to disclose their vulnerability each time they are in contact with us. That's why we ask them if they are happy to have details of how best we can support them recorded on our system. If they agree, we tag their record with a heart, so colleagues dealing with that individual in the future know to read the details of the specific case and the support that may be required. If someone says they do not want it recorded on their file, we don't record it.

Green Flag

In our Green Flag business we offer roadside rescue and recovery services, recognising that some customers require assurance that we are on the way. Our customer-facing teams therefore actively prioritise customers who might need immediate support, such as lone or vulnerable travellers on the roadside at night or families with young children.

Building a quality claims experience

In a normal year, we handle around 1 million claims, fix approximately 200,000 cars and pay out claims totalling in the region of £1.8 billion.

To make claiming easier we are increasingly digitalising the customer journey, providing peace of mind when our customers need it most:

- **100%** of Motor and Home claims can now be registered online
- **Reducing the time to settle** total loss claims in our Motor business by developing our own in-house damage evaluation tool that identifies how best to support customers by either fixing their vehicle or providing a cash settlement
- **Whole process online** for simple Home claims so customers can complete their claim without needing to call us if they don't want to

Note:

1. At the end of the policy year, once they are sent their renewal invite, the customer is required to submit a new mileage reading. The mileage driven is then compared to the estimated mileage on the policy with a 2% refund for every 1,000 miles driven under the estimate up to a maximum of 20%.

Communicating clearly with customers

Plain Numbers
Clear. Fair. Never misleading.

In line with our company behaviour to 'Encourage simplicity', this year we collaborated with Plain Numbers, an organisation which aims to change the way numbers are presented to improve comprehension, particularly for vulnerable customers.

In the Plain Numbers trial alongside the Bank of England and other major companies, we used the Plain Numbers approach to reduce technical language, define complex terms more simply, and place numbers that were less important further down a page to avoid confusion.

The trial showed that using the approach improved the number of people who could understand individual communications.

We are now reviewing the results and beginning to consider how some of the changes can be added into the current design of documents to help customer understanding and will be looking to train staff in the Plain Numbers approach.

We are also evaluating changes across the multiple channels we use and the online content we produce, to ensure that communications and language are clear across the Group.

People

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

At DLG we believe that the best way to serve our customers is by having the best possible people. Our millions of customers have individual needs and we know that we will understand them better if our workforce reflects that diversity.

It's why we work hard to attract, develop and retain excellent people from a diverse range of backgrounds. We do this by offering rewarding and enjoyable careers, with the scope to learn new skills, contribute new ideas and work with great colleagues.

We look after our people and reward them for their hard work with a generous range of benefits.

Supporting our people through the pandemic

Across 2021 we continued to support our people through the pandemic. From working at home, to ensuring as safe an environment as possible for those colleagues who continued to physically come into work, from allowing people time off for vaccinations, to offering flexibility for those having to home-school and then working to make time in the office feel secure. We've been supporting and caring for each other every step of the way.

A diverse workforce

We are proud to be one of only four companies in the FTSE 350 that has both a female CEO and a female Board Chair[1]. This year the diversity of our Executive Committee has been transformed; its composition is now six women and five men. Two of our Executive Committee are from a minority ethnic background. You can't be what you can't see, so we hope our diverse leadership team will inspire more colleagues to aspire to the top roles.

But we know that inspiration is not enough, which is why we are offering our people the practical support they need to succeed and removing barriers to their success.

We have introduced new recruitment principles for senior roles, including anonymised CVs[2], a stronger focus on diverse shortlists and panel-based assessment to help protect against bias.

"This year the diversity of our Executive Committee has been transformed; its composition is now six women and five men."

Notes:

1. Source: https://www.gov.uk/government/news/sea-change-in-uk-boardrooms-as-women-make-up-nearly-40-of-ftse-100-top-table-roles
2. Anonymised CVs do not apply to Executive Committee and Board Roles.

Sustainability *continued*

Our values

Do the right thing
Build sustainable outcomes not processes. Think commercially and choose the right path for our customers, our people and wider stakeholders.

Say it like it is
Challenge drives progress. Your input matters so have the courage to say what you think and the patience to listen to others. Keep it simple and customer-focused.

Aim higher
Be ambitious to achieve even better results. Have confidence, innovate and try new things. Embrace change to deliver for each other, our customers and our shareholders.

Work together
Nobody has all the answers. Collaborate and draw upon the diverse skills across our business. Trust each other and focus on customer outcomes to win against our competitors.

Take ownership
Own our success by getting things done. Take the initiative and be accountable. Be curious and own your development and performance.

Bring all of yourself to work
Diversity delivers better outcomes. Be the real you and celebrate difference. Respect others, have fun and make this a great place to be.

Bring your whole self to work

We know we will never be an inclusive and diverse workforce if people don't feel free to be themselves. That's why "bring all of yourself to work" is one of our core values. To bring this to life we have a thriving Diversity Network Alliance (DNA), run by our people, with communities of colleagues that champion diversity and inclusion within our business.

This year each strand has delivered an extensive programme of activity to build greater empathy and understanding around the things that matter to the communities they represent.

This has included people stories, vodcasts, panel discussions and external speakers, which have helped to raise awareness of issues and drive more open conversations.

- REACH (Race, ethnicity, and cultural heritage)
- Neurodiversity and Disability
- Belief
- Social Mobility
- LGBT+
- Thrive (gender)
- Life (working families and carers)

The Inclusive Top 50 UK Employers List

This year we were listed 13th on the Inclusive Companies Top 50 UK Employers List, which recognises those companies that promote inclusion throughout each level of employment within their organisation.

The Charter for Faith & Belief Inclusion

In 2021 we signed up to The Charter for Faith & Belief Inclusion, which aims to help create understanding between people of different faiths and beliefs and a society which is fair to people of all backgrounds – religious and non-religious.

Gender

Our long-term focus on investing in women means we have been able to significantly strengthen representation at the most senior levels of our business. Our Women in Finance figures, FTSE Leaders figures and breakdown by levels within the organisation each cut the data in different ways.

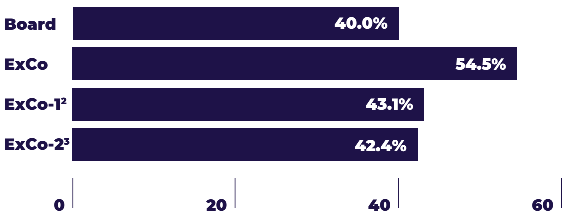
Women in Finance

Having achieved our Women in Finance target for 30% of women in senior leadership roles back in 2019 we chose to push ourselves further by targeting reaching 35% by the end of 2022. At the end of 2021, representation of women in senior leadership roles has risen to 32.8%.

FTSE Women Leaders Review

Last year we exceeded the Hampton-Alexander Review's 2020 target for FTSE 350 companies to have at least 33% representation of women on their Board and in their Executive Committee and direct reports. We are pleased that for 2021, we have reported 40% women on our Board and 40.5% women in leadership roles in the FTSE Women Leaders Review, placing us 18th in the FTSE 250 and 3rd in life and non-life insurance sector[1] and meeting the new FTSE Women Leaders Review recommendations on gender balance and women in the most senior board and leadership roles.

Senior women representation (%)



Pay Gap Reporting

Our gender pay gap continues to be low compared with the broader financial services sector, but we know there is still more to do. We're comfortable that we don't pay people differently because of their gender and believe that the way to reduce the gap in the medium- to long-term is to take concerted action now to address the disproportionate representation of women across certain areas and levels of the business.

This year we announced that from 2022 we will also voluntarily publish our ethnicity pay gap, showing the difference in average pay between our ethnic minority and white colleagues across the whole organisation.

Notes:

1. Board representation at 10 January 2022 and Executive Committee & direct report representation at 31 October 2021 as per FTSE Women Leaders Review data sourcing
2. Percentage of women in roles reporting directly to ExCo, excluding administrative and support staff.
3. Percentage of women in roles two reporting levels below ExCo, excluding administrative and support staff.

Ethnicity

Across 2021 we have continued to focus on delivering the targets we set ourselves in 2020 to increase ethnic minority and Black representation in leadership by the end of 2022 (leadership roles are defined and fixed as those above a certain level in our internal grading structure). We know more needs to be done and are committed to building on progress year on year:

– **Growing ethnic minority representation from 10% to 13% – increasing roles at this level by around a third**

At the end of 2021, representation of ethnic minority colleagues in leadership roles has risen to 11.7%.

– **Growing Black representation from 0.5% to 1.5% – quadrupling roles at this level**

At the end of 2021, representation has increased to 0.9% of Black colleagues in leadership roles.

To hold ourselves to account internally, we produced a specific report detailing the steps the Group has taken across 2020-21 towards "Building a diverse business; improving Black inclusion" in October to coincide with Black History Month.

In addition we have signed up to:

Business in the Community's Race at Work Charter, which commits us to act and take positive action towards supporting ethnic minority representation and inclusion.

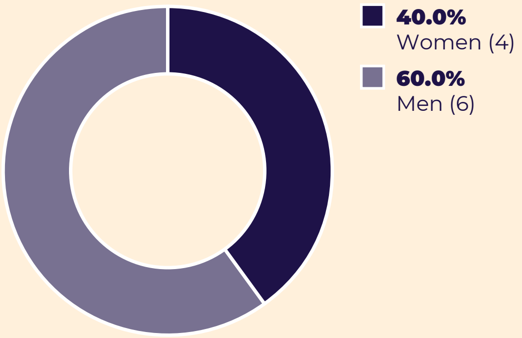
The If Not Now, When? campaign for Black inclusion within business, calling for organisations to commit to sustainable and long-term actions on Black inclusion in the workplace.

The 10,000 Black interns programme, which aims to transform the prospects of young Black people across the UK through paid internships across a range of industries. We will be welcoming our first interns in Summer 2022.

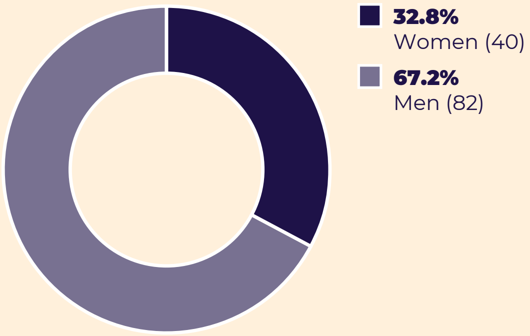
The 5% Club

This year we joined the 5% Club, committing that within five years 5% of our workforce will be apprentices, graduates and sponsored students.

Gender diversity of our board

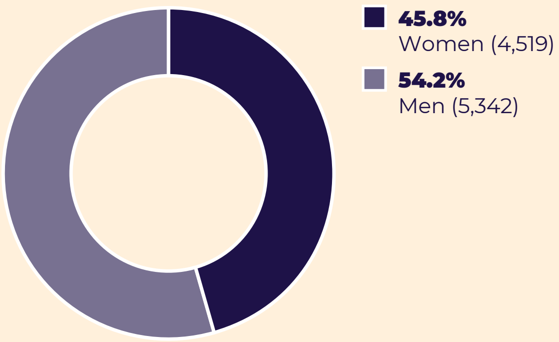


Gender diversity of senior leadership



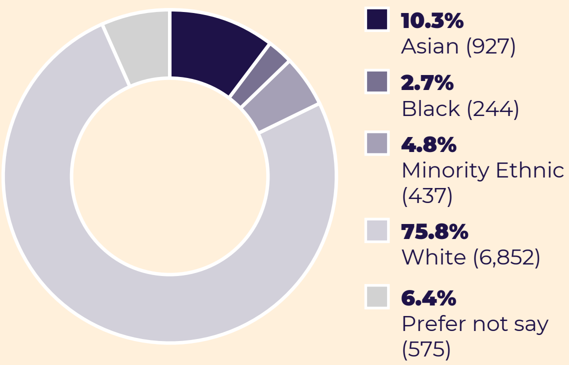
Gender diversity of senior leadership figures based on 2021 Women in Finance reporting

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

Ethnicity of all employees



Excludes 8.4% of colleagues who have not submitted an option for ethnicity

> For more information on leadership gender diversity, including gender diversity of the Board see page 114

Looking after our people

Mixed model working

During the pandemic, the Group moved quickly to enable over 9,000 of its staff to work from home. Over the following 18 months we learnt that we can serve our customers effectively and deliver big transformation projects while giving our people the flexibility they've told us they want.

Therefore we have chosen to move to a mixed model that combines remote working with using our offices in a different way. Trusting our people to get the job done wherever they are working from. From September 2021, our people have been able to come into the office for collaboration, training and team building and continue to log on from home to do computer and phone work. We believe this offers our people the best of both worlds and it helps to maintain the culture our people enjoy.

Early careers

We have always been a great place for people to start their career. We now want to build on the early career opportunities it offers, playing our part in improving the career prospects and enhancing the skills of the UK's young people.

Making Flexible Work Charter

Making Flexible Work

This year we signed up to the Association of British Insurers 'Making Flexible Work' Charter because we know one size does not fit all. We are actively looking at how we can build on the flexible options we already offer.

Mental health

We strongly encourage our people to be open about how they feel and that's never been more important than during Covid-19 with all the additional pressures and concerns that have arisen. We have a cohort of colleagues who are trained as mental health first aiders that people can reach out to, as well as a confidential external service that they can call for help, support and advice.

Employee Representative Body (ERB)

Our ERB meets regularly, has an engaged membership and is much valued by our people. It brings colleagues together from across the business to discuss and input into proposals and initiatives that may affect our future and impact our people. It also offers the opportunity for individuals, via their ERB reps, to feed in their views and suggestions. More information on the work of the ERB can be found in the Corporate Governance report on pages 109 and 111.

Pensions

We want to support our people to save for their retirement. That's why all our people are offered an additional 9% on top of their salary a year to go into their pension.

Rewarding our people

Our people work hard on behalf of our customers so it's only right they should receive proper financial reward for their contribution. In 2021 salary increases were awarded of between 1.5% to 2% and, in addition, a £400 one-off "thank you" bonus was given in April 2021 to everyone who is not usually eligible for a bonus.

In April 2021 all eligible colleagues received £350 of free shares, making this our sixth award of free shares since 2012. These shares are now worth £2,059 or £2,888 inclusive of dividends received[1].

Minimum salaries

We strive to ensure that our colleagues are rewarded for the contribution they make to our success. While we seek to ensure the pay proposition is good for all our people, we have shown a clear commitment to lifting the salaries of our lowest-paid colleagues. We have done this through ensuring the minimum pay ranges are ahead of the National Living Wage and the Real Living Wage.

During 2021 the minimum salary was £19,500 for a 37.5 hour week. This was 11% above the Government's statutory National Living Wage (April 2021 figure for those aged 23 or over), and 5% above the Living Wage Foundation's Real Living Wage (November 2020 figure for roles outside London).

The business has announced that from 1 April 2022 our minimum salary will rise by 6.7%, seeing pay for a 37.5 hour week rise to £20,800[2]. This will be 12.3% above the Government's statutory National Living Wage (April 2022 figure for those aged 23 or over), and 7.7% above the Living Wage Foundation's Real Living Wage (November 2021 figure for roles outside London). In keeping with our learning culture the decision has also been taken that apprentices will be paid our minimum salary rate from that date[3].

Human rights

As we work to become increasingly sustainable we want our people to both flourish and to build a reputation for ethical business and this drives our commitment to have employment practices and policies that exceed those in the Universal Declaration of Human Rights. We are committed to ensuring modern slavery is not present in our supply chain. Our risk profiling, including specific requirements within our due diligence and assurance processes, incorporates the Modern Slavery Act 2015.

Listening and responding to our people

It's important to us to understand how our people are feeling so we can take action, which is why we conduct regular employee engagement surveys. This year we have improved our capability by bringing in a new survey platform which provides enhanced functionality. This has made it even easier for colleagues to give feedback and for people leaders to understand the results.

In response to 2021 survey findings, we have focused on supporting a successful transition to mixed model working by:

- **Creating an intranet hub** which provides our people access to all the practical guidance and support materials they need for a successful transition to mixed model working. It is regularly updated with new information in response to colleagues' requirements
- **Delivering new technology bundles**, direct to colleagues' homes, equipping them with the right tools to work at their best, both at home or when on the move
- **Keeping people involved and in touch** and building a real sense of connectivity with ExCo members, participating in regular interactive "ask anything" sessions including virtual townhalls, business update calls and getting to know you online 'cuppas'.

Notes:

1. Based on the share price at 31 December 2021.
2. Subject to satisfactory performance and excluding apprentices in DLG Auto Services who receive different rates of pay.
3. DLG Auto Services apprentices will receive a different level of pay for the course of their apprenticeship.

Society

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

We know that being a force for good means more than just providing great customer service. Our stakeholders expect us to make a positive contribution to the society around us and we do this in many ways, whether it is the causes our Community Fund supports, the campaigns we run on issues like social mobility, or the tax contribution we make.

As a business we aim to have a wider impact on the communities we serve and society as a whole. This has been particularly important in 2021, as many people continued to live with the impact of Covid-19. In response, colleagues across the business have found new ways to support families and individuals via our Community Fund, driven by our Diversity Network Alliance ("**DNA**") and Community and Social Committees ("**CASCs**").

> **"Our colleagues across the business have found new ways to support families and individuals via our Community Fund, driven by our Diversity Network Alliance and Community and Social Committees."**

This year we have made further progress on our social mobility journey and in driving inclusion for left-behind groups. We have provided chances for young people still at school to broaden their understanding of the opportunities available within financial services, offering more apprenticeships as a route in, and helping our Social Mobility Employee Network to provide support, broaden understanding and advocate for change.

Social Mobility Action Plan

Getting In, Getting On, Getting Ahead

In partnership with the Social Mobility Pledge, we launched our Opportunity Action Plan setting out a series of recommendations the Group can implement to strengthen our contribution to addressing social mobility within the UK. Recommendations included:

- Targeting efforts towards areas around the Group's sites with the widest inequalities and maximising remote working opportunities
- Utilising our Community Fund to prioritise social mobility causes in partnership with charities and organisations that aim to make positive change
- Monitoring and tracking employee data to understand potential barriers for colleagues and gain better insight into how people are progressing to senior positions within the Company
- Evaluating over time how the Group's actions can be measured to quantify impact

Targeting social mobility cold spots

Coming out of the pandemic we want to harness the benefits of remote working, because we recognise we can offer opportunities in areas of the country where we have traditionally been unable to recruit. At the start of the year we piloted a remote customer service apprentice scheme, targeting social mobility cold spots in Derby, Mansfield, Hastings and Crawley where we relaxed traditional recruitment criteria so that we assessed candidates on panel-based assessment, rather than on professional experience.

Social mobility insight days

Building on the success of last year, we held two insight days in 2021 in conjunction with the Social Mobility Business Partnership and the Social Mobility Foundation, for bright students from less-advantaged backgrounds, to break down barriers around careers in insurance and to develop their skills.

We've also partnered with Teach First and Envision to support training and provide mentoring through colleagues across our business.

Read more about our Opportunity Action plan at www.directlinegroup.co.uk/en/sustainability/our-society/

Social Mobility

Our 2021 tax contribution

We ensure that we are compliant with all applicable tax laws and regulations and that we meet our responsibilities both as a contributor of corporate taxes and as a collector of taxes on behalf of HMRC. For 2021, our total tax contribution was £885.1 million which included the Group's direct and indirect taxation.

Our customers	IPT	**£391.1m**
Our suppliers	VAT	**£10.1m**
Our people	PAYE NIC	**£99.2m**
Our operations	Other taxes including business rates	**£8.5m**
	Irrecoverable VAT	**£232.6m**
	Employers' NIC	**£41.0m**
Our profits	Corporation Tax	**£102.6m**

HM Treasury

£885.1m[1]
total tax contribution

Society

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

Note:

1. The Group's total tax contribution in 2021, including direct and indirect tax contributions.

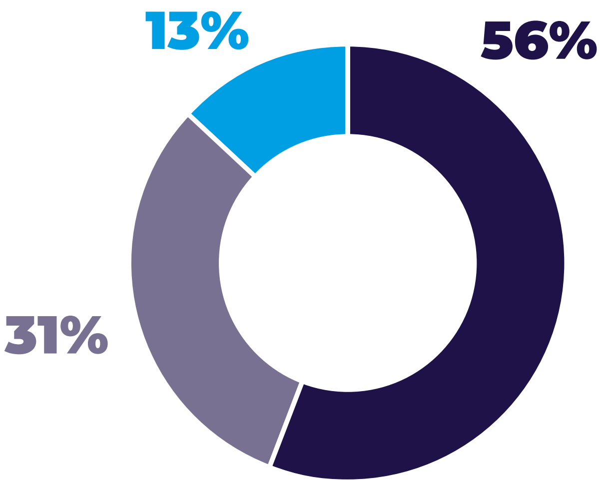
Community Fund 2021

Our Community Fund has gone from strength to strength in 2021. We continued to work with a number of the charities where we had pre-existing relationships and forged new partnerships by addressing three priority areas:

1. Marginalised Groups and Loneliness

2. Mental Health and Wellbeing

3. Food Poverty



Some of the charities and organisations we have donated to are:

KidsOut · envision · Business in the Community · girls out loud

Kids Out

We delivered over 300 laptops and tablets for 100 refuges throughout the UK. The funding supports vulnerable schoolchildren, many of whom have fled domestic violence and on average spend at least three to four months in refuge accommodation where over 50% do not attend school for fear of meeting their abuser. Colleagues also dedicated their time to call refuges and identify what individual sites' needs were so they could receive the right equipment.

Sepsis Trust

We helped raise awareness of the condition sepsis through our customer newsletter which reached over 2 million people. Amazingly, one of our customers recognised the signs in her partner after reading the newsletter and he managed to receive lifesaving treatment as a result of our partnership.

DNA strands

We empowered our DNA network to nominate several charity partners to support, helping us to bring to life the 'personal and inclusive' element of our vision. In total, £100,000 was distributed to a number of organisations.

> Read more about our DNA Strands on page 62

Sprintathon

We continued to support Stand up to Cancer with colleagues completing as many 100m legs of a 400 metre track as possible within an hour. In total, we raised over £125,000 to help accelerate life-saving research and cancer treatments.

£1.5m
given out in 2021

£225k
donated for laptops and tablets

£120k
for emergency funding and equipment supplies in UK hospices

Community Fund 2022

We are incredibly proud of what the Community Fund has managed to achieve over the last two years. It has been a huge success from delivering immediate support to those who needed it the most to empowering colleagues to be at the heart of decision making.

Looking to 2022, we want to capitalise on these building blocks and focus the Community Fund on improving social mobility and driving inclusion in the UK.

Quartet Community Foundation · carersUK · dreams come true · Stand Up To Cancer · The UK Sepsis Trust · The Active Wellbeing Society

NSPCC

During the pandemic, through our Mileage MoneyBack scheme, we offered customers the opportunity to donate their mileage refund to a number of charities including NSPCC. Over the last year our customers gave £411,000 to NSPCC, helping to keep children safe across the country.

Mind

Building on the great work of our partnership from last year, we continued to train mental health first aiders and break down barriers so that colleagues feel empowered to discuss mental health issues. We additionally delivered pro-bono support for Mind's operations and ran a graduate fundraising initiative.

Community and Social Committees

Our employee-led CASCs, which involve colleagues across all of our sites to co-ordinate local volunteering and charitable giving, delivered over £100,000 in funding for IT equipment to schools during the height of lockdown and £100,000 to food banks and local causes during Christmas time.

Green Flag community deliveries

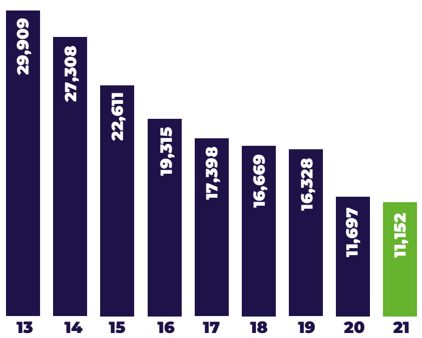
From March 2021, with the support of Business in the Community, our Green Flag recovery drivers have helped to deliver food parcels, laptops and other essential items to families, children, and local councils across the country.

Planet

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

We view the climate emergency as a race to find solutions. Across the business we are focused on climate risk mitigation and playing our part in accelerating the transition to a low-carbon future. There are three steps to our plan:

Greenhouse gas emissions (tCO_2e)[1,2,3]



Energy consumption (kWh)[2,3]

	2021	2020
Electricity	**14,856,315**	16,669,842
Gas	**24,286,023**	21,699,765
Total	**39,142,338**	38,369,607

Step 1

Disclose to track progress

We have done a lot of work to understand where the most carbon-intensive areas of our business are, because only by understanding and reporting our carbon footprint can we find solutions.

We have measured and disclosed our Scope 1 and 2 emissions and certain Scope 3 emission categories since 2013. In recent years, we have expanded the categories we report under Scope 3 to include some of the Green House Gas Protocol categories which are material to our business operations. We have also measured and disclosed our Supply Chain emissions since 2020 and this year, for the first time, we are disclosing our Homeworking emissions in recognition of more colleagues working from home.

In regards to progress made, we have:

- Reduced our energy consumption by 45% since 2013[4]
- Procured 100% renewable electricity for our operations since 2014
- Diverted 100% of our office waste from landfill

We are focused on providing greater transparency and want to now go further in our disclosures which is why we report our office, accident repair centre and supply chain emissions to guide our carbon reduction strategy going forward.

Step 2

Commit to tangible actions

Target setting
We have committed to set Science-Based Targets for Scope 1, 2 and 3 emissions via the Science Based Targets initiative ("**SBTi**") and this year joined the Race to Zero because we recognise our role in taking a leadership position as we reduce emissions. It means we will set targets in line with a 1.5°C emissions scenario where we are aiming to achieve net zero emissions by 2050 at the latest.

As we work to set targets, the most carbon-intensive areas of our business – our accident repair centres, supply chain and investments – are already starting to put in place plans.

Establishing Strategic Management Actions
In 2021, we established the following Strategic Management Actions which business areas are now prioritising:

- **Electric vehicles** – improving our capability and understanding to support the transition to EVs.
- **Supply chain** – implementing a Supply Chain Sustainability Programme to engage and influence suppliers.
- **Flood resilience** – engaging with policymakers on the importance of flood defences and helping to shape thinking around resilient repairs.
- **Underwriting footprint** – evaluating the impact of climate change on our underwriting footprint so that we can manage risks to our business and help inform strategic decision making.

> Read more about DLG Auto Services on page 74

Step 3

Offset while we reduce

We know that it will take time to reduce emissions and facilitate the transition to net zero, whilst we enhance our approach to sustainability across the Group and set Science-Based Targets.

Last year we took the step to become a carbon neutral business by offsetting our Scope 1 and 2 emissions as well as elements of our Scope 3 emissions under our direct control by partnering with ClimateCare, an organisation that is dedicated to tackling climate change and improving lives by financing, developing and managing carbon reduction projects across the world.

From November 2020 to November 2023, we've pledged support to carbon offsetting projects which will deliver high social impact benefits to communities and environments in three countries.

> See page 73 for more information on our offsetting projects

Notes:
1. Total Scope 1 and 2 emissions. The 2020 result of 11,697 tCO_2e differs from the reported result of 12,137 tCO_2e in the 2020 Annual Report and Accounts following recalculation.
2. 100% of the GHG emissions and energy consumption reported relates to operations all of which are based in the UK.
3. Data is reported in compliance with the SECR requirement to disclose annual global GHG emissions and annual global energy consumption (see page 87).
4. Reduction in energy consumption is reported on a like-for-like basis.

Group emissions

We believe accurate measurement and transparency can guide the business in making targeted interventions as part of our carbon reduction strategy. We implemented a number of test and learn activities, and continue to innovate and explore a range of solutions. We have provided a comparison of emissions data for Scope 1, 2 and 3 with greater clarity of the activities under our direct control, as well as our supply chain emissions. 100% of the emissions reported relates to operations all of which are based in the UK. The data is reported in compliance with the SECR requirement to disclose annual global GHG emissions (see page 87 for more information).

Definitions

Scope 1: This covers direct emissions from owned or controlled sources. For example, our office sites throughout the UK using gas boilers, the paint booths in our Auto Services sites currently relying on gas powered processes and our fleet vehicles.

Scope 2: These are indirect emissions. They are emissions associated with the production and transmission of energy we eventually use as a company across our office and Auto Services sites. For example, the production of the electricity we buy to heat and cool our buildings generates emissions.

Scope 3: These are indirect emissions that occur in the value chain to support our company operations. For example, employee commuting, activities related to the disposal of waste and the goods and services we purchase to fulfil customer claims as part of our supply chain. It will also include our investment portfolio which we are currently evaluating as we work to set Science-Based Targets.

Reporting methodology

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.

Our carbon emissions are calculated by an external third party and reviewed internally. The calculation method used for 2021 remains consistent with prior periods and with the reporting standards stated above.

Scope 1	**2021**	2020	2019 baseline
Office sites[1]	**1,220**	1,339	1,881
Auto Services[1]	**6,777**	6,472	7,838
Total (tCO_2e)[1]	**7,997**	7,811	9,719

Scope 2	**2021**		2020		2019 baseline	
	Location-Based[2]	**Market-Based[2]**	Location-Based[2]	Market-Based[2]	Location-Based[2]	Market-Based[2]
Office sites	**1,372**	**0**	2,176	0	4,516	0
Auto Services	**1,783**	**0**	1,710	0	2,093	0

	2021	2020	2019 baseline
Total (tCO_2e)	**3,155**	3,886	6,609
Total Scope 1&2 (tCO_2e)[1]	**11,152**	11,697	16,328
Of which: office sites (tCO_2e)[1]	**2,592**	3,515	6,397
Of which: Auto Services (tCO_2e)[1]	**8,560**	8,182	9,931

Scope 3 emissions under our direct control	**2021**	2020	2019 baseline
Fuel and energy related activities	**2,586**	2,332	2,465
Waste generated in operations	**474**	413	1,245
Business travel – air travel	**28**	198	928
Business travel – hotel night stays	**34**	75	469
Business travel – rail	**29**	63	410
Employee commuting[3,4]	**5,962**	1,450	4,599
Of which: homeworking emissions[4]	**5,501**	–	–
Upstream leased assets[5]	**110**	63	193
Upstream transportation and distribution of auctioned vehicles	**655**	625	912
Total (tCO_2e)	**9,878**	5,219	11,221
Total emissions under our direct control (tCO_2e)[1,6]	**21,030**	16,916	27,549

Scope 3 – supply chain	**2021**	2020	2019 baseline
Total procured goods and services (tCO_2e)[7]	**217,062**	144,114	249,929

Direct Line Group carbon footprint (operational control)	**2021**	2020	2019 baseline
Total (tCO_2e)[1]	**238,092**	161,030	277,478
Of which: under our direct control[1,4]	**21,030**	16,916	27,549

Notes:

1. The 2020 Scope 1 total of 7,811 tCO_2e (office sites: 1,339 tCO_2e, Auto Services: 6,472 tCO_2e) differs from our previously reported figures of 8,251 tCO_2e (office sites: 1,432 tCO_2e, Auto Services: 6,819 tCO_2e) in the 2020 Annual Report and Accounts following recalculation.
2. 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.
3. 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.
4. In line with the GHG Protocol standards our homeworking emissions are reported under the Scope 3 category 'Employee Commuting'. Prior period measurement is not available.
5. 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.
6. Total of Scope 1 & 2 emissions and Scope 3 emissions under our direct control.

Intensity metric

We monitor the intensity metric of emissions[1] 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.

Year	Emissions per £ million of net earned premium[2]
2021	**3.8**
2020[3]	4.0
2019	5.5
2018	5.4
2017	5.5
2016	6.4
2015	7.7
2014	9.1
2013	9.5

Notes:

1. Scope 1 and 2 emissions.
2. 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.
3. The 2020 result of 4.0 differs from the previously reported result of 4.1 in the 2020 Annual Report and Accounts following recalculation of our Scope 1 emissions (see footnote 1, page 72).

Offsetting projects

We supported three high-impact projects in Kenya, Bangladesh and Brazil to reduce carbon and support communities for a cleaner future. Over the last year, activity has progressed on all these projects, as they have not only reduced emissions, but delivered a range of benefits for people and planet.

Water filters, Kenya

We have provided funding which has helped the continued manufacture and distribution of Aqua Clara water filters.

Our support has contributed to the provision of over 8 million litres of safe water to Kenyan schools and households and is enabling future growth of the programme through further training and expanding distribution.

Clean cookstoves, Bangladesh

Through our support of this Gold Standard-verified project, we have contributed financing to subsidise the manufacture, distribution and after-sales support of Bondhu Chula cookstoves throughout local communities in Bangladesh, improving air quality and lowering household costs.

Our help has contributed to the distribution of almost 6,000 cookstoves, lowering fuel costs and improving household air quality for over 25,000 people.

Rainforest protection, Brazil

Our financial assistance for this project is helping to provide benefits to the local ecosystem by providing jobs in forest conservation and training in agroforestry techniques, in addition to protecting multiple vulnerable species that live within the region.

Local communities are empowered by offering land use and tenure rights in exchange for positive conservation results. This provides access to loans from development banks in Brazil, which can deliver a transformative impact on the area.

Notes (continued):

7. In accordance with the GHG Protocol under which we report, the following are excluded from the total:
   a. operational control activities already detailed under ‘Scope 3 emissions under our direct control’;
   b. cash payments to customers or other insurance companies / legal firms as compensation;
   c. intragroup transfers between our operating companies for financial accounting purposes as the actual purchase of goods and services to our third-party suppliers is already captured; and
   d. reinsurance costs to third-party reinsurers as this is a financing transaction.

Sustainability *continued*

DLG Auto Services

Direct Line Group writes close to 4 million in-force motor insurance policies, and customers are supported by our 22 Auto Services accident repair centres throughout the UK. We have the largest insurer-owned body shop business in the UK, and operate a partnership network with other body shop suppliers around the country.

Our Auto Services are fundamental to our claims and supply chain operation, but we also recognise they are one of the most carbon-intensive areas of the business. We are exploring a range of solutions to embed our environmental goals as part of our emissions reduction strategy:

Moving away from reliance on gas powered repair processes
Paint booths that currently rely on gas could be switched to electricity derived from renewable sources. We are trialling this in our Birmingham site.

Taking advantage of innovative products
Working collaboratively with commercial partnerships can realise environmental benefits. For instance, new paint technologies might reduce or remove the need to cure paint used on vehicles, thereby reducing energy consumption.

> **"As a major UK motor insurer we believe our 'green' USP should be to insure and fix electric vehicles, while aiming to do this in the most energy-efficient repair network in the UK."**

Green parts
Offering customers the option of 'green' parts could reduce the need for new replacement parts. It could also provide confidence about what can be recycled from salvage operations if motorists select this option when fitting parts to their vehicle.

Using alternative fuels
Testing the viability of alternative fuels, such as hydrogenated vegetable oil ("**HVO**"), to power recovery trucks which play an important part in servicing customer motor claims.

Energy-efficient lighting
Introducing LED lighting is more energy efficient and is preferred by our technicians who can see jobs more clearly. Our Weybridge site is enabling energy savings of up to 60% and a reduction in maintenance costs over a projected lifespan of 10 to 20 years.

Continuing with our energy efficiency activities

This year we continued to invest in energy-efficient measures in both our office estate and our Auto Services sites. In particular:

- We've continued with the project to replace the gas heating system in Bromley with a new Variable Refrigerant Flow ("**VRF**") and Smart Cool Energy-saving devices. The VRF system is a fully electric heating and cooling system delivering a 36% energy efficiency compared to the old gas boilers and electric chillers;
- Replaced the Fan Coil Units ("**FCUs**") in our Leeds Wharf office with new energy-efficient FCUs delivering an improved energy efficiency of 57%;
- Installed Power Factor Correctors in our Crawley Auto Services site to maximise the efficiency of our electrical supply onsite, delivering energy efficiency of 13%. This was a successful trial, and the plan is to assess the power efficiency of the rest of the Auto Services sites this year; and
- We're trialling hydrogenated vegetable oil ("**HVO**") in our recovery trucks at our Stechford Auto Services site delivering a GHG emissions reduction of over 90% compared to diesel.

In comparison, last year the delivery of energy-efficient activities in our office and Auto Services sites was heavily impacted by the Covid-19 pandemic. However, we delivered the following energy efficiency projects in 2020:

- New air conditioning and LED lighting systems and environmental sensors in the Bromley office enabling a reduction in gas usage and better maintainability; and
- New and more efficient LED lighting systems in our Birmingham and Glasgow offices, as well as sections of our Doncaster office, and at the Weybridge Auto Services site.

Our investments

All external investment managers are signatories of the United Nations Principles for Responsible Investment ("**UN PRI**"), which ensures that Environmental, Social, and Governance criteria is integrated into the investment process. For investment-grade corporate bond portfolios, as an added measure we require that managers maintain an average MSCI ESG rating of "A" or higher.

As part of our Group commitment to set Science-Based Targets, we are also required to set targets for in-scope asset classes in the investment portfolio which is a key initiative for 2022. We have committed that the investment portfolio will be net zero emissions by 2050 and have developed a climate framework for corporate bond portfolios that was initiated in 2021 and includes the below criteria and commitments:

- A 50% reduction in weighted average greenhouse gas emission intensity for corporate bond portfolios by 2030 versus a FY2020 baseline;
- A requirement for portfolios to be tilted towards companies taking Positive Climate Action ("**PCA**")[1];
- The exclusion of any companies with a low-carbon transition score indicating assets could be economically stranded;
- The exclusion of companies involved in thermal coal activity, either mining or power generation at greater than 5% of revenues[2];
- In support of our RE100 membership, no investment in firms opening new thermal coal mines or power stations; and
- Managers instructed to prefer investments in green bonds where the risk return characteristics are similar to conventional bonds.

In setting Science-Based Targets, we recognise that some of the existing investment portfolio targets may need to be amended, or new targets added, in order to meet the criteria set.

Using our influence

Using our influence to be a force for good, we played an active role in a number of climate-related groups where we contributed to a number of cross-sector solutions. These include:

- Electric Vehicle Fleet Accelerator
- ABI Climate Change Roadmap
- Sustainable Markets Initiative

Giving back to the planet

This year we became a supporter of the Get Nature Positive campaign where we will play our part, alongside other likeminded companies, to restore nature and biodiversity.

We also announced a partnership with the nature recovery charity Heal, providing a £3 million loan facility that can support the purchase of their initial two sites.

Notes:

1. PCA firms are those that have either committed to set Science-Based Targets for emissions reduction or have a 2 degree or better carbon performance alignment from the Transition Pathway Initiative. Portfolio tilt refers to a requirement that the market weight of portfolios to companies taking PCA should be greater than respective benchmark weight and is a requirement for all portfolios except two active strategies where a slightly lower threshold is required.
2. Waivers are granted for issuers that generate greater than 5% of revenue from thermal coal activity if they are taking PCA or if the particular bond issuance is defined as a green bond.

Task Force on Climate-related Financial Disclosures

Introduction

We welcome the reporting framework established by the Task Force on Climate-related Financial Disclosures ("**TCFD**"). The framework continues to enhance our reporting as we make further progress on our approach to evaluating and managing climate-related risks and opportunities and as we strengthen our strategic response to one of the biggest challenges facing the world today.

The Group has complied with the requirements of Listing Rule 9.8.6R by including climate-related financial disclosures consistent with the TCFD recommendations and recommended disclosures including the supplemental guidance for all sectors and insurance companies (see pages 76 to 87).

2021 highlights

- **Joined the Race to Zero**, committing to set Science-Based Targets that reduce our emissions based on a 1.5°C pathway.
- **Launched our first electric vehicle insurance package**, supporting the transition to a low-carbon economy and making it easier for customers to insure electric vehicles.
- **Announced our Supply Chain Sustainability Programme,** outlining our plan for the next ten years to engage and influence suppliers so we can make the transition to a pathway consistent with a 1.5°C scenario.

Governance

Our approach

The Group's approach to the governance of its sustainability strategy is underpinned by our Vision and Purpose (see page 23) and a clear commitment from the Board and senior management to align sustainability goals with the Group's strategy and encourage accountability across the business.

Our five-pillar sustainability strategy, endorsed by the Board, aims to foster the highest standard of Environmental, Social and Governance practice and deliver long-term sustainability for all of our stakeholders. The Planet pillar takes the lead on climate-related issues and is sponsored by our Chief Risk Officer ("**CRO**").

Boards and Committees

The potential impact of climate change on the business ("**inbound**"), as well as the Group's impact on the environment ("**outbound**"), are issues requiring robust governance to empower business areas in the management of climate-related risks and opportunities.

It starts with the Group's Board, which seeks to underpin all of the Group's activities with the highest standards of corporate governance. The Board has oversight on two key aspects of the Group's approach:

- 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.
- 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.

Committees

- The **Audit Committee** meets a minimum of four times a year and is responsible for overseeing the Group's financial statements and non-financial disclosures, including any climate-related financial disclosures.
- The **Board Risk Committee** oversees all aspects of financial, regulatory and operational risk, including the long-term risk to the Group from climate change. It meets a minimum of four times a year and receives reports on stress testing of long-term climate change scenarios, discusses strategies for managing the associated risks and considers emerging risks twice a year, recently involving a review of climate change.
- The **Sustainability Committee** supports the strategy by scrutinising progress against the plan to ensure that our Planet, People and Society pillars' activity continues moving forward. It meets a minimum of four times a year.
- The **Investment Committee** meets a minimum of four times a year and considers the strategy for incorporating ESG factors into the Group's investment management which has seen our credit portfolios tilted to issuers with higher sustainability weightings.
- The **Nomination and Governance Committee** meets a minimum of three times a year, monitoring the Board's overall structure, size, composition, and balance of skills. This Committee also works to understand and integrate investors' ESG expectations.

The Group's **Sustainability Committee** considers the work of the Planet pillar, alongside the Group's wider sustainability strategy. The Committee has taken a keen interest in the process towards setting Science-Based Targets, external activity undertaken by the Group to influence climate debates including the ABI's Climate Change Roadmap and the Sustainable Markets Initiative Insurance Task Force. The Committee has also discussed prominent public policy challenges such as flooding and accelerating the transition to electric vehicles.

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 CFO is responsible for overseeing the implementation of the Group's investment strategy and is advised by the Investment Committee on the application of ESG weightings, including those related to climate change, to the relevant portfolios. The CFO is a member of the Investment Committee and the CEO, CRO and the Director of Investment Management & Treasury are attendees.

To support the Sustainability Committee's oversight and in recognition of the Group's increased focus on climate-related activity the Group formed a **Climate Executive Steering Group** which reports into the Sustainability Committee. Chaired by Tim Harris, our former CFO, the Climate Executive Steering Group consists of members representing various teams from across the business to assess potential impacts of climate change with the aim of ensuring risks are identified and managed effectively. The Steering Group's responsibilities include:

- prioritising the Group's focus on preparation for submitting Science-Based Targets;
- overseeing input in the Group's business development and strategic processes to make sure climate is given appropriate consideration in long-term strategy and planning; and
- considering the risk management challenges presented by climate change including financial risk related to underwriting and investments.

Group Audit

Group Audit provides an independent and objective view of the adequacy and effectiveness of the Group's risk management, governance and internal control framework. The Group Audit Plan includes climate-related reviews.

Strategy

There is strong empirical evidence and scientific consensus that human activity is causing an increase in global temperature. The impact has far-reaching implications for economies and societies around the world. If further warming was to continue the physical and economic impacts that could result may be significant, with the extent of these impacts dependent on the action taken to tackle climate change.

The insurance industry is not immune and for general insurers there are specific risks and opportunities at play. We want to contribute to a long-term sustainable future and know that through our actions as a business we can contribute to climate risk mitigation.

As a major motor insurer, we recognise our position in the motor eco-system and that we have a part to play in reducing the impact motor vehicles have on climate change.

The adoption of electric vehicles continues to increase and we are providing our customers access to insurance solutions that support this transition. In 2021, we released our first ever electric vehicle insurance package for new Direct Line policyholders (see page 81), a proposition that makes it easier for customers to insure electric vehicles, while aiming to fix them in the most energy-efficient repair network in the UK.

Our new electric vehicle proposition is only one of a number of initiatives that are now underway across the organisation, supporting our aim of protecting our business from climate change and giving back more to the planet than we take out.

Climate change risks and opportunities

We recognise that the long term and forward-looking nature of climate-related risk is complex to manage, and that the risk the Group is exposed to could vary in materiality depending on product, business area or investment. The specific impacts of climate change on our business fall into three broad categories:

- **physical risks and opportunities** resulting from the physical effects of climate change;
- **transition risks and opportunities** arising from the transition to a lower-carbon economy; and
- **liability risks** arising when parties who have suffered losses from climate change seek to recover them from those they believe may have been responsible.

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.

Task Force on Climate-related Financial Disclosures *continued*

Whilst such risks can create uncertainty that we must continue to manage, we also recognise the transition to a low-carbon future creates opportunities to help accelerate the transition and contribute to a sustainable economy. For more information on how we are mitigating risks and harnessing opportunities across our underwriting, operational and investment activities see pages 81 to 83.

During 2021, we took action to examine how we define the time horizons relating to climate risk and opportunity. We consider the following to broadly describe the climate-related risks and opportunities impacting the Group over the short, medium and long term. We have aligned the time frames closely to pathways representing possible future climate-related scenarios over a thirty-year plus time horizon. Specific issues alongside the associated time horizons are discussed throughout the TCFD disclosure.

Short (1 – 10 years) The frequency and severity of natural catastrophes and other weather-related events in the UK could increase, adversely impacting insurance liabilities. The speed of transition to a low-carbon economy could also increase, supported by changes in technology and policy, including the planned ban of new petrol and diesel car sales in the UK from 2030, as announced by the UK Government in November 2020. Throughout these initial stages of transition, we intend to ensure product offerings and capabilities provide insurance solutions that best meet our customers' evolving needs, for example, as seen through the launch of our electric vehicle insurance package for new Direct Line customers in November 2021. On page 81 we report the key risks and opportunities relating to our underwriting activities which includes how we view the potential impacts the transition to electric-powered vehicles could have.

Medium (10 – 30 years) The transition towards a low-carbon economy continues to prompt a strategic and operational response. As consumers become more widely impacted by the transition and further changes in policy and technology are implemented we may see changes to risk nature and profile, and more acute weather-related events in the UK could occur if global temperatures were to continue rising (see page 81 for more information). We aim to enable consumers access to insurance that supports low-carbon choices and that reflects the green transition shift by utilising data and capability generated in the earlier stages of transition. We also plan to reduce climate-related risk exposure in our investment portfolio, which includes the target of ensuring our entire investment portfolio is net zero emissions by 2050 (see pages 83 and 86).

Long (30+ years) If further warming was to continue and no action taken to curb the longer-term impacts of climate change on our planet, the physical impacts could intensify. If chronic risks such as changes in precipitation patterns and extreme variability in weather-related events were to occur, we could see significant changes in the Group's underwriting criteria to maintain risk appetite. We may also see a shift in dynamics within the markets we operate and invest in, creating both risk and opportunity.

Financial planning

We acknowledge that there are risks posed by climate change that could potentially have impacts on financial performance and financial position.

As an underwriter, we actively measure climate-related risk through climate risk modelling due to the nature of the Group's products (see page 84). Climate risk is also integrated into the Group's overall approach to risk management (see page 84). We also undertake scenario analysis to enhance management of longer-term climate-related financial risks (see pages 79 and 80).

We recognise our prices, products and operations will evolve as climate change influences manifest themselves through changing loss patterns, however, a failure to understand the scale of change in market demand for products and services due to climate-related policy, technology and consumer preference, could have adverse impacts on revenue.

We are already experiencing increased climate-related operating costs and capital expenditure, seen, for example, through the ongoing investments we make to reduce the overall GHG emissions in our office estate and repair centres. We are aware, however, of the longer-term benefits such investments can bring in enhancing operational efficiency and resilience whilst also reducing impact on the environment.

Our financial investments represent one of the largest assets on our balance sheet. The impacts of potential physical and transition risks arising in the wider economy could have an impact on our investment portfolio, through their influence on the value of assets. See pages 83 and 86 for further information on how we are integrating climate-related considerations into our long-term investment management strategy to develop resilience against this risk.

As the potential for increasing adverse physical impacts due to climate change exists, we, as a general insurer, are aware that insurance liabilities could be impacted as more acute, and potentially more chronic, weather-related events are experienced in the UK. Approaches to understand this impact further are discussed throughout the TCFD disclosure.

Establishing Strategic Management Actions

Alongside science-based target setting we have also established Strategic Management Actions which business areas are now prioritising. These include actions on electric vehicles, our supply chain, flood resilience and underwriting footprint. For more information please see page 71.

Stress test

During 2021, we considered the financial impacts from three distinct climate scenarios at a ten- and thirty-year time horizon. The analysis was applied to the Group's Solvency II balance sheet as at 31 December 2020. Two of the scenarios represent routes to net zero greenhouse gas emissions and primarily explore transition risk from climate change:

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

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

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

Relative Impact – No Action to Early Action

The following graph illustrates the potential adverse impact to the Group's Solvency II balance sheet value of investment assets and insurance liabilities at Year 30 under the Early Action, Late Action and No Additional Action scenarios. The financial impact of the Early and Late Action are shown relative to the impact of the No Additional Action scenario which is set at 100%.

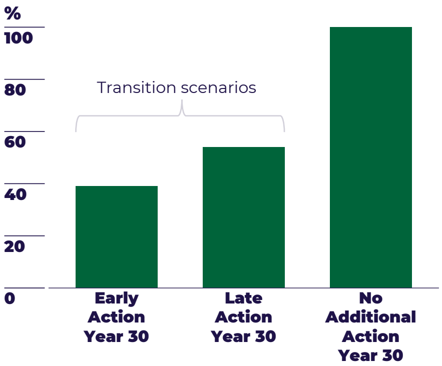


Figure 1: Year 30 impacts of scenarios relative to the largest No Additional Action scenario

In the Late Action scenario, the delay in policy implementation to transition to a low-carbon economy means there are no transition impacts over the initial ten-year time horizon. However, accelerated transition from 2031 results in greater impacts versus the Early Action scenario over the thirty-year time horizon. Whilst both of these transition scenarios saw material impacts on the investment portfolio, the most significant impacts on both investments and insurance liabilities arose from the physical risk effects of no transition in the No Additional Action scenario (where no additional actions are taken beyond those already announced).

At the thirty-year time horizon, financial impacts in the No Additional Action scenario are nearly double those in the Late Action scenario and physical risks also drove the largest impact on investment results in absolute terms. However, these impacts do not take into account the Group's long-term commitments within its investment strategy, which includes the target of holding a net zero emissions investment portfolio by 2050 (see pages 83 and 86).

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

Task Force on Climate-related Financial Disclosures *continued*

Impact on insurance liabilities v investments

The graph below shows the potential adverse impact on the Solvency II balance sheet value of investment assets and insurance liabilities under the Early Action, Late Action and No Additional Action scenarios at Year 10 and Year 30. The total impact for each scenario is set at 100% and is split between the impact on investments and insurance liabilities.

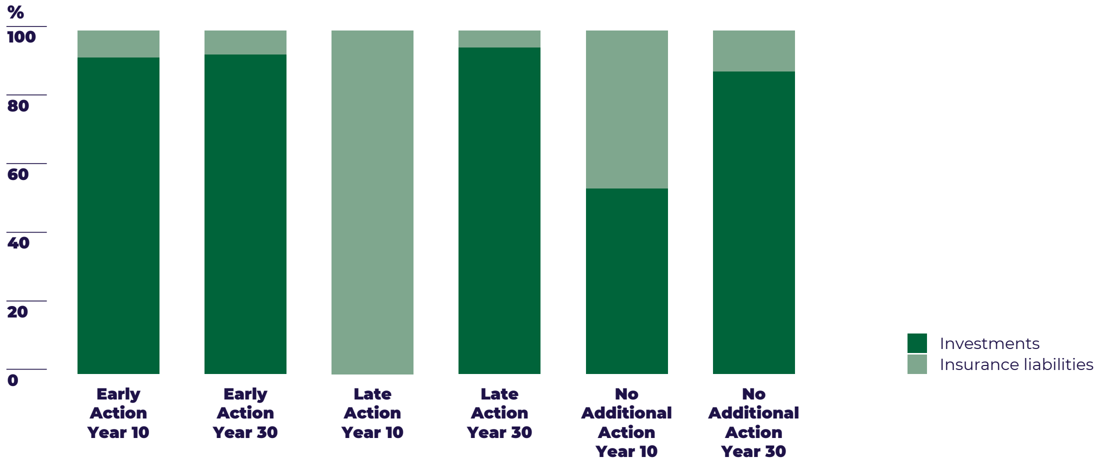


Figure 2: Share of impacts on insurance liabilities v investments

In all scenarios at the thirty-year time horizon, the impact on insurance liabilities was more limited than on investments. However, insurance liabilities were considered gross of reinsurance and in practice the short-term nature of the business, the ability to re-price annually and the risk mitigation provided by reinsurance arrangements is likely to limit the impact on general insurance liabilities further.

Physical risk by peril

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

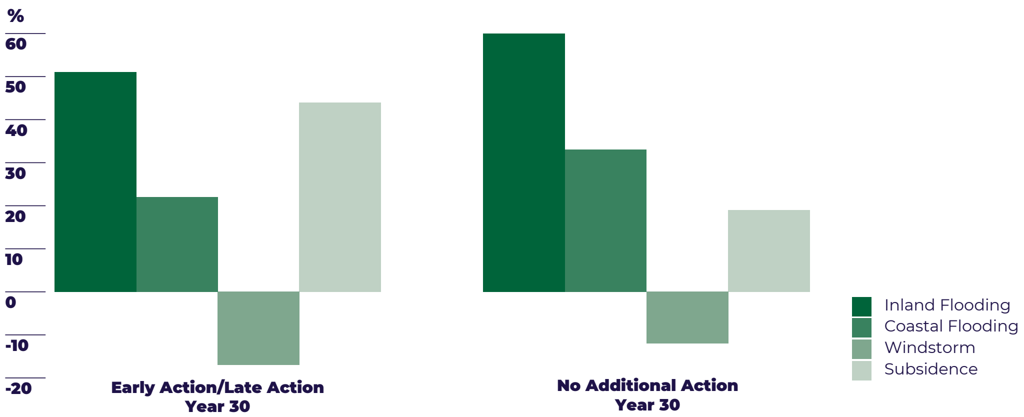


Figure 3: Split of physical risk impacts on insurance liabilities by peril

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

During 2021, we also participated in the Bank of England's CBES exercise which was designed to test the resilience of the UK financial system to physical and transition risks from climate change and to assist banks and insurers in enhancing their management of climate-related financial risk.

Going forward, we will continue to work towards developing scenarios specific to our own risk profile, that focus on the most material aspects of our business. This will enable us to more effectively make use of scenario-testing output to inform our strategic approach to mitigating these impacts.

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. The move to low-carbon vehicles, particularly electric-powered cars, also presents new challenges from which the Group could benefit, for example creating innovative products that enable consumers access to insurance solutions that support the transition to a low-carbon economy. We summarise a number of risks and opportunities in the table below relating to our underwriting activities, and highlight key action and assessment taken in 2021 against these.

INBOUND **Impact of climate change on the Group**	OUTBOUND **The Group's impact on the environment**
– The frequency and severity of natural catastrophes and other weather-related events could be affected by climate change and impact insurance liabilities. – The way we price property underwriting risk due to changes in building codes or standards could be affected. – Liability loss could arise as people suffer losses from climate change. – The transition to electric-powered vehicles could have significant strategic and operational impacts, including fundamental changes to the profile of accidents and the nature of risks, supply chain and repair processes. – Understanding the transition to electric-powered vehicles provides an opportunity to contribute to and benefit from the transition to a greener future. This will ensure optimum risk assessments influence pricing decisions, safeguard efficient repair process in our accident repair centres and help develop new products and propositions for our customers. – Climate change creates an opportunity to enhance our risk-modelling expertise and help strengthen our pricing decisions.	– Remaining active participants in developing solutions to influence the debate on weather-related events provides 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. – Issuing communications on preventative measures customers can take could reduce claims numbers. – 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 commercial opportunities. – Integrating electric vehicles into our fleet of courtesy cars to support customer awareness of electric vehicle capability. – Developing products and propositions that could encourage a reduction in emissions and open up potential commercial opportunities, for example our "Mileage MoneyBack" proposition. – Monitoring consumer attitudes to green products and develop insurance solutions that best meet our customers' evolving needs and accelerate the transition to a low-carbon future.

Key Group action 2021

In 2021, we continued to explore the potential longer-term climate-related underwriting risk, and how we can support the transition to a low-carbon economy through underwriting activities.

As a participant in the Bank of England's 2021 CBES exercise, we gained extensive insight into the potential impact of modelled climate scenarios on our insurance liabilities over a thirty-year period; this has also expanded our capabilities to enhance in-house scenarios specific to our own risk profile and most material aspects of our business (see pages 79 and 80).

In our Motor business, we announced a new partnership with Motability Operations Ltd which is due to take effect from 2023 (see page 8). The Motability Scheme helps over 640,000 individuals gain access to mobility with lease terms on most vehicles being three years. Over the course of the 10-year partnership we expect the number of electric vehicles we insure to grow significantly, providing valuable underwriting data, insight and capability into the future of vehicle technology and repair, crucial for building long-term strategic resilience against key transition risks.

Demonstrating our commitment to developing insurance products that can support the transition to a low-carbon economy, in Q4 2021 we announced our first 'green' motor insurance solution, launching a fully electric vehicle insurance package to new Direct Line customers (see below).

Making electric easy

Our Direct Line brand is working to make electric easy for our motor insurance customers, offering all new business customers access to a bundle of electric vehicle essentials as well as insurance that covers batteries and charging cables. The bundle includes discounted access to public and community charging, discounted home charger installation, help with grants and discounted parking for electric vehicles*. Our customers also benefit from our repair expertise via our network of body shops.

* One bundle per Direct Line motor policy, available to new customers only who buy between 28/10/2021 and 31/10/2022. Free bundle provided by Zoom EV for 12 months from activation and validation of Zoom EV account.

Operations

Given the scale of our operations we are all the more determined to ensure action is taken to reduce our impact on the environment. To support this, we are setting clear, transparent and science-based emission reduction targets, improving the way individual business areas operate and exploring the way we leverage our relationship with suppliers. Our operations are also exposed to physical and transition risks, such as possible disruption to direct operations due to the physical impacts of climate change, and we could also see a rise in operating costs through carbon cost increases and regulatory requirements designed to limit GHG emissions. We summarise a number of risks and opportunities in the table below relating to our operations, and highlight key action and assessment taken in 2021 against these.

INBOUND **Impact of climate change on the Group**	OUTBOUND **The Group's impact on the environment**
– Operating costs could rise due to potential carbon cost increases, regulatory requirements designed to limit carbon emissions and as a result of failure to improve operational efficiencies. This would drive the need for more aggressive energy reduction measures across the Group. – Frequency and severity of natural catastrophes and other weather-related events could impact direct operations leading to business interruption. – 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.	– A failure to set long-term emission reduction targets for business operations could see energy consumption increase. – Investing in energy-efficient features and equipment across our office estate and accident repair centres provides the opportunity to reduce energy consumption, which could otherwise increase. – Improving operational efficiencies can save on energy consumption particularly in our roadside rescue and recovery business and in our repair centres. – Encouraging employees to make environmentally conscious decisions can enhance education, increase recycling rates and save on consumption over the long term. – Once validated, our new Science-Based Targets will ensure we have a clear and transparent route to further reduce and monitor our Scope 1, 2 and 3 emissions.

Key Group action 2021

In 2021, we remained committed to reducing the impact of our operations on the environment and continued to make progress to mitigate the impact physical and transition risk could have on our operations.

At the end of 2020 we announced our commitment to set science-based reduction targets for our Scope 1, 2 and 3 emissions via the SBTi and in 2021 we continued to make progress against this. Working with environmental consultancy Carbon Intelligence, we plan to submit the targets to the SBTi for their independent validation in 2022.

We also joined the Race to Zero in 2021, taking a leadership position as we reduce GHG emissions. It means we will set targets in line with a 1.5°C emissions scenario where we are aiming to achieve net zero emissions by 2050 at the latest.

We have also continued to offset the carbon emissions from our operations we can't yet avoid, see pages 71 and 73 for further information.

Throughout 2021, we continued to implement further operational efficiencies and improve long-term operational resilience against climate-related matters, key action included:

- Launching our **Supply Chain Sustainability Programme**, which outlines our plan for the next ten years to support the reduction of Scope 3 emissions in our supply chain (see below); and
- Embedding new solutions in our Auto Services repair centres by making use of alternative fuels, offering customers the option of choosing 'green' parts in vehicle repairs and moving away from reliance on gas powered repair processes (see page 74 for more information).

Supply Chain Sustainability Programme

We are using our established relationships and purchasing capabilities through procurement to mitigate our risks by seeking to reduce the emissions in our supply chain. The Group's Ethical Code already sets out our expectations of suppliers that they should support a precautionary approach to environmental challenges, promote greater environmental responsibility and encourage the development of environmentally friendly technologies.

We have launched our Supply Chain Sustainability Programme which outlines our plan for the next ten years. We recognise this will be a gradual process but by acting now we can work with suppliers by signalling our expectations so that we can make the transition to a pathway consistent with a 1.5°C emissions scenario.

Our approach means:

- Engaging with our largest emitting suppliers to encourage them to sign up to SBTi targets or an equivalent.
- Requesting information on what efforts firms have made to measure their carbon footprint across Scopes 1, 2 and 3 and their plans to reduce emissions, including targets.
- Changing our sourcing approach on appropriate contracts by introducing a sustainability rating that will increase over the next ten years, which could exclude prospective suppliers if they have no plans to reduce emissions.

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 will have an impact on our investment portfolio, through their influence on the value of assets. For example, our portfolio is exposed to physical risks through our investment in companies that are exposed to disruption from adverse weather events across their supply chain. It is also exposed to transition risks, where companies that we are invested in are not adapting their strategy to a low-carbon future. However, the transition to a low-carbon economy also creates significant investment opportunities.

We have committed to ensuring our entire investment portfolio is net zero emissions by 2050. In the table below, against the inbound and outbound impacts our investment portfolio brings regarding climate risk, we summarise key climate initiatives started in 2021.

INBOUND **Impact of climate change on the Group**	**OUTBOUND** **The Group's impact on the environment**
– The impacts of physical and transition risks arising in the wider economy could have an impact on our investment portfolio, through their influence on the value of assets and the potential for certain carbon-intensive assets to become stranded.	– Working to ensure our climate strategy is aligned with the Race to Zero campaign on climate change, we can reduce the impact of climate risk on our financial assets. The transition to a low-carbon economy will require large scale public and private market investment. This creates opportunities for institutional investors like ourselves to ensure capital is directed to help with the transition.

Key Group action 2021

At the beginning of 2021 we implemented our climate strategy for corporate bond portfolios which represent around two-thirds of assets held. The initiatives are summarised below:

- We have committed that by 2030 the Group will have reduced by 50% the weighted average carbon intensity of corporate bond portfolios (from a 2020 base year).
- Given the need for a phaseout of thermal coal power production (since it's one of the most carbon-intensive forms of energy generation), bond issuers that generate >5% of revenues from thermal coal activity (mining or power production) have been divested unless the company is taking positive climate action[1].
- We do not invest in companies opening new thermal coal mines or thermal coal power plants.
- Investment within corporate bond portfolios will increasingly be tilted towards companies evidencing they are taking the transition to a low-carbon economy most seriously. These will be companies that have committed to setting Science-Based Targets, or those with a 2°C or better carbon performance alignment from the transition pathway initiative.
- The exclusion of companies with an MSCI Low Carbon Transition Category of "asset stranding".

The actions detailed in the table above form part of the ongoing development of the wider ESG framework underpinning investments. In terms of holding investments in other companies, those with higher reported ESG credentials have more sustainable practices which better align to our investment, environmental and social goals. As such, a requirement of all investment-grade corporate bond portfolios is that each portfolio must maintain a minimum MSCI ESG rating of 'A' or better.

Looking through the climate lens, we also have in place the following current initiatives:

- We actively encourage our investment managers to invest in green bonds. Green bonds are designated bonds intended to encourage sustainability and to support climate-related or other environmental projects. All our relevant corporate bond mandate guidelines now direct the portfolio manager to purchase a green bond where the risk return characteristics are similar to those of a comparable non-green bond.
- Within our investment property portfolio all assets must have an Energy Performance Certificate of 'D' or better, or a plan and funds in place to achieve that level. The property portfolio also has a tailored set of end 2022 ESG targets covering, inter alia, carbon, energy, water and waste.

A key objective to enhance further our climate objectives in 2022 is to submit Science-Based Targets for the investment portfolio. The setting and validation of investment targets will form part of our wider application with the SBTi.

Using our influence

We are committed to using our influence to drive wider change. For example, we expect all of our investment managers to be signed up to the UN Principles for Responsible Investment. We also talk regularly to our external asset managers to understand (and where necessary, challenge) how they are using their global presence, size and leverage to engage and encourage corporations to tackle climate change.

Note:

1. Companies taking positive climate action are defined as those that are committed to setting Science-Based Targets or have a 2°C or better carbon performance alignment from the transition pathway initiative.

Risk Management

Enterprise Risk Management Strategy and Framework

The Enterprise Risk Management Strategy and Framework sets out the Group's approach to setting risk strategy and for managing risks to the strategic objectives and day-to-day operations of the business. Further information can be found in the Risk management section of the Strategic report on page 89.

Risk taxonomy

The effects of climate change are wide-ranging, affecting many risks across the risk universe. For this reason, the Group reflects the effects of climate change in the drivers of those risks which are defined in the Group Risk Taxonomy rather than adding climate change as a separate risk category. For example, the effects of climate change would be a driver of meteorology risk, which is a subset of underwriting risk.

Risk impact

The impacts of all risks, events and action plans are rated using the Impact Classification Matrix which facilitates a consistent approach to the sizing and categorisation of risk across the Group. This includes those risks relating to climate change, and allows the Group to determine the relative significance of climate-related risks in relation to other risks.

Climate-related risk identification process

Annual risk identification process

Each year, the business is required to review all current and developing risks which could impact on the achievement of strategic objectives. This process includes assessing risk drivers, such as those due to climate change, and their potential impact and likelihood of risk crystallisation on both an inherent and residual basis, in addition to identifying the position which aligns with risk appetite.

Regulatory monitoring

The Group monitors and reviews relevant outputs from the FCA, the PRA, European supervisory authorities (including the European Insurance and Occupational Pensions Authority ("**EIOPA**")), the European Commission and Her Majesty's Treasury, to consider existing and emerging regulatory requirements.

During 2021, this included reviewing:

- the PRA's launch of the 2021 Climate Biennial Exploratory Scenario on financial risks from climate change;
- the FCA's Policy Statement confirming the introduction of a new comply or explain listing rule requiring companies with a UK premium listing to include a statement in their annual report for accounting periods beginning on or after 1 January 2021 which sets out whether they have made disclosures consistent with the recommendations of the TCFD;
- the HM Treasury roadmap 'A new chapter for financial services', which confirms that the UK Government will implement an integrated Sustainability Disclosures Requirement which will require businesses to disclose their risks and opportunities from, and impact on, the climate and the environment; and
- the minutes of the PRA and FCA's joint Climate Financial Risk Forum.

We continue to monitor future developments and reviews are summarised and distributed to relevant stakeholders, and, where necessary, responses are co-ordinated and overseen by members of Second Line of Defence.

Emerging risk process

In addition to the annual risk review process, the Group has in place an emerging risks process which facilitates the identification, management and monitoring of new or developing risks which are difficult to quantify or are highly uncertain. The Group records emerging risks within an Emerging Risk Register. An update on emerging risk is presented to the Risk Management Committee twice a year, and the Board Risk Committee annually, and is supplemented by deep dives on selected emerging risks.

Climate change is one of the Group's most prominent emerging risks and is owned by the Executive Committee with regular oversight provided by the Climate Executive Steering Group, consisting of First Line of Defence subject matter experts from around the business where the impact of climate change is the highest, in addition to Second Line of Defence subject matter experts who provide oversight and challenge of risk management activity relating to this.

Each emerging risk is owned by an Executive sponsor to help ensure alignment of how it is managed to the strategic objectives and priorities.

Climate risk modelling

The predominant direct physical drivers of risk to the Group's capital position are major UK floods and windstorms. Whilst additional risks such as freeze 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 Management 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. In addition, we purchase risk covers to protect against large individual commercial losses and we make extensive use of Flood Re to cede high flood risk residential properties.

Metrics and targets

We use a variety of indicators across the different lines of our business to assess, monitor and manage our climate-related risks and opportunities.

Underwriting

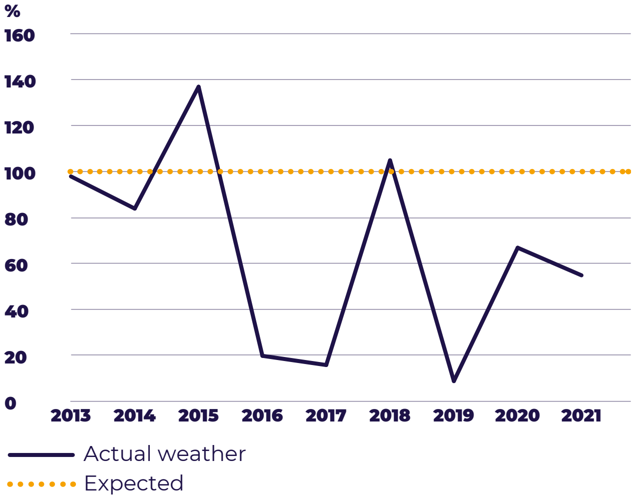
Weather-related loss impact

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

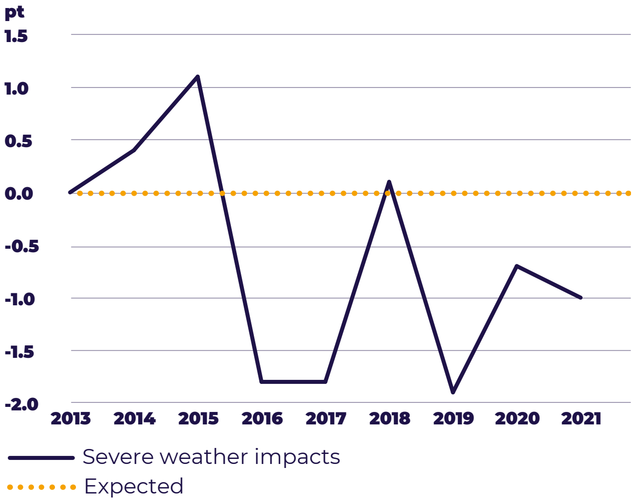
Catastrophe reinsurance is purchased annually to protect against event losses greater than £150 million and additional reinsurance cover protects against large individual commercial losses (see page 43). Use of the Flood Re scheme mitigates against the highest individual residential flood risks.

The Group uses sophisticated modelling techniques to determine the expected losses from severe weather events and uses these to set a weather load for budgeting purposes. The following graph shows the impact of severe weather events relative to the weather load; the trend is downwards reflecting recent benign activity, although there is significant variability. The 2018 peak was driven by the 'Beast from the East' freeze event whilst the 2015 peak was a result of a number of weather events in December which caused severe flooding across the UK.

Severe weather losses (actual % of expected loss)



Impact of severe weather on combined operating ratio (pt)



These results can be translated to impacts on the Group's combined operating ratio[1]; the relatively benign 2019 year for example improved the Group's combined operating ratio by nearly two percentage points against plan.

The frequency and severity of extreme weather events will be affected by climate change, which in turn will affect our view of risk, how we price severe weather risk, and the type and level of reinsurance we purchase to protect our balance sheet.

Home

Key risk indicators are produced by Underwriting and reviewed quarterly through relevant business forums. The key climate change-related activities are flood, subsidence and weather incidents. For flood and subsidence perils, we monitor the Group's market share for risks deemed to be in the high- or very high-risk segments. We also monitor and review the proportion of policies ceded to Flood Re. Each peril is monitored against set tolerances, with movements in amber or red ratings generating investigation and action as required. We maintain a view of trends and look to take action where a trend is likely to result in a breach of tolerance.

Note:

1. See glossary on page 248 for definition.

Task Force on Climate-related Financial Disclosures *continued*

Subsidence
Subsidence as a peril is a relatively low overall cost, however a subsidence event can be very costly. We monitor this risk via our subsidence market share by geo risk classification. This risk classification aims to give a market view of geographic risk of having a subsidence claim. This enables us to understand the proportion of subsidence risk that we write compared to our estimate of the total in the market.

The classifications take the geographic factors in the subsidence buildings models and not the individual property estimated sums insured.

Flooding
Governments have been working with insurers since 2000 to help make flood risk insurance more affordable. In 2016, a previous solution was replaced with a longer-term plan, called Flood Re. Every insurer that offers home insurance in the UK, the Group included, must pay into the Flood Re scheme. This levy has raised £180 million every year which is used to cover the flood risks in home insurance policies.

To ensure the Group and its customers benefit from the levy and guard against the highest of flood risks, we monitor the volume and proportion of policies we are ceding to Flood Re. Properties are eligible to be ceded to Flood Re when they meet certain criteria. Since early 2019, the cost to cede policies to Flood Re has dropped, driving an increase in ceded volumes.

Motor
The Group's motor market is diversified throughout the UK, and weather-related claims make up a very small part of total motor claims. As such we do not currently consider there to be any valuable climate-related risk indicators that can be tracked for this portfolio.

In order to track the transition towards electric and alternatively fuelled vehicles (such as hybrids), we monitor both the number and proportion of policies we underwrite for these types of vehicles as well as electric vehicle and alternatively fuelled vehicle registration data from The Society of Motor Manufacturers and Traders.

Operational
Our performance to date
We are proud of the progress we have made on reducing emissions and have a record of setting targets to hold the business to account. In 2013 we set two Group-wide environmental targets for our Scope 1 and 2 GHG emissions which we have tracked, reported against and successfully met in 2020. The two targets we set were:

- a 57% reduction in emissions (Scope 1 and 2) on a like-for-like basis by the end of 2020 against a 2013 baseline. In 2021, we saw a 61% reduction in energy-related emissions, which takes into account the impact of Covid-19 where mixed model working measures altered our energy usage; 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 delivered a 45% reduction in energy consumption, which takes into account the continued impact of Covid-19.

Overall, in 2021, we saw an increase in emissions under our direct control compared to 2020, which is explained by an increase in activity in vehicles being repaired in our Auto Services business as a result of Covid-19 restrictions being eased during the year. We have also for the first time this year calculated and included our homeworking emissions under the Scope 3 'Employee Commuting' category in recognition of more colleagues working from home.

Holding ourselves to account in the future: Setting Science-Based Targets across Scopes 1, 2 and 3
We are pleased with the success we have made in reducing our Scope 1 and 2 emissions having met the two targets we set as planned. We now want to go further because we believe transparency can guide the business in making targeted interventions as part of our carbon reduction strategy:

- We continue 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, as well as our supply chain emissions. See page 72 for our 2021 emissions data.
- Throughout 2021, we continued to place an increasing focus on calculating and validating our emissions data across all areas of the business, including our Operations, Supply Chain and our Investments which are embedding plans to reduce carbon footprint.

We are undertaking this activity because we want to enhance our carbon reduction strategy. To go further we are committed to setting Science-Based Targets for Scope 1, 2 and 3 emissions via the SBTi and this year we joined the Race to Zero because we recognise our role in taking a leadership position as we reduce emissions. It means we will set targets in line with a 1.5°C emissions scenario where we are aiming to achieve net zero emissions by 2050 at the latest. We will submit our science-based reduction targets for validation by the SBTi in 2022.

Investments
More than 100 financial institutions have publicly committed to set emissions reduction targets through the SBTi. In 2018, the SBTi launched a project to help financial institutions align their lending and investment portfolios with the ambitions of the Race to Zero campaign. The project audience includes universal banks, pension funds, insurance companies and public financial institutions.

Our long-term goal is for our entire investment portfolio to be net zero emissions by 2050, in line with the aims of the Race to Zero campaign. To support this aim we have an interim target of a 50% reduction in weighted average carbon emissions intensity by 2030 (from a 2020 base year) within our corporate bonds portfolio, the largest asset class within the investment portfolio.

Carbon intensity is the GHG emissions intensity per $1 million of sales. Normalising by sales allows the investor to compare carbon efficiency of different-sized firms within the same industry and has become a standard metric used in the investment industry.

We will continue to progress towards setting Science-Based Targets for the investment portfolio in line with SBTi's guidance and plan to submit these targets for validation to the initiative in 2022.

Future Group Activity

We want to continue gaining a deeper understanding of how climate change might affect the business, and below we outline the future Group activity to support this.

Governance	We plan to maintain strong Board oversight, ensuring the Planet pillar, as part of our sustainability strategy, continues to take a lead. We will also continue setting the Board's strategic debates in a climate change context, which will be supported by periodic debates on climate-related risks and opportunities. In 2022 we will also incorporate ESG-related metrics into executive management remuneration plans (see page 155).
Strategy	We intend to build further understanding around how we systematically consider climate-related issues from a risk and opportunity perspective across business areas and in our strategic decision making; a key part of how we can achieve this includes driving forward the Strategic Management Actions set in 2021 that business areas are already prioritising (see page 71). Alongside these actions, we also plan to enhance central scenario planning and testing by developing climate-related scenarios specific to our own risk profile. We are also considering how these scenarios could be incorporated into the development of the Group's business plan. We will also be taking part in a second round of the Bank of England's CBES exercise in Q1 2022. This is expected to further explore participants' strategic responses to the climate scenarios published as part of the first round and the associated implications for their business models. During 2022, the Climate Executive Steering Group will maintain its oversight into the Group's business development and strategic processes to make sure climate is given appropriate consideration in long-term strategy and planning. It will also continue to consider the risk management challenges presented by climate change including oversight of the modelling of climate change risk and financial risk related to underwriting and investments.
Risk management	We will continue our robust approach towards the management of physical risk and intend examining in more depth inbound and outbound impacts in order to enhance understanding of transition risks. This includes through the use of central scenario planning as discussed above. 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.
Metrics & Targets	In 2022, we plan to submit our Science-Based Targets to the SBTi for their independent validation. The structured and measurable nature of the emission reduction targets will mean that, once validated, they will formulate the path we must take to ensure we meet our commitment of achieving net zero emissions by 2050 at the latest, which is in line with a 1.5°C emissions scenario.

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	70 and 72
– from buying electricity, heat, steam or cooling by the Group for its own use	70 and 72
Annual global energy consumption in kWh, being the aggregate of:	
– energy consumed from activities for which the Company is responsible	70
– energy consumed resulting from buying electricity, heat, steam or cooling by the Group for its own use	70
The proportion of GHG emissions and energy consumed relating to the UK and offshore area[1]	71 and 72
Methodology used to calculate emissions and energy consumption	72
At least one intensity metric in relation to emissions	73
Description of energy efficiency actions taken	75 and 86 ('operational' section)

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.

Environment

	Pages
Journey to net zero	12, 71
Recycling and waste management	70, 82
Science-Based Target initiatives	71
Scope 1, Scope 2 & Scope 3 emissions	72
Sustainable Development Goals	56
Sustainability report	54
TCFD report	76

Anti-bribery and anti-corruption

	Pages
Code of Business Conduct	20, 106
Ethical Code for Suppliers	82, 110
Fraud and money laundering	121, 125
Tax contribution	44, 67
Whistleblowing	125

Employees

	Pages
Diversity and inclusion	12, 61, 115, 128
Employee share incentive scheme	161, 232
Flexible working policy	64, 108
Gender pay gap	63
FTSE Women Leaders Review	63
Health and safety	64, 69
Parker Review	114, 128
Performance, pay and recognition	63, 65, 134
Training and development	59, 114
Workforce engagement	31, 65, 111

Business model

	Pages
Customer complaints	31
Net Promoter Score	31, 58
Pricing Practices Review	27, 28, 94, 108
Prompt payment code	110
Risk management	89
Talent pipeline	18, 114
UK Corporate Governance Code	96, 104
Values, strategy and corporate culture	23, 62, 105

Social and community matters

	Pages
Our Community Fund	68
Social mobility action plan	67
Volunteering	69

Human rights

	Pages
Living wage	65, 135
Mental wellbeing	64, 68
Modern Slavery Statement	65, 110, 131

Risk management

Our aim is to make risk management simple, well understood and embedded. Risk will provide oversight which is pro-active, proportionate 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 risks arising from the strategic plan.

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 rest of 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 has led significant cultural change to drive ownership of risks across the Group. The Group has a strong risk culture, and a mature and embedded Enterprise Risk Management 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 112 for governance structure

Risk appetite

Our risk appetite statements define the opportunities and associated 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 Enterprise Risk Management Framework sets out, at a high level, the Group's approach to setting risk strategy and managing risks to the strategic objectives and day-to-day operations of the business. The risk management framework is designed to manage the Group's risk proactively and to enable dynamic risk-based decision making.

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 pages 84 to 85 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 management *continued*

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 the partial internal model 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.

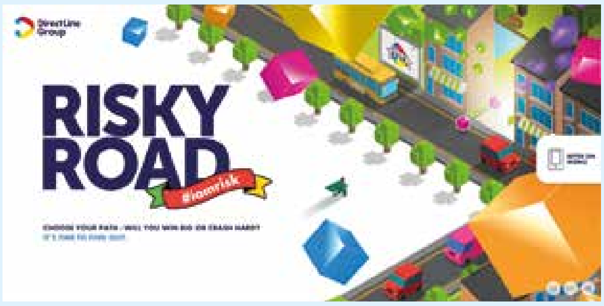
During the year, Risk has worked collaboratively across the Group to support the embedding of the new ways of working, including working closely with HR, the Agile Centre of Expertise and Group Audit. This activity included ensuring the Enterprise Risk Management Framework remained fit for purpose and efficient, whilst still enabling sufficient Board and Senior Manager oversight.

Risky Road Campaign

Having a good risk culture is critical to the organisation, and we use the Risk Communications Plan to influence a positive risk culture by driving a consistent understanding of risk management and the concept of risk ownership throughout the Group.

Our flagship risk campaign, **Risky Road**, built on the success of our previous campaigns by exploring risk-based decision making in a novel way, while continuing to remind our colleagues about the important part they play in managing risk.

We created an online computer game that challenged colleagues to guide their Risk Hero though myriad mazes and respond to risk-based questions for a chance to earn points and compete via league tables with people right across the business.



We used a number of communications channels to promote the game and risk management, including a launch video from the Chief Risk Officer, supporting intranet articles, digital advertising and interactive social media posts on Yammer.

The campaign reached a great number of staff across the Group, garnering over 7,000 click throughs and online interactions, and more than 1,500 individual users.

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 Relative size of risk Trend over next 12 months – 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 strategic plan include reserve, underwriting, distribution, pricing and reinsurance risks. Issues relating to Covid-19, the Pricing Practices Review and claims inflation risk have been a key area of focus for the Group in 2021 and the main driver of the increasing trend in insurance risk. Claims trends have been significantly impacted by Covid-19, leading to uncertainty in claims reserving and pricing. In addition, in 2022 and beyond there is a risk of higher than expected claims inflation driven by customer behaviour, a rebound in global growth and supply chain disruption from the UK's new trading relationships.	Uncertainty following the implementation of the FCA Pricing Practices Regulations will continue to have financial impacts on the market in 2022. We have used scenario testing to understand the potential financial impacts of these risks and continue to monitor these risks closely. 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 and Motor.
Market Risk Relative size of risk Trend over next 12 months – 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. Global geopolitical, economic and other uncertainty 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 amount of illiquid investments we hold. We also use risk reduction techniques such as hedging foreign currency exposures with forward contracts.
Operational Risk Relative size of risk Trend over next 12 months – stable	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 become manifest as a result of inadequate or failed internal processes or systems, human error or because of external events. Our approach is to proactively manage our operational risks to mitigate potential customer harm, regulatory or legal censure, and financial or reputational impacts. The stable trend in operational risk is driven mainly by the progress demonstrated by the business in delivering key strategic technology improvements that strengthen resilience and have enabled the Group's transition to a more flexible operating model, utilising both virtual and office-based working solutions. We have in place robust operational processes and systems, including prevention and detection measures, that seek to ensure the Group is well placed to absorb and/or adapt to internal or external events that have the potential to impact our customer operations and the wider business more generally.	With large numbers of staff working mainly from home, significant progress has been made to improve the performance and ability of our IT systems, focusing on delivering system stability and optimising capability. Streamlining change implementation and ensuring we drive effective prioritisation in our investment decisions has remained a key area of management focus, to support the Group in achieving its strategic aims, whilst also actively strengthening its controls to further mitigate impacts from potential risk events. Finally, the Cyber threat landscape has continued to remain volatile globally, including the increase in ransomware attacks, and we have introduced new controls, strengthened existing ones, and enhanced our suite of automated monitoring and reporting, to enable us to respond to malicious and unintended threats from both internal and external entities.

Risk management *continued*

Principal risks and uncertainties continued

Principal risk	Description	Risk commentary	
Regulatory & Compliance Risk Relative size of risk Trend over next 12 months – 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. Pricing practices within the general insurance market has remained a key area of focus for the FCA and for the Group. We have devoted a lot of attention and resource with the intention of enabling the Group to meet the FCA's Pricing Practices Review requirements within the challenging deadlines prescribed by the FCA, and to be in a position to deliver the intended customer outcomes. Focus has also been given to the ability of the Group to trade effectively post the implementation of the FCA's Pricing Practices Review requirements.	For product lines which sit outside of the FCA's pricing remedies, the Group continues to operate to a set of conduct pricing principles which enable the fair pricing of business across our book and the provision of fair outcomes for our customers. We have maintained regular and open dialogue with both the FCA and PRA on our responses to climate change and the Covid-19 pandemic. We have also engaged with HM Treasury and participated in the PRA's Quantitative Impact Study on the UK review of the Solvency II framework. 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 Relative size of risk Trend over next 12 months – 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 material counterparty and actively monitor credit exposures. In addition, we only purchase reinsurance from reinsurers with at least 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 Relative size of risk Trend over next 12 months – 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, the UK's new trading relationships and FCA's Pricing Practice Review. In addition, the adoption of agile ways of working allows 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.

Potential effects of Covid-19 and the UK's new international trading relationships on inflation

The UK's new international trading relationships may have had an impact on claims inflation and may still do so, although the Covid-19 pandemic continues to mask the effects of these relationships. Certain risks related to Brexit could still occur or be exacerbated and we continue to be alert to possible developments.

Emerging risks

Emerging risks are defined by the Group as newly developing or changing threats or opportunities, external to the Group, that are subject to a high degree of uncertainty but have the potential to materially impact 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 emerging risks; and
- mitigate the impact of emerging risks that could impact the delivery of the strategic plan.

The Group records emerging risks within an Emerging Risk Register. An update on emerging risks is presented to the Board Risk Committee annually and is supplemented by deep dives on selected emerging risks.

The most notable emerging risks currently being monitored via the emerging risks process are outlined below:

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 risk can be divided into physical and transition risks. Both of these categories can manifest themselves through a range of existing financial and non-financial risks, including insurance, market, operational, strategic and reputational risks.

In 2021, we participated in the Bank of England's Climate Biennial Exploratory Scenario ('**CBES**'), which was designed to test the resilience of the financial system to the physical and transition risks from climate change. The CBES covered both quantitative scenario analysis, spanning a 30-year time horizon, and qualitative assessment of management actions and the sustainability of different business models.

We continue to monitor these risks closely and to develop our climate change modelling capability. Further details on our risk management approach to climate change are included on pages 84 to 85, in our TCFD report.

Ethical use of data

The insurance industry is gathering and processing greater volumes of data than ever before. The adoption of artificial intelligence and machine learning introduces the potential to create unfair outcomes if data is not processed responsibly. The use of technology to automate decisions could magnify the impact of problems caused by inaccurate or biased data.

The Group has developed a Data Ethics Framework which introduces a set of principles to drive the ethical use of data and a new governance model to ensure appropriate visibility and escalation of ethical concerns. Furthermore, the Group has an established Data Ethics Steering Group which gathers internal and external views on data ethics, reviews business propositions on data use and helps to drive the embedding of the data ethics framework across the Group.

Global financial instability

Global financial instability can occur through unexpected or unpredictable external events that affect fundamental macroeconomic variables, such as GDP growth, consumption, inflation or unemployment. As markets worldwide continue to recover from the impact of Covid-19, there is a risk that global financial instability could be triggered and/or worsened by numerous external events, including natural disasters, war, terrorism, natural resource or fuel shortages and global technological failures. Should the Russia-Ukraine situation continue to deteriorate, there is a likelihood that the impact on global financial instability will increase.

The principal impacts of global financial instability would likely be felt on the Group's investment portfolio, through changes in credit spreads and sovereign yields. Depending on the cause, there may also be operational and insurance risk impacts to consider.

The Group's investment portfolio is already positioned relatively defensively, reducing the potential exposure to global financial instability. However, if global financial instability were to materialise, further steps could be taken, such as shifting the portfolio further towards 'defensive' sectors, pausing reinvestment or increasing the allocation to cash and sovereign debt.

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 95, 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 91 to 92. Note 3 to the consolidated financial statements starts on page 192 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 ("the **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. By its nature, a strategic plan comprises a series of underlying assumptions which can be uncertain in nature and rely on judgement. Each year, the Group's Risk Function assesses the Plan and provides the ORSA to the Board which supports the Board in concluding on the Group's viability.

When reviewing the 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 Plan. The Board has assessed the principal risks of the Group over the duration of the planning cycle. All of the Group's principal risks, as outlined on pages 91 to 92 were reviewed as part of the preparation of the ORSA and the outlook of those risks over the period covered by the Plan was taken into account (i.e. whether the outlook for each risk was increasing, broadly static or decreasing over the period of the Plan). The Plan did not introduce any new material risks other than those already contained within the Group's Material Risk Register. This review also included reviews of the Group's solvency and liquidity position, up to 31 December 2023 with a further two years of indicative planning from 2024 to 2025. The first year following approval of the 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. As the Plan and the ORSA are used for planning over a timeframe of four years, to 31 December 2025, this has been selected as the most suitable period for the Board to review the Group's viability.

The Group's Risk Function has carried out an assessment of the risks to the Plan and the dependencies for the success of the Plan. The key scenarios considered were in relation to the impact of the FCA's Pricing Practices Review ("**PPR**") on customer behaviour, the legislative and regulatory environment and the likely time period of continued Covid-19 related effects including the impact on the underwriting cycle, motor claims frequency, travel and supply chain disruption and claims inflation. The key judgements and assumptions applied were as follows:

PPR: the Group's Plan includes a scenario for the impact of PPR from 2022 onwards based on assumptions made on how new business and renewal prices equalise and new business premium inflation in the Motor and Home markets. The Group has made a judgement on the impact of PPR, whilst acknowledging that there are inherent limitations, such as limited historical data on which to base assumptions. Stress testing has been performed on the assumptions, included on the Plan, with a focus on premium inflation being lower than that assumed.

Legislative and regulatory environment: the Plan is consistent with the current Ogden discount rate of minus 0.25%. The table on page 42 in the Finance review quantifies the impact on the Group of a change in the Ogden discount rate of plus or minus 1.0 percentage points. Other scenarios considered included an increase in levies and tax rates.

Covid-19 pandemic: in addition to the scenarios for the implementation of PPR, the Plan has been stress tested for market premium inflation assumptions, following deflation during the Covid-19 pandemic, as well as the impact of a deep UK recession triggered by the end of furlough and a spike in unemployment leading to a reduction in the market for certain insurance products. Although there have been a number of significant developments in 2021, such as the success of the vaccination programme, these scenarios remain relevant in quantifying severe but plausible business impacts. The stress tests have focused on scenarios where premium inflation is lower than the Plan. In addition, there is uncertainty in future claims costs. The risks associated with Covid-19 include frequency of Motor claims, travel disruption, increased demand for building supplies and labour, and reduced supply as a result of increased global competition for products or production shortages. The scenarios applied have focused on claims inflation and claims frequency.

The scenarios have been used to challenge the Group's contingent management actions, which are a series of actions designed to restore the solvency ratio to within our stated risk appetite range after suffering an event which results in a solvency ratio that is lower than our risk appetite range. These actions include short-term actions, such as restriction of dividends or other capital distributions, which can return or preserve capital surplus quickly at certain times of the year, to longer-term actions, such as reducing reinsurance retention levels or reducing marketing or investment spend.

The capital and solvency requirements of the Group have been subject to stress tests over the duration of the Plan using the above inputs. 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 (2021 to 2025).

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 U K Insurance Limited, the Group's principal underwriter, i.e. a reduction of own funds to below the solvency capital requirement. The purpose of this reverse stress test was to assess the coverage and scope of the internal economic capital model and there were no findings that invalidate the internal model.

The results of the key sensitivities that have been applied to the Group's Solvency II balance sheet at 31 December 2021 in respect of the solvency capital ratio are shown on page 40, and applied to profit before tax in respect of claims reserves on page 42 of the Finance review.

Climate change: during the year, the Group undertook a number of stress and scenario tests, designed to reflect the potential impact of short- and long-term climate change risk on the Group's balance sheet and solvency position. The tests are discussed in more detail on pages 79 to 80. The overall conclusion of these tests was that there could be breaches in the Group's risk appetite, however a combination of contingent management actions could be deployed in each scenario to address the risks and allow the business to recover to above risk appetite.

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 2025.

Statement of the Directors in respect of the Strategic report

The Board reviewed and approved the Strategic report on pages 1 to 95 on 7 March 2022.

By order of the Board

Penny James
Chief Executive Officer

7 March 2022