Company Registration No: 01179980

U K Insurance Limited

Annual Report and Financial Statements

31 December 2019

Direct Line Group Company Secretariat
Churchill Court
Westmoreland Road
Bromley
BR1 1DP

U K Insurance Limited

01179980

Annual Report and Financial Statements

Contents

Officers and professional advisers

Directors:	M N Biggs D M Gray M J Gregory J C Hanson T W Harris P J James S R E C James F C McBain G N Stewart R C Ward
Company Secretary:	R C Clifton
Registered office:	The Wharf Neville Street Leeds LS1 4AZ
Auditor:	Deloitte LLP 1 New Street Square London EC4A 3HQ
Company registration	Registered in England and Wales

Strategic report
For the year ended 31 December 2019

The Directors present their strategic report for the year ended 31 December 2019.

Activities and business review

Activity

The principal activity of U K Insurance Limited (the "Company") is the provision of general insurance.

The Company is a member of the Direct Line Group (the "Group") headed by Direct Line Insurance Group plc ("DLIG") of which the Company is a subsidiary. The Group provides the Company with access to all Group central resources and provides policies in key areas such as finance, risk, human resources and environmental. For an understanding of the Group's business as a whole, please refer to the DLIG annual report and accounts. Copies can be obtained from Direct Line Group Company Secretariat, Churchill Court, Westmoreland Road, Bromley, Kent, BR1 1DP, the Registrar of Companies or through the Company's website at www.directlinegroup.co.uk

The Company is authorised by the Prudential Regulation Authority ("PRA") and regulated by the PRA and the Financial Conduct Authority ("FCA").

Review of the year

Business review

The Directors are satisfied with the Company's performance during the year. The Company may take into account proposals from within the Group, in seeking future opportunities for growth.

Profit on ordinary activities before taxation was down 13% to £369.5 million (2018 restated: £422.9 million). The impact of benign weather in 2019 was more than offset by lower reserve releases, in part Ogden Discount Rate related, and lower investment gains in 2019.

The Civil Liability Act 2018 introduced a new framework for setting the personal injury ("Ogden") discount rate, requiring the Government to reset the Ogden Discount Rate by reference to low risk rather than very low or zero risk investments. Following a Government review, on 15 July 2019 the Lord Chancellor announced a new Ogden Discount Rate of minus 0.25% to take effect from 5 August 2019. The Ogden Discount Rate will be reviewed again, at the latest in 2024. The effect of the new rate on the Company's reserves is explained below.

New products, and new routes to market and technology, particularly in cars, are emerging. In response we are preparing for a shift in the risk pool and an increase in the importance of data and analytics. The Company's new brand Darwin is using new pricing technology for motor customers who purchase via the Price Comparison Website channel and the Company's new motor insurance platform is being rolled out to make customer journeys easier.

Key performance indicators

Combined operating ratio (%)		
Definition - A measure of financial year underwriting profitability. A combined operating ratio of less than 100% indicates profitable underwriting. The combined operating ratio is the sum of claims, expense and commission ratios and compares the cost of doing business against net earned premium generated. *Aim* – The Company aims to make an underwriting profit.	**2019:**	**95%**
	2018 restated:	94%

Gross written premium (£ million)		
Definition - The total amount customers are required to pay for insurance coverage on policies issued by a company during a specific period of time. They are the principal source of an insurance company's revenues and appear on the top line of the profit and loss account. *Aim* – The Company aims to increase premium income where this can be done in a profitable manner whilst acting in the best interests of its customers.	**2019:**	**3.203.1**
	2018:	3212.0

Strategic report
For the year ended 31 December 2019

Solvency capital ratio[1] (%)		
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* – The Company seeks to hold capital resources such that in the normal course of business, the Solvency II capital coverage ratio is maintained at a minimum threshold of 125% of its SCR.	**2019:**	**145%**
	2018:	165%

Note:
1. Estimates based on the Company's Solvency II partial internal model.

Customer complaints (%)		
Definition - The number of complaints received during the year as a proportion of the average number of in-force policies. *Aim* – This measure indicates the level of customer service we provide. The Company aims to improve this over time.	**2019:**	**0.63%**
	2018:	0.77%

Net promoter score[1] (points)		
Definition – This is an index that measures the willingness of customers to recommend products or services to others. It is used to guage customers' overall experience with a product or service, and customers' loyalty to a brand. *Aim* – The launch of the Company's customer experience strategy, along with a new transactional feedback tool and improved propositions have increased the Company's overall brand score.	**2019:**	**155.0**
	2018:	145.6

Note:
1. On an aggregated 12-month rolling basis.

Financial performance

The Company's financial performance is presented in the profit and loss account on page 16 and statement of comprehensive income on page 17.

Gross premiums written of £3,203.1 million (2018: £3,212.0 million) decreased by 0.3% as modest reductions in Motor and Home were offset by growth in Rescue and other personal lines and Commercial.

Prior-year reserve releases decreased this year but continued to be significant at £294.0 million (2018: £404.0 million) and were equivalent to 9.8% of net earned premium (2018: 13.1%) and were concentrated towards more recent accident years. In 2019, prior-year reserves increased by £16.9 million in relation to a change in the Ogden Discount Rate to minus 0.25% (2018 £54.8 million reserve release). Assuming current claims trends continue, prior-year reserve releases are expected to reduce further in future years, although they are expected to remain a significant contribution to profits.

The Company's combined operating ratio increased by one percentage point to 95% (2018: 94%), with the loss ratio remaining constant whilst the expense and commission ratios increased.

The Company's technical result reduced by £50.0 million to £141.8 million (2018 restated: £191.8 million), mainly due to lower prior-year reserve releases of £110.0 million offset by decreased major weather-related claims of £6 million, as the the major freeze event in Q1 2018 was not repeated (2018: £75 million major weather-related claims).

Profit on ordinary activities before taxation reduced by £53.4 million to £369.5 million (2018 restated: £422.9 million) mainly as a result of reductions in the technical result.

Investment income decreased by £13.6 million to £143.3 million (2018: £156.9 million). This was due, primarily as a result of lower assets under management. Other income decreased by £4.7 million to £134.8 million (2018: £139.5 million) as a result of lower instalment income.

At the end of the year, the balance sheet reflected total assets of £8,224.7 million (2018 restated: £8,374.7 million) and total equity was £1,945.1 million (2018 restated: £1,659.6 million).

Dividends

Dividends of £98.0 million were paid during the year (2018: £405.0 million). The Directors have declared a second interim dividend of £300.0 million (2018: £nil).

Debt repurchase

On 7 March 2019 the Company repaid £250 million of its subordinated debt to its parent, Direct Line Insurance Group plc.

Strategic report
For the year ended 31 December 2019

***Financial performance** continued*

Solvency capital

The Company's solvency capital ratio as at 31 December 2019 was 145%. The Board has taken into account the developments in the political and economic environment. While there remain many uncertainties, including the outcome of the UK's trade negotiations with the EU, it considers those risks to have reduced somewhat but still considers it appropriate to operate above its risk appetite range of around 140%. In normal circumstances, the Board expects the Company to operate around this solvency capital ratio.

Principal risks and uncertainties

The Company's risk management objectives are set out in note 3 to the financial statements.

Brexit

The Company prepared for the possibility of a disruptive Brexit. The UK left the EU on 31 January 2020. The terms, if any, of any future trading relationship between the UK and the EU are not yet known and there remains uncertainty and the possibility of disruption, particularly at the end of the implementation period. Although the Company is predominantly a UK business, it does, for example, have exposure to financial markets and imports goods and services to fulfil insurance claims. The Group has been monitoring events carefully and has proactively taken steps to mitigate the likely impact on the Group and the Company to the extent it is considered appropriate and proportionate to do so, given the considerable uncertainties; however, in the event of a disruptive end to the implementation period the Company will not be immune. For more information, please refer to note 3.1.3.

Section 172(1) Statement and engagement with stakeholders

The Group is a leading motor, home and commercial insurer which depends on the trust and confidence of, and the quality of its engagement with, its stakeholders to operate sustainably in the long term. It seeks to put its customers' best interests first, invest in its employees, support the communities in which it operates and strives to generate sustainable profits for shareholders.

The Directors of the Company have acted in accordance with their duties codified in law, in particular their duty to act in the way in which they consider, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole, having regard to the stakeholders and matters set out in section 172(1) of the Companies Act 2006.

The Directors of DLIG, the ultimate parent entity of the Group, are also the Directors of the Company. Except in cases in which a decision relates solely to the Company, such as the payment of a dividend, the debates and decisions of the Directors concern both companies. The Group's governance framework, which is consistent with the 2018 UK Corporate Governance Code, applied to the Company during the year. Further information about the Company's governance arrangements can be found in the Directors' report on page 7. The Company relies on resources made available by the Group including staff and suppliers who are respectively employed and contracted by a fellow subsidiary undertaking, DL Insurance Services Limited. Disclosures relating to employees and suppliers may be found in the financial statements of DL Insurance Services Limited and the DLIG annual report and accounts for the year ended 31 December 2019.

The Group's vision, purpose and values are set out in the DLIG's strategic report for the year ended 31 December 2019 on pages 20 and 21 and further information on the Group's five-pillar sustainability strategy, which includes engagement with the community and protection of the environment and which applies to the Company, can be found on pages 59 to 73 in DLIG's 2019 annual report.

Examples of how the Group has engaged with its stakeholders and had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the Company during the financial year are detailed in DLIG's corporate governance report for the year ended 31 December 2019 on pages 88 and 89. The Company is the principal underwriter of the Group and the combined Board meetings of DLIG and the Company monitor customer engagement by receiving customer experience and conduct and complaints reports at each scheduled meeting. During 2019, the Board focused on improvements in pricing transparency and customer purchasing and claims experiences. During the year, the Group held its first Capital Markets Day ("CMD") at which investors and analysts were able to see how investments in technology and staff training are supporting our customer experience. More information about the Group's 2019 CMD can be found on the Group's corporate website.

The Directors consider the likely consequences of any decision in the long-term. Each company within the Group is bound by Group policies consistent with the Group's culture in all key areas including supplier management and outsourcing, customer conduct, human resources and the environment. Group policies and minimum standards applied by the Company during the financial year included, for example, the capital management minimum standard to which the Directors adhered when making decisions concerning the management of the Company's capital and declaration of dividends. Details of decisions made regarding dividends can be found on page 3.

Strategic report
For the year ended 31 December 2019

The Directors and management operate the business in a responsible manner with the aim of ensuring that the Company maintains a reputation for high standards of business conduct and good governance. Each year, the Directors of DLIG, who are also the Directors of the Company, review the Group's Code of Business Conduct which embodies the Group's culture, purpose and values. The Code of Business Conduct provides guidance to the Group's employees and contractors on the high standards of professional and ethical conduct expected of them and aims to preserve the Group's and the Company's reputation for high standards of conduct. Information on the Group's Ethical Code for Suppliers can be found in the DLIG annual report and accounts for the year ended 31 December 2019 on page 67. The Company's statement on Modern Slavery can be found on the Group's corporate website.

Outlook

High level strategies of the Group are determined by the Board of DLIG and these are shown in the DLIG Annual Report and Accounts for the year ended 31 December 2019. The directors consider that the Company's principal activities will continue unchanged for the foreseeable future. For this purpose the foreseeable future is taken to mean a period of at least twelve months from the date of signing of these financial statements.

Approved by the Board of Directors and signed on behalf of the Board by:

T W Harris
Director
2 March 2020

Directors' report
For the year ended 31 December 2019

The Directors present their annual report and the audited financial statements for the year ended 31 December 2019.

The Company has chosen, in accordance with section 414c(11) of the Companies Act 2006, and as noted in this Directors' report, to include certain additional matters in its strategic report, that would otherwise be required to be disclosed in this Directors' report:

- details of dividends declared;
- a summary of company's trading activities, future prospects and principle activities of the Company are included in the Business review section of the strategic report;
- risk management of financial instruments disclosures are stated in note 3 to the financial statements.

Directors and Secretary

The names of the present Directors and Company Secretary are listed on page 1.

From 1 January 2019 to date the following changes have taken place:

Director	Appointed	Resigned
T W Harris	1 October 2019	
P R Geddes		9 May 2019
M A Holliday-Williams		30 June 2019
C E Thompson		9 May 2019

Going concern

Having made due enquiries, the Directors reasonably expect that the Company has adequate resources to continue in operational existence for at least 12 months from the date of approval of the financial statements. Accordingly, the Directors have adopted the going concern basis for the foreseeable future in preparing the financial statements.

Existence of branches outside the UK

The Company has a branch, as defined in section 1046(3) of the Companies Act 2006, in the Republic of South Africa

Employees

All staff are employed by a fellow subsidiary undertaking of DLIG, DL Insurance Services Limited. Disclosures relating to employees may be found in the annual report and financial statements of DL Insurance Services Limited.

Disclosure of information to the Auditor

Each person who was a Director of the Company on the date of approval of this report confirms that:

a) so far as the Director is aware, there is no relevant audit information, being information needed by the auditors in connection with preparing their report, of which the Company's Auditor is unaware; and

b) each Director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Auditor is aware of that information.

This confirmation is given and shall be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Auditor

Deloitte LLP have expressed their willingness to continue in office as Auditor and it is the intention of the Directors to reappoint Deloitte LLP under the deemed appointment rules of section 487 of the Companies Act 2006.

Directors' indemnities

DLIG has made qualifying third-party indemnity provisions for the benefits of the Directors of the Company which remain in force at the date of this report.

Directors' report
For the year ended 31 December 2019

Statement of corporate governance arrangements

The Directors are committed to maintaining the highest standards of corporate governance, but do not regard it to be necessary or appropriate for the Company formally to adopt a corporate governance code. The Group provides each member company with access to its central resources and provides policies in all key areas such as finance, risk human resources and the environment. These central resources and policies are aligned to the Group's governance framework, which is consistent with the 2018 UK Corporate Governance Code.

The core elements of the Group's governance framework are the:

- schedule of Matters Reserved to the Board and the Board Committees' Terms of Reference;
- High Level Control and System of Governance Framework document;
- Risk appetite statements;
- Enterprise Risk Management Strategy and Framework;
- Group policies, which address specific risk areas, are aligned to the Group's risk appetite, and inform the business how it needs to conduct its activities to remain within risk appetite; and
- Minimum Standards, which interpret the Group policies into a set of requirements that can be implemented throughout the Group.

During the year, the Company complied with the Group's governance framework. Further information on the system of governance in operation throughout the Group can be found in DLIG's 2019 Annual Report and Financial Statements.

Business Relationships

Examples of how the Directors have had regard to the need to foster the Company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the Company during the financial year can be found in the section 172(1) statement on page 4.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law, including FRS 101 "Reduced Disclosure Framework", and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company at the end of the year and the profit or loss of the Company for the financial year. In preparing these financial statements the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable United Kingdom standards, comprising FRS 101 have been followed subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose, with reasonable accuracy, the Company's financial position at any time; and enable them to ensure the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the Company's assets and, hence, taking reasonable steps to prevent and detect fraud and other irregularities.

Approved by the Board of Directors and signed on behalf of the Board by:

T W Harris
Director

2 March 2020

Independent Auditor's report to the members of U K Insurance Limited
For the year ended 31 December 2019

Report on the audit of the financial statements

1. Opinion

In our opinion the financial statements of UK Insurance Limited (the 'Company'):

- give a true and fair view of the state of the Company's affairs as at 31 December 2019 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the profit and loss account;
- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity; and
- the related notes 1 to 28 of the financial statements , excluding the capital adequacy disclosures in note 3 and note 28 calculated in accordance with the Solvency II regime which are marked as unaudited.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced Disclosure Framework".

2. Basis for opinion

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

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

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

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Valuation of insurance liabilities - The frequency and severity assumptions for large bodily injury claims - The inflation and discount rate assumptions for periodic payment orders ("PPOs") • Impairment of investments not held at fair value
Materiality	The materiality that we used was £25.2m, which approximates 5.8% of three-year average profit before tax.
Scoping	Audit work to respond to the risks of material misstatement was performed directly by the audit team.
Significant changes in our approach	There have been no significant changes in our approach.

4. Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where: • the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or • the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.	We have nothing to report in respect of these matters.

Independent Auditor's report to the members of U K Insurance Limited
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5. Key audit matters

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

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

5.1. Valuation of insurance liabilities

Refer to page 24 (Accounting Policies) and page 55 (Financial Statements)

The Company's insurance liabilities total £3.8 billion (2018: £4.0 billion) and represent the single largest liability on the balance sheet. Valuation of these liabilities requires management to select methods and assumptions that are subject to high levels of estimation uncertainty. Consequently, small changes in these methods or assumptions can materially impact the valuation of these liabilities. We have identified the following two key areas of focus for our audit given their significance to the company result and the high level of estimation uncertainty. We have also identified these as potential fraud risk areas.

5.1.1. The frequency and severity assumptions for large bodily injury claims

Key audit matter description	The frequency and severity of large bodily injury claims have a significant impact on the valuation of the insurance liabilities and the setting of these assumptions is driven by a variety of factors. These factors include the completeness and accuracy of source data, the transparency of any changes in the reporting of large bodily injury claims, and actuarial assumptions being consistent with emerging data and market factors. As a result of these factors, there is a significant level of estimation uncertainty in the valuation of these claims, which increases the susceptibility of the balance to material misstatement due to error and fraud. A key market factor that significantly impacts the valuation of large bodily injury claims is the Ogden discount rate. Following the Civil Liability Act passing Royal Assent in 2018, the Government announced a change in the discount rate from -0.75% to -0.25% in July 2019 in England and Wales. At 31 December 2018 the Company selected an estimate of 0% for valuing lump sum bodily injury claims, however following the announcement in July 2019 the Company has elected to reserve for these claims using a rate of -0.25% in 2019. This change in rate impacted the valuation of the insurance liabilities adversely by £16.9 million.
How the scope of our audit responded to the key audit matter	We have gained a detailed understanding of the end-to-end claims and reserving process and obtained an understanding of relevant controls. Our work included attendance at the year-end reserving committee meeting in order to observe the operation of a key management review control. In order to gain assurance over the completeness and accuracy of source data used in the Company's actuarial calculations and by our in-house actuarial specialists in performing their work, we have tested the data reconciliation controls and performed reconciliations on the actuarial data back to the financial ledger. Having done this, we worked with our actuarial specialists to: • Challenge the Company's frequency and severity assumptions through market benchmarking, considering the comparison in the context DLG's portfolio; • Review and challenge the Company's claim development patterns, and identify any emerging trends, by using our in-house reserving software; • Analyse the consistency in reserving strength and reserve releases in comparison with prior years; and • Review and challenging the output of the Company's Ogden sensitivity model and assess the adequacy of the Company's disclosures regarding the rate change.
Key observations	In the prior year we considered the frequency and severity assumptions for large bodily injury claims to be reasonable, albeit slightly prudent. In the current year we have concluded that the assumptions continue to be reasonable and the insurance liabilities are prudent, albeit somewhat less prudent than last year, as Direct Line's actuaries have given credit for recent favourable experience.

5.1.2. The inflation and discount rate assumptions for PPOs

Key audit matter description	The Company is required to settle a proportion of large bodily injury claims as PPOs rather than lump sum payments. The valuation of PPOs has a material impact on the financial statements, with liabilities totalling £774.0 million (2018: £848.2 million) on a discounted gross basis as detailed in note 2. The PPOs are sensitive to the economic assumptions selected and as at 31 December 2019 the Company valued PPOs using an inflation rate of 4% (2018: 4%) and a discount rate of 4% (2018: 4%). These assumptions represent a key source of estimation uncertainty for the Company which increases the susceptibility of the balance to material misstatement due to error and fraud.
How the scope of our audit responded to the key audit matter	We have gained a detailed understanding over management's process for setting these assumptions and obtained an understanding of relevant controls surrounding the setting of the PPO inflation rate and discount rate. In addition, we tested the relevant direct and precise business control, which the Company performs weekly, over the completeness of the PPO listing; this is a key data input which has a material impact on the PPO assumptions and hence the valuation. We have worked with our actuarial specialists to challenge: • The PPO inflation assumption through inquiries with the Actuarial Director, reviewing relevant supporting documentation and benchmarking against market economic data and peers; • The Company's sensitivity testing on the PPO inflation assumption; • The selected discount rate with reference to current and future performance of the assets backing the PPO liabilities; and • The consistency of the approach with that used in the 2018 year-end valuation and the appropriateness of maintaining that approach in light of the current economic climate and market benchmarking against industry peers.
Key observations	We have determined that the inflation and discount rate assumptions used in the calculation of the PPO claims reserve are in the middle of a reasonable range.

5.2. Valuation of investments not held at fair value

Refer to page 25 (Accounting Policies) and page 52 (Financial Statements)

Key audit matter description	We have identified a key audit matter in relation to investments that are not held at fair value totalling £588 million (2018: £592 million). Our work primarily focused on the following three portfolios, which are less liquid and represent a higher credit risk relative to the majority of DLG's investment portfolio: • Commercial real estate loans • Infrastructure debt • Private placement bonds Given the Company continues to recognise and measure financial instruments under IAS 39, these debt instruments are measured at amortised cost and require the recognition of an impairment when an incurred loss event arises. Significant management judgement is required in determining if an incurred loss event has occurred and, in the instance an event has occurred, there is significant estimation uncertainty in determining the impairment charge.

Independent Auditor's report to the members of U K Insurance Limited
For the year ended 31 December 2019

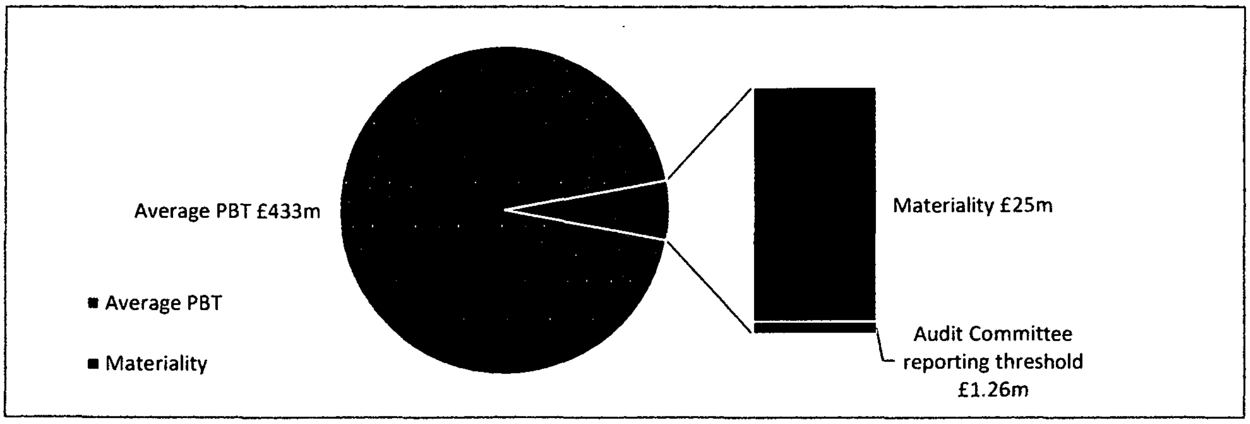
How the scope of our audit responded to the key audit matter	We have obtained an understanding and tested the key controls that mitigate the risk over the valuation of investments not held at fair value. Our work included attendance at the year-end impairment review meeting in order to observe the operation of a key management review control. • In addition, we performed the following audit procedures: Traced a sample of interest payments to bank during the year to test for default or delinquency in interest payments; • Engaged our in-house complex pricing team to determine an independent fair value of these assets and identify any significant decreases in fair value below book cost; • Assessed the need for impairment on a collective basis through analysing significant macroeconomic and sector specific developments, such as the ongoing high street decline; and • Challenged management on loans of interest where indicators could point to issuer financial difficulty, obtaining evidence to assess whether the position taking by management is reasonable.
Key observations	We considered the accounting treatment applied to be reasonable. In performing our procedures, we did not note any indicators of material impairment.

6. Our application of materiality
6.1. Materiality

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

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

Materiality	£25.2million (2018: £25.2million)
Basis for determining materiality	Materiality was determined as approximately 6.0% (2018: 5.5%) of three-year average profit before tax, excluding the impact of the Ogden rate discount change on year-end results.
Rationale for the benchmark applied	We determined that the critical benchmark for the company was average profit before tax. This measure uses a threeyear average of profit before tax which we deemed appropriate due to the inherent volatility of profits in the insurance industry. We also elected to exclude the impact of the Ogden discount rate change to 0% in the 2018 results and -0.25% in the 2019 results due to the non-recurring nature of these events. We also considered this measure to be suitable having compared to other benchmarks: our materiality equates to 6.8% (2018: 5.9%) of statutory profit before tax, 0.8% (2018: 0.8%) of gross earned premium and 1.3% (2018: 1.4%) of total equity.



Independent Auditor's report to the members of U K Insurance Limited
For the year ended 31 December 2019

6.2. Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Performance materiality for the Company was set at 70% of Company materiality for the 2019 audit (2018: 70%) and this equates to £17.6 million (2018: £17.6 million). In determining performance materiality, we considered the following factors:

- We have audited the Company for a number of years and so have knowledge of both the Company and the environment it operates in;
- Our ability to rely on controls over a number of significant business processes;
- Our past experience of the audit, which has indicated a low number of corrected and uncorrected misstatements identified in prior periods; and
- Misstatements noted in prior periods have not been indicative of deficiencies in internal control and so there is a low likelihood they will occur in the current period.

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £1.26 million (2018: £1.26 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. An overview of the scope of our audit

7.1. Scoping

The scope of our audit was determined by obtaining an understanding of the Company and its environment, including internal control and assessing the risks of material misstatement. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7.2. Our consideration of the control environment

Business processes and financial reporting controls

In planning our 2019 audit we identified 12 business cycles that were material to the Company's financial reporting processes. These cycles spanned the Company's material transactions and account balances including the premiums, claims, reinsurance, expenses, and investments cycles and part of the reserving cycle relating to reconciliation of data, and we intended to rely on the business controls associated with all of these cycles. Having completed our testing over the operating effectiveness of business controls associated with these cycles, through a combination of current period testing and reliance on prior period testing, we concluded that we were able to rely upon the business controls associated with all 12 cycles.

IT Controls

In planning our 2019 audit we identified 7 systems that were material to the Company's financial reporting processes. These systems handled data relating to premiums and claims, and we intended to rely on the IT and business controls associated with these systems. Having worked with our in-house IT specialists to assess the operating effectiveness of the IT controls associated with these systems, as well as the wider general IT control environment across the Company, we were able to rely upon the IT controls associated with all 7 systems identified.

8. Other information

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

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

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

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

We have nothing to report in respect of these matters.

9. Responsibilities of directors

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

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

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

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

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud and non-compliance with laws and regulations are set out below.

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

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

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

11.1. Identifying and assessing potential risks related to irregularities

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

- the nature of the industry and sector, control environment and business performance including the design of the Company's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- the Company's own assessment of the risks that irregularities may occur either as a result of fraud or error that was approved by the Board Risk Committee of the Parent Company, Direct Line Insurance Group plc on 6 February 2020;
- results of our enquiries of management, internal audit, and the audit committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the Company's documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations; and
- the matters discussed among the audit engagement team and involving relevant internal specialists, including tax, valuations, pensions, IT and industry specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

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

We also obtained an understanding of the legal and regulatory framework that the Company operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act and tax legislation. In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the Company's ability to operate or to avoid a material penalty. These included the Company's operating licence and regulatory solvency requirements, such as those under the relevant Solvency II requirements and those required by the PRA and FCA.

11.2. Audit response to risks identified

As a result of performing the above, we identified valuation of insurance liabilities and valuation of investments not held at fair value as key audit matters related to the potential risk of fraud or non-compliance with laws and regulations. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to those key audit matters.

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

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

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

Report on other legal and regulatory requirements

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

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

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

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

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

13.1. Adequacy of explanations received and accounting records

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

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

We have nothing to report in respect of these matters.

13.2. Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report in respect of these matters.

14. Other matters

14.1 Auditor tenure

Following the recommendation of the audit committee of Royal Bank of Scotland Group plc ("RBSG"), which at the time owned Direct Line, we were appointed by the Board of Directors of RBSG on 21 March 2000 to audit the financial statements for the year ending 31 December 2000 and subsequent financial periods. When the Group became independent of RBSG the Group's Board reappointed us to audit the newly demerged Direct Line Insurance Group, including UK Insurance Limited. Taking into account our service to predecessor organisations, the period of total uninterrupted engagement including previous renewals and reappointments of the firm is 20 years, covering the years ending 31 December 2000 to 31 December 2019. Under the Companies Act 2006, the last financial year of our maximum engagement period is the year ending 31 December 2023.

14.2 Consistency of the audit report with the additional report to the audit committee

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

15. Use of our report

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

Colin Rawlings FCA (senior statutory auditor)
For and on behalf of Deloitte LLP
Senior Statutory Auditor
London, United Kingdom

2 March 2020

Profit and loss account
For the year ended 31 December 2019

Technical account – general business	Notes	2019 £m	2018[1] £m restated
Earned premiums, net of reinsurance			
Gross premiums written		**3,203.1**	3,212.0
Outward reinsurance premiums		**(215.9)**	(223.4)
Net premiums written		**2,987.2**	2,988.6
Change in the provision for unearned premiums			
Gross amount		**(0.5)**	94.7
Reinsurers' share		**(1.8)**	6.2
Change in the net provision for unearned premiums		**(2.3)**	100.9
Earned premiums, net of reinsurance	4	**2,984.9**	3,089.5
Claims incurred, net of reinsurance			
Claims paid			
Gross amount		**(2,206.9)**	(2,277.1)
Reinsurers' share		**25.2**	30.4
Net claims paid		**(2,181.7)**	(2,246.7)
Change in the provision for claims			
Gross amount		**187.9**	222.6
Reinsurers' share		**42.4**	20.3
Net change in provision for claims		**230.3**	242.9
Claims incurred, net of reinsurance	4	**(1,951.4)**	(2,003.8)
Net operating expenses	5	**(891.7)**	(893.9)
Balance on the technical account for general business – transferred to non-technical account		**141.8**	191.8
Non-technical account – general business			
Investment income	6	**143.3**	156.9
Realised gains/(losses) on investments	6	**6.3**	(12.7)
Unrealised (losses)/gains on investments	6	**(17.1)**	14.5
Investment expenses and charges	6	**(39.6)**	(67.1)
Other income	7	**134.8**	139.5
Profit on ordinary activities before taxation		**369.5**	422.9
Tax on profit on ordinary activities	8	**(70.2)**	(80.2)
Profit on ordinary activities after taxation		**299.3**	342.7

Note:
1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

The attached notes on pages 21 to 62 form an integral part of these financial statements.

Statement of comprehensive income
For the year ended 31 December 2019

	Notes	2019 £m	2018[1] £m restated
Profit on ordinary activities after taxation		**299.3**	342.7
Other comprehensive income			
Items that may be reclassified subsequently to the profit and loss account:			
Fair value gain/(loss) on available-for-sale investments	19	**117.9**	(121.4)
Less realised net loss on available-for-sale investments included in the profit and loss account	19	**(14.5)**	(10.3)
Tax relating to items that may be reclassified	19	**(17.6)**	22.1
Other comprehensive income for the year		**85.8**	(109.6)
Total comprehensive income for the year attributable to owners of the Company		385.1	233.1

Note:
1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

The attached notes on pages 21 to 62 form an integral part of these financial statements.

Balance sheet
As at 31 December 2019

	Notes	31 December 2019 £m	31 December 2018[1] £m restated	1 January 2018[1] £m restated
Assets				
Intangible assets	10	**4.9**	0.4	4.7
Right-of-use assets	11	**126.9**	131.6	134.8
Investments				
Land and buildings	12	**287.6**	317.0	303.9
Investments in Group undertakings and participating interests				
Shares in Group undertakings	13	**11.5**	11.5	11.5
Other financial investments				
Debt securities and other fixed income securities	14	**4,104.6**	4,241.4	4,549.8
Other loans	14	**483.8**	491.2	485.4
Derivative financial instruments	14, 15	**121.0**	46.8	83.4
	14	**4,709.4**	4,779.4	5,118.6
Total investments		**5,008.5**	5,107.9	5,434.0
Reinsurers' share of technical provisions				
Provision for unearned premiums	16, 22	**101.5**	103.3	97.1
Claims outstanding	16	**1,128.2**	1,085.8	1,065.5
		1,229.7	1,189.1	1,162.6
Debtors				
Debtors arising out of direct insurance operations – policyholders		**683.7**	739.5	839.1
Debtors arising out of direct insurance operations – intermediaries		**111.4**	82.9	70.9
Debtors arising out of reinsurance operations		**9.5**	12.6	25.9
Amounts owed by Group undertakings		**–**	–	0.2
Other debtors		**16.7**	15.8	21.5
		821.3	850.8	957.6
Other assets				
Cash at bank and in hand		**798.7**	869.4	1,122.4
Prepayments and accrued income				
Accrued interest and rent		**0.1**	3.0	–
Deferred acquisition costs	17	**177.1**	171.4	186.1
Other prepayments and accrued income		**57.5**	51.1	69.8
		234.7	225.5	255.9
Total assets		**8,224.7**	8,374.7	9,072.0

Note:

1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

Balance sheet
As at 31 December 2019

	Notes	31 December 2019 £m	31 December 2018[1] £m restated	1 January 2018[1] £m restated
Liabilities				
Capital and reserves				
Called up share capital	18	**580.8**	580.8	580.8
Other reserves	19	**44.1**	(41.7)	67.9
Profit and loss account		**1,320.2**	1,120.5	1,190.1
Shareholders funds		**1,945.1**	1,659.6	1,838.8
Subordinated liabilities	20	**259.8**	514.8	520.4
Technical provisions				
Claims outstanding	21	**3,793.8**	3,981.7	4,204.3
Provision for unearned premiums	22	**1,506.1**	1,505.6	1,600.3
		5,299.9	5,487.3	5,804.6
Provisions for other risks	23	**55.7**	38.6	63.7
Creditors				
Creditors arising out of direct insurance operations		**9.7**	15.2	24.5
Creditors arising out of reinsurance operations		**43.7**	47.4	74.3
Amounts owed to Group undertakings		**68.8**	77.7	134.6
Amounts owed to credit institutions		**46.7**	55.4	48.6
Derivative financial instruments	15	**30.3**	25.9	12.0
Lease liabilities		**141.1**	144.3	145.9
Other creditors including taxation and social security	24	**228.0**	216.8	255.8
		568.3	582.7	695.7
Accruals and deferred income				
Accruals		**93.0**	88.6	145.9
Deferred income		**2.9**	3.1	2.9
		95.9	91.7	148.8
Total liabilities		**8,224.7**	8,374.7	9,072.0

Note:
1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

The attached notes on pages 21 to 62 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 2 March 2020.

They were signed on its behalf by:

T W Harris
Director

Statement of changes in equity
For the year ended 31 December 2019

	Notes	Called up share capital (Note 18) £m	Other reserves (Note 19) £m	Profit and loss account £m	**Total £m**
Balance at 1 January 2018		580.8	67.9	1,202.0	1,850.7
First application of IFRS 16		–	–	(11.9)	(11.9)
Balance at 1 January 2018[1] restated		580.8	67.9	1,190.1	1,838.8
Profit for the year		–	–	342.7	342.7
Other comprehensive income		–	(109.6)	–	(109.6)
Transfer of business realised net gain on available-for-sale investments – gross	19	–	–	(9.2)	(9.2)
Transfer of business realised net gain on available-for-sale investments – tax	19	–	–	1.9	1.9
Dividends paid	9	–	–	(405.0)	(405.0)
Balance at 31 December 2018[1] restated		580.8	(41.7)	1,120.5	1,659.6
Profit for the year		–	–	**299.3**	**299.3**
Other comprehensive income		–	**85.8**	–	**85.8**
Transfer of business realised net gain on available-for-sale investments – gross	19	–	–	**(2.0)**	**(2.0)**
Transfer of business realised net gain on available-for-sale investments – tax	19	–	–	**0.4**	**0.4**
Dividends paid	9	–	–	**(98.0)**	**(98.0)**
Balance at 31 December 2019		**580.8**	**44.1**	**1,320.2**	**1,945.1**

Note:
1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

Total changes in equity for the year were entirely attributable to the equity shareholders of the Company.

The attached notes on pages 21 to 62 form an integral part of these financial statements.

Notes to the financial statements
For the year ended 31 December 2019

1. Accounting policies

1.1 Basis of Preparation

The Company's financial statements are prepared in accordance with Financial Reporting Standard 101 'Reduced Disclosure Framework' ("FRS101"). The financial statements are prepared on a historical cost basis except for available for sale ("AFS") financial investments, investment property and derivative financial assets which are measured at fair value.

The Company is incorporated and domiciled in the UK and registered in England and Wales. The Company is limited by shares.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of EU-adopted International Financial reporting Standards ("IFRS") but makes amendments where necessary to comply with Companies Act 2006, which includes presenting its profit and loss account and balance sheet in accordance with the formats prescribed for insurance entities under company law.

The Company has taken advantage of the following FRS101 disclosure exemptions:

- FRS 101.8 (eA): the requirements of the second sentence of paragraph 110 and of paragraphs 113 (a), 114, 115, 118, 119 (a) to (c), 120 to 127 and 129 of IFRS 15 'Revenue from contracts with customers;
- FRS 101.8 (eB): the requirements of paragraph 52, paragraph 58, the second sentence of paragraph 89 and paragraphs 90 to 91 of IFRS 16 'Leases';
- FRS 101.8 (g): the requirements of paragraphs 10(d), 16, 38A, 38B, 38C, 38D, 111 and 134-136 of IAS 1 'Presentation of Financial Statements' to produce a cash flow statement, and to make an explicit and unreserved statement of compliance with IFRSs;
- FRS 101.8 (h): the requirements of IAS 7 'Statements of Cash Flows' to produce a cash flow statement and related notes;
- FRS 101.8 (i): the requirements of paragraphs 30 and 31 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' to include new IFRSs that have been issued but that have yet to be applied;
- FRS 101.8 (k): the requirements in IAS 24 'Related Party Disclosures' to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary party to the transaction is wholly owned by such a member;

The Company has considerable financial resources and as a consequence, the Directors believe the Company is well placed to manage its business risks successfully. After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, the Directors continue to adopt the going concern basis in preparing the financial statements. The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic report on pages 2 to 5 and the Directors' report on pages 6 and 7. In addition, note 3 to the financial statements includes the Company's objectives, policies and processes for managing its insurance and financial risks and capital.

Adoption of new and revised standards

The Company has adopted the following new standards and amendments to IFRSs and the International Accounting Standards ("IAS") that became mandatorily effective for the Company for the first time during 2019.

The Company has adopted IFRS 16 'Leases' for the first time in 2019. IFRS 16 replaces IAS 17 'Leases' and sets out the principles for recognition, measurement and disclosure of lease arrangements entered into by the Company. For all contractual arrangements where the Company is a lessee, it is required to account for these leases under a single on-balance sheet model with exemptions available for low value and short-term leases. The Company recognises a lease liability measured at the present value of future lease payments from the commencement of all lease arrangements which were previously classified as 'operating leases' under IAS 17. A further assessment was performed to ensure all leases had been recognised. These lease payments are discounted using the lessees' incremental borrowing rate at the commencement of the lease unless the interest rate implicit in the lease is readily determinable. A corresponding right-of-use asset is recognised on the balance sheet. Lease payments are allocated between the liability and finance cost, and the right-of-use asset is depreciated on a straight-line basis over the lease term.

IFRS 16 has been adopted on a fully retrospective basis and therefore, in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', prior periods have been restated. The opening equity and prior period impact of IFRS 16 on the primary financial statements are presented in note 28 to the financial statements. An assessment has been undertaken to determine whether adoption of IFRS 16 included any material new accounting judgements or identifying any sources of estimation uncertainty. The Company concluded that there were none.

1. Accounting Policies continued

In September 2019, the IASB issued 'Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39 and IFRS 7' which although not mandatory for the Company until 2020, has been adopted in 2019. The amendments modify some specific hedge accounting requirements to provide relief from the potential effects of the uncertainty caused by the IBOR reform. In addition, it requires companies to disclose additional information about their hedging relationships which are directly affected by these uncertainties. By adopting these amendments early, the Company is able to continue hedge accounting to some of its benchmark interest rate exposure as the amendments permit the continuation of hedge accounting where in future the hedged benchmark interest rate may no longer be separately available. The amendment does not alter the requirement for the designated interest rate risk component to be reliably measurable. If the risk component is no longer reliably measurable the hedging relationship is discontinued.

- *The Company has issued sterling-denominated fixed rate subordinated loan from its parent Company which it* hedges to fair value using a sterling fixed to GBP LIBOR interest rate swap.
- The Company holds investments in US dollar and euro fixed rate debt securities which it includes in a macro fair value hedge of the USD LIBOR and EURIBOR risk component of these investments respectively.

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

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

Amendments to IAS 28: 'Long-term Interests in Associates and Joint Ventures' clarifies that an entity applies IFRS 9 to long-term interests in associates or joint ventures that form part of the net investment in the associate or joint venture but to which the equity method is not applied.

IFRIC 23 'Uncertainty over Income Tax Treatments' provides interpretation when there is uncertainty over income tax treatments under IAS 12 'Income Taxes'.

Amendments to IAS 19 'Employee Benefits: Plan Amendment, Curtailment or Settlement' clarify the accounting when a *pension plan amendment*, curtailment or settlement occurs.

'Annual Improvements to IFRS Standards 2015-2017 Cycle' includes the following three amendments:

- IFRS 3 'Business Combinations' and IFRS 11 'Joint Arrangements' – the amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business; the amendments to IFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.
- IAS 12 'Income Taxes' – the amendments clarify that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognised consistently with the transactions that generated the distributable profits.
- IAS 23 'Borrowing Costs'– the amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.

1.2 Consolidated financial statements

The financial statements contain information about U K Insurance Limited as an individual Company and do not contain consolidated financial information as the parent of a group. The Company is exempted by section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as the Company and its subsidiaries are included by full consolidation in the IFRS consolidated financial statements of its ultimate parent, Direct Line Insurance Group plc, a public Company registered in the United Kingdom.

1.3 Foreign currencies

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

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the foreign exchange rates ruling at the balance sheet date.

Notes to the financial statements
For the year ended 31 December 2019

1. Accounting Policies continued

Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in the profit and loss account. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into sterling at foreign exchange rates ruling at the dates the values are determined.

1.4 Contract classification

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

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

1.5 Revenue recognition

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

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

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

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

Income from land and buildings
Rental income from investment property is recognised in the profit and loss account on a straight-line basis over the period of the contract. Any gains or losses arising from a change in fair value are recognised in the profit and loss account.

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

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

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

1. Accounting policies continued

1.6 Claims incurred

Insurance claims are recognised in the accounting period in which the loss occurs. Provision is made for the full cost of settling outstanding claims at the balance sheet date, including claims incurred but not yet reported at that date, net of salvage and subrogation recoveries. Outstanding claims provisions are not discounted for the time value of money except for claims to be settled by Periodical Payment Orders ("PPOs") established under the Courts Act 2003. A court can award damages for future pecuniary loss in respect of personal injury or for other damages are wholly or partly to take the form of PPOs. These are covered in more detail in note 2.3. Costs for both direct and indirect claims handling expenses are also included.

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

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

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

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

1.7 Reinsurance

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

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

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

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

1.8 Deferred acquisition costs

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

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

Notes to the financial statements
For the year ended 31 December 2019

1. Accounting policies continued

1.9 Intangible assets

Intangible assets that are acquired by the Company are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the profit and loss account over the assets' economic lives using methods that best reflect the pattern of economic benefits and is included in net operating expenses.

1.10 Right-of-use assets and lease liabilities

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

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

The Company leases office space.

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

1.11 Investments – Land and buildings

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

Land and buildings are derecognised when they have been either disposed of or permanently withdrawn from use and no future economic benefit is expected from disposal. Any gains or losses on the retirement or disposal of land and buildings are recognised in the profit and loss account in the year of retirement or disposal.

1.12 Investments in group undertakings

Investments in group undertakings are stated at cost less any impairment.

1.13 Other financial investments

Other financial investments are classified as AFS, held-to-maturity ("HTM"), designated at fair value through profit or loss, or loans and receivables.

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

1. Accounting policies continued

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

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

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

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

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

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

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

Available-for-sale
When a decline in the fair value of a financial investment classified as AFS has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in the profit and loss account. The loss is measured as the difference between the amortised cost of the financial investment and its current fair value. Impairment losses AFS debt instruments are reversed through profit or loss, if there is an increase in fair value that is objectively related to a subsequent event.

1. Accounting policies continued

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

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

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

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

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

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

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

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

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

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

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

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

1.14 Cash at bank and in hand

Cash at bank and in hand comprises cash in hand and demand deposits with banks together with short-term highly liquid investments, such as money market funds, that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

Amounts owed to credit institutions, comprising bank overdrafts, are measured at amortised cost using the effective interest rate method and are repayable on demand.

1. Accounting policies continued

1.15 Financial liabilities

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

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

1.16 Subordinated liabilities

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

1.17 Provisions for other risks

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

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

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

1.18 Taxation

The tax charge or credit represents the sum of the tax currently payable or receivable and deferred tax.

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

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

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

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

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

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

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

1.19 Dividends

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

Notes to the financial statements
For the year ended 31 December 2019

1. Accounting policies continued

1.20 Amendments to IFRS 4 interim IFRS 9 disclosures

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

In September 2016, the IASB issued Amendments to IFRS 4 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' to address issues arising from the different effective dates of IFRS 9 and IFRS 17. The amendments to IFRS 4 were endorsed by the EU in November 2017. These amendments permitted insurers who satisfied certain criteria to defer the effective date of IFRS 9, to coincide with the expected effective date of IFRS 17 'Insurance Contracts'. The Company conducted a high-level assessment of the three aspects of IFRS 9 and based on current information, the impact of applying the expected loss model for the first time is currently immaterial. The Company does not expect any other significant impact on its financial statements.

When first published, Amendments to IFRS 4 required insurance entities to evaluate whether their activities were predominantly connected to insurance as at its annual reporting date immediately preceding 1 April 2016, providing an option to defer adoption of IFRS 9 if liabilities connected to insurance comprised a predominant proportion of its total liabilities as at that date. The Company concluded that it satisfied the criteria and there have been no significant changes in the Company's activities since this assessment to require a reassessment of the criteria. As a result the Company decided to defer the application of IFRS 9 and continues to do so. The amendments to IFRS 4 also require certain interim disclosures in relation to the fair value movements of financial assets as outlined below.

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

- debt securities and other fixed interest securities £122.3 million increase (2018: £106.9 million decrease);
- infrastructure debt £10.6 million increase (2018: £18.2 million decrease); and
- commercial real estate loans £2.5 million decrease (2018: £nil).

Derivative assets do not have contractual terms that give rise on specified dates to cash flows that are solely payment of principal and interest on the principal amount outstanding. The fair value of these financial assets is disclosed in note 27 and the amount of change in the fair value during the period was an increase of £111.6 million (2018: £25.3 million increase).

In note 3.3.3 the Company has disclosed the carrying amount of financial investments at the end of the reporting period by credit risk rating grade, as defined in IFRS 7 'Financial Instruments: Disclosures'. The fair value and the carrying amount of financial assets that meet the solely payments of principal and interest criteria and, at the end of the reporting period do not have a low credit risk, was £390.8 million (2018: £393.9 million).

2. Critical accounting judgements and key sources of estimation uncertainty

The reported results of the Company are sensitive to the accounting policies, assumptions and estimates that underly the preparation of its financial information. The Company's principal accounting policies are set out on pages 21 to 29. Company law requires the Directors, in preparing the Company's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent.

In the absence of an applicable standard or interpretation, IAS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant reliable information in the light of the requirements and guidance in United Kingdom Generally Accepted Accounting Practice and International Financial Reporting Standards dealing with similar and related issues and Schedule 3 of the Companies Act 2006 for the Preparation and Presentation of Financial Statements. The judgements and assumptions involved in the Company's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below.

2. Critical accounting judgements and key sources of estimation uncertainty continued

2.1 *Impairment provisions – financial assets*

Accounting judgement

The Company makes a judgement that financial assets are impaired when there is objective evidence that an event or events since initial recognition of the assets have adversely affected the amount or timing of future cash flows from the asset. The determination of which events could have adversely affected the amount or timing of future cash flows from the asset requires judgement. In making this judgement, the Company evaluates, among other factors, the normal price volatility of the financial asset, the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flow or where there has been a significant or prolonged decline in the fair value of the asset below its cost. Impairment may be appropriate when there is evidence of deterioration in these factors.

On a quarterly basis, the Company reviews whether there is any objective evidence that the financial assets are impaired based on the following criteria:

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

Sources of estimation uncertainty

Sources of estimation uncertainty can arise where there are indicators of impairment of a financial asset and an impairment provision is deemed appropriate. Factors such as expected future cash flows and the carrying value of the loan asset against future expected recoveries are considered when determining the level of impairment against the asset. There was no evidence of impairment of any assets within the loan and receivables portfolio in the year ended 31 December 2019 (2018: £6.0 million).

Had all the declines in AFS asset values met the criteria above at 31 December 2019, the Company would suffer a further £4.0 million loss (2018: £21.0 million loss), being the transfer of the total AFS reserve for unrealised losses to the profit and loss account. These movements represent mark-to-market movements and where there is no objective evidence of any loss events that could affect future cash flows, no impairments are recorded for these movements.

2.2 Fair value

Accounting judgements

The Company has made the judgement that level 1 of the Company's fair value hierarchy set out in note 27 include only sovereign debt securities issued by members of the G10 group of countries within the Company's AFS debt securities portfolio, with all other financial assets and liabilities carried at fair value included in level 2 as they are not considered to be quoted in a deeply liquid market.

The Company has also made the judgement that land and buildings, most of the HTM debt securities, commercial real estate loans and infrastructure debt fall within level 3 of the Company's fair value hierarchy (note 27) as the valuation models used are driven predominantly by unobservable inputs: land and buildings valuations are derived from recent market transactions which are adjusted for specific characteristics of each property including the size, location and condition by reference to the benchmark property transactions.

2.3 General insurance: outstanding claims provisions and related reinsurance recoveries

Sources of estimation uncertainty

The Company makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling costs. Outstanding claims provisions net of related reinsurance recoveries at 31 December 2019 amounted to £2,665.6 million (2018: £2,895.9 million).

Claims reserves are assessed separately for large and attritional claims, typically using standard actuarial methods of projection. Key sources of estimation uncertainty include those arising from the selection of specific methods as well as assumptions for claims frequency and severity through the review of historical claims and emerging trends, including the Company's assessment of the future impact of climate change. The Company seeks to adopt a conservative approach to assessing claims 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 long and short-term risks not reflected in the actuarial inputs, as well as management's view of the uncertainties in relation to the actuarial best estimate.

2. Critical accounting judgements and key sources of estimation uncertainty continued

The corresponding reinsurance recoveries and impairment provision are calculated on an equivalent basis, with similar estimation uncertainty, as discussed in note 1.7. The reinsurance impairment provision is mainly for expected recoveries against future PPO payments.

The most common method of settling bodily injury claims is by a lump sum. When this includes an element of indemnity for recurring costs, such as loss of earnings or ongoing medical care, the settlement calculations apply the statutory discount rate (known as the Ogden Discount Rate) to reflect the fact that payment is made on a one-off basis rather than periodically over time. The Ogden Discount Rate changed from 2.5% to minus 0.75% in 2017 in England, Wales and Scotland, reflecting the low interest rate environment, and case law holding that claimants were entitled to invest purely in zero risk investments, i.e. index-linked gilts. The Civil Liability Act 2018 changed the law in two ways: firstly by requiring the Government to review the Ogden Discount Rate at least every five years, and secondly to do so by reference to low risk rather than very low or zero risk investments.

At 31 December 2018, the Company decided that it was likely that the Ogden Discount Rate would change in 2019 and selected an estimate of 0% to value its lump sum bodily injury reserves. When the Ogden discount rate review process subsequently concluded in July 2019, the discount rate increased from minus 0.75% to minus 0.25% for England and Wales. As the Ogden discount rate is a devolved matter in Scotland and Northern Ireland, it has remained at minus 0.75% in Scotland, and at 2.5% in Northern Ireland.

The Company reserves its large bodily injury claims at the relevant discount rate for each jurisdiction, with the overwhelming majority now reserved at minus 0.25% as most will be settled under the law in England and Wales. The Ogden Discount Rate will be reviewed again at the latest in 2024. There has been an ongoing reduction in large bodily injury exposures as a result of continued positive prior-year development of claims reserves, and a higher proportion of reserves being covered by reinsurance as a result of the decision to opt for a lower reinsurance attachment point from 2014 onwards.

The Company settles some large bodily injury claims as periodic payment orders (PPOs) rather than lump sum payments. The Company has estimated the likelihood of large bodily injury claims settling as PPOs. In line with the Company's experience, and the negative Ogden Discount Rate, the assumed PPO propensity has reduced in 2019. Anticipated PPOs consist of both existing large loss case reserves including allowances for development and claims yet to be reported to the Company. Reinsurance is applied at claim level and the net cash flows are discounted for the time value of money. The discount rate is consistent with the long duration of the claims payments and the assumed future indexation of the claims payments.

The table in note 21 to the financial statements provides an analysis of outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2019 and 31 December 2018 and further details on sources of estimation uncertainty. Details of sensitivity analysis to the discount rate applied to PPO claims are shown in note 3.3.1.

3. Risk management

3.1 Risk management overview

DLIG's Board ("Group Board") has responsibility for setting and monitoring adherence to the risk strategy risk appetite and risk framework for the Group, including the Company. The Group Board has established a risk management model that separates the business's risk management responsibilities into "Three lines of defence" as set out below.

First line of defence	- Risk ownership
Second line of defence	- Oversight, challenge and support of first line
Third line of defence	- Independent assurance

The DLIG annual report contains a comprehensive review of the risk management framework for the Group. Copies can be obtained from Direct Line Group Secretariat, Churchill Court, Westmoreland Road, Bromley, BR1 1DP, the Registrar of Companies or through DLIG's website at www.directlinegroup.co.uk

3.1.1 Risk strategy and risk appetite

The Group's risk appetite statements express the level of risk the Group is prepared to accept to achieve its business objectives. Details of the Group's risk strategy and risk appetite are contained in the DLIG annual report.

3.1.2 Enterprise risk management strategy and framework

This sets out, at a high level, the Group's (which includes the Company) approach to setting risk strategy and the Enterprise-wide Risk Management Framework for managing risks. Details of the Group's Enterprise-wide Risk Management Framework are contained in DLIG's annual report.

3. Risk management continued

3.1.3 Potential effects of Brexit

The UK left the EU ('Brexit') on 31 January 2020. At the date of this report there remains uncertainty as to when the implementation period will end (it is due to end on 31 December 2020 but could yet be extended, albeit requiring a change to the law) and as to what, if any, trading agreement may or may not be agreed between the UK and EU to take effect subsequent to the implementation period. There is also uncertainty as to what trading agreements may or may not be agreed with key non-EU countries to supersede such arrangements previously subject to EU trade agreements. Accordingly, there remains uncertainty as to the effect of Brexit on the Company.

If there is a smooth end to the implementation period with an agreed future trading agreement between the UK and the EU (and other key countries), and accordingly without significant disruption to the UK economy and to business generally, then any adverse impact on the Company (if any) would also not be expected to be significant. If, however, trade discussions (or the failure of them) were to lead to significant disruption then the impact on the Company could correspondingly also be disruptive and potentially material.

Internal review

Following the EU referendum result in 2016, which saw the UK vote to leave the EU, the Group established a Brexit Working Group comprising representatives from across the Group and Company. It was identified that there was a risk that the UK could enter a prolonged period of reduced growth due to Brexit, potentially reducing insurance sales and the value of our investment portfolio. Whilst our operations are based mainly in the UK, Brexit-related issues which could impact adversely on the Company could include: changes to the value of sterling which impact claims and non-claims supplier costs; inflation; impacts on credit spreads which in turn could impact on the Company's investments and capital; recession; recruitment and retention of people; impacts on the speed of delivery and cost of goods and services required by the business including for fulfilling insurance claims made by customers, for example because of delays at borders caused by increased border regulations and by additional costs caused by increased tariffs and devaluation of sterling; availability of reinsurers authorised to write business in the UK; data transfers; the removal of the European Health Insurance Card ("EHIC") leading to greater reliance on travel insurance; travel disruption; increased use of Green Cards (internationally recognised certificates that act as proof of insurance, including in the EU); potential changes to direct and indirect tax; and the regulatory impact on our capital position.

Possible implications

The Company has proactively considered a variety of possible implications of a disruptive end to existing trading and other arrangements between the UK and the EU, including of a financial and operational nature; for example:

The Company's investment portfolio

The impact on the Company's investment portfolio and in particular credit spreads related to its debt securities and therefore Company solvency: A sensitivity analysis relating to credit spreads is provided in the Group's Annual Report & Accounts. The Group has also considered Brexit in its Investment Committee, and further information is provided on the work of the Investment Committee in the Group's Annual Report & Accounts. A disruptive end to previous arrangements between the UK and EU could impact adversely on the Company's investments and therefore capital and the solvency capital coverage ratio and the appropriateness of paying dividends.

Procurement and supply chain

In particular as part of the Company's ability to deal with claims made under insurance policies, the Company needs to acquire a wide range of goods and services. A significant amount and spread of goods, for example such as car parts, are sourced from within the EU. The Group and Company have been in discussion with principal suppliers who took steps to increase stocks within the UK in the event of a potential 'hard' Brexit leading to disruption at borders. However, in the event of a lack of appropriate trading arrangements with the EU (and other countries) following the implementation period and for example in the event of the imposition of tariffs and quotas, the Company's ability to deal with claims in its normal ordinary course of business manner could be adversely impacted and there could be delays and extra costs.

The Republic of Ireland

The Company has a small amount of business in the Republic of Ireland, servicing a small Irish part of a UK partner's wider business. The Group had obtained approval in principle from the Central Bank of Ireland for the establishment of a formal third country branch in the Republic of Ireland, in order to be able to continue with this business post a 'hard' no-deal Brexit, should that have become necessary. It remains to be seen whether similar arrangements will be needed at the end of the implementation period.

Crisis management

The Group and Company have also been focusing on Brexit from a potential crisis management perspective, with the objective of maintaining operational resilience in the event of a disruptive Brexit and with a view to being able to react better to events as they unfold, including during and following the implementation period.

Notes to the financial statements
For the year ended 31 December 2019

3. Risk management continued

3.2 Risk and capital management modelling

The directors guided by the Group Board have ultimate responsibility for ensuring that the Company has sufficient funds to meet its liabilities as they fall due. The Company carries out detailed modelling of its assets, liabilities and the key risks to which these are exposed. This modelling includes the Company's own assessment of its solvency capital requirement ("SCR") using its Full Internal Model approved by the PRA in 2016. The SCR quantifies the insurance, market, credit and operational risks that the regulated entities are undertaking.

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

3.3 Principal risks from insurance activities and use of financial instruments

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

There is considerable uncertainty as to the effect of Brexit on the Company as the terms, if any, of any future trading relationship with the EU are not yet known. We have proactively considered a variety of possible implications of a disruptive end to the implementation period, including of a financial and operational nature; these are set out in the risk management section of the strategic report.

3.3.1 Insurance risk

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

The Company is mainly exposed to the following Insurance risks:

Reserve risk

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

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

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

Reserve risk is controlled through a range of processes:

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

The Company's reserves are subject to the risk of retrospective changes in judicial conditions such as the recent changes in the Ogden Discount Rate. Detailed information on the Ogden Discount Rate is provided in note 2.3.

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

3. Risk management continued

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 and separately the Ogden Discount Rate) with all other assumptions left unchanged. Other potential risks beyond the ones described could have an additional financial impact on the Company.

	Increase / (decrease) in profit before tax[1,2]	
At 31 December	**2019 £m**	2018 £m
PPOs[3]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	**47.7**	49.9
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	**(65.4)**	(68.9)
Ogden Discount Rate[4]		
Impact of reserving at a discount rate of 0.75% compared to 0.25% (2018: 1.0% compared to 0.0%)	**53.3**	56.2
Impact of reserving at a discount rate of minus 1..25% compared to 0.25% at (2018: minus 1.0% compared to 0.0%)	**(75.0)**	(76.2)

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

The sensitivity above is calculated on the basis of a change in the internal discount rate used for the actuarial best estimate reserves as at 31 December 2019. It does not take into account any second order impacts such as changes in PPO propensity or reinsurance bad debt assumptions.

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

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

Underwriting risk

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

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

3. Risk management continued

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

- geographic concentration risk – the Company purchases a catastrophe reinsurance programme to protect against a modelled one in 200-years catastrophe loss. The programme is structured with the retention and limits expressed as percentages of gross earned premium. At 31 December 2019 this was the equivalent of £1,000 million (118% of gross earned premium of the previous 12 months) in excess of a retained deductible of £132.5 million (15.64% of gross earned premium);
- product concentration risk – the Company's business is heavily concentrated in the UK general insurance market. However, the Company offers a diversified portfolio of products and a variety of brands sold through a range of distribution channels to its customers; and
- sector concentration risk – the concentration of the Company to any given industry sector is monitored and analysed in respect of commercial customers.

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

Distribution risk
This is the risk of a material reduction in profit compared to plan due to the Company not writing its planned policy volumes in each segment.

Pricing risk
This is the risk of economic loss arising from business being incorrectly priced or written outside of the Company's underwriting rules.

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

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

The Company uses reinsurance to:

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

3. Risk management continued

3.3.2 Market risk

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

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

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

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

The Company monitors its market risk exposure on a monthly basis and has established an aggregate exposure limit consistent with its risk objective to maintain capital adequacy. Interdependencies across risk types have also been considered within the aggregate exposure limit. The allocation of the Company's investments across asset classes has been approved by the Investment Committee.

The strategic asset allocation within the investment portfolio is reviewed by the Investment Committee which makes recommendations to the Board for its investment strategy approval. The Investment Committee determines policy and controls, covering such areas as risk, liquidity and performance. The Investment Committee meets at least three times a year to evaluate risk exposure, the current strategy, associated policies and investment guidelines and to consider investment recommendations submitted to it. Oversight of the implementation of decisions taken by the Investment Committee is via the first and second Lines of Defence.

The investment management objectives are to:

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

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

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

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

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

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3. Risk management continued

The table below analyses the distribution of debt securities and other fixed income securities by geographical area.

	Debt securities and other fixed income securities 2019 £m	Debt securities and other fixed income securities 2018 £m
Australia	**195.3**	169.5
Austria	**17.8**	11.3
Belgium	**35.6**	37.2
Bermuda	**–**	1.5
Canada	**83.7**	72.7
Cayman Islands	**10.9**	5.7
Denmark	**7.6**	12.0
Finland	**32.1**	34.5
France	**298.2**	224.6
Germany	**172.9**	200.5
Hong Kong	**–**	6.3
Ireland	**10.8**	13.8
Italy	**30.2**	38.7
Japan	**33.6**	33.9
Luxembourg	**8.0**	2.6
Mexico	**15.2**	14.3
Netherlands	**129.7**	139.9
New Zealand	**34.7**	27.0
Norway	**29.7**	25.8
South Africa	**2.4**	–
South Korea	**3.0**	–
Spain	**59.6**	35.2
Sweden	**77.4**	85.4
Switzerland	**83.6**	64.5
UK	**1,160.3**	1,233.3
USA	**1,539.9**	1,708.0
Zambia	**1.1**	–
Supranational	**31.3**	43.2
Total	**4,104.6**	4,241.4

3. Risk management continued

The tables below analyses the distribution of debt securities and other fixed income securities held across industry sector classifications.

	2019		2018	
At 31 December	**£m**	**%**	£m	%
Basic materials	**115.3**	**3%**	104.4	2%
Communications	**257.7**	**6%**	241.9	6%
Consumer, cyclical	**303.0**	**7%**	312.8	7%
Consumer, non-cyclical	**405.5**	**10%**	449.8	11%
Diversified	**6.4**	**0%**	51.8	1%
Energy	**181.7**	**4%**	206.9	5%
Financial	**1,818.3**	**44%**	1,817.6	43%
Industrial	**282.2**	**7%**	233.3	6%
Sovereign, supranational and local government	**155.0**	**4%**	224.4	5%
Technology	**145.3**	**4%**	115.5	3%
Transport	**13.4**	**1%**	13.4	0%
Utilities	**420.8**	**10%**	469.6	11%
Total	**4,104.6**	**100%**	4,241.4	100%

The table below analyses the distribution of other loans by industry sector classifications.

	2019		2018	
At 31 December	**£m**	**%**	£m	%
Social, of which:				
Education	**121.1**	**25%**	125.8	26%
Healthcare	**73.2**	**15%**	76.0	15%
Other	**53.5**	**11%**	54.9	11%
Transport	**30.3**	**6%**	32.9	7%
Other sectors	**205.7**	**43%**	201.6	41%
Total	**483.8**	**100%**	491.2	100%

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

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

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

The Group has subordinated guaranteed dated notes with fixed coupon rates which were issued on 27 April 2012 at a fixed rate of 9.25% and have a redemption date of 27 April 2042;. At the same time the Company entered into a 10 year designated hedging instrument to exchange the fixed rate of interest on these notes, issued by the Group, to a floating rate, to hedge exposure to the interest rate. Of the £500 million notes issued, the Group has bought back a total nominal value of £250 million. The hedging relationship was redesignated to reflect this transaction and ensure continuing hedge effectiveness.

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

3. Risk management continued

The market value of the Company's financial investments with fixed coupons is affected by the movement of interest rates. For the majority of investments in US Dollar and Euro corporate bonds, excluding £398.9million of USD short duration high yield bonds (2018: £405.2 million) and £111.4 million of USD subordinated financial debt and £64.7 million of Euro subordinated financial debt (2018: £147.3 million USD & £20.3 million Euro), the Company hedges the exposure of this portfolio to the US Dollar and Euro interest rate risk using swaps.The Company is exposed to the following interest rate benchmarks within its hedge accounting relationships, which are subject to interest rate benchmark reform: GBP LIBOR, USD LIBOR and EURIBOR (collectively 'IBORs'). As listed in note 1, the hedged items include issued sterling fixed rate subordinated debt and holdings of US Dollar and Euro denominated fixed rate debt securities.

As well as the benchmark interest rate exposures described in note 1, the Company has material non-derivative financial instruments in its investment portfolio that are not included in hedge accounting relationships. Given hedge accounting is not applied, there is no accounting relief. The fair values of these financial assets reflect the uncertainties arising from the interest rate benchmark reforms.

The Company is closely monitoring the market and the output from the various industry working groups managing the transition to new benchmark interest rates. This includes announcements made by LIBOR regulators (including the *Financial Conduct Authority (FCA) and the US Commodity Futures Trading Commission)* regarding the transition away from LIBOR (including GBP LIBOR, USD LIBOR) to Sterling Overnight Index Average Rate (SONIA) and the Secured Overnight Financing Rate (SOFR) respectively and announcements on the transition from EURIBOR to Euro Short Term Rate (€STR). The FCA has made clear that, at the end of 2021, it will no longer seek to persuade, or compel, banks to submit to LIBOR.

In response to the announcements, the Company has prepared an IBOR transition plan which has been reviewed by the Group Board's Investment Committee and shared with the Prudential Regulation Authority. The plan identifies where the Company has IBOR exposures and the departments responsible for ensuring suitable actions/ monitoring is in place to enable a smooth transition to alternative benchmark rates. Delivering the plan is under the governance of the Group's Chief Financial Officer.

Some of the Company's current GBP LIBOR linked loan contracts do contain fall back provisions for the cessation of the referenced benchmark interest rate. Different working groups in the industry are working on fall back language for different instruments and different IBORs, which the Company is monitoring closely and will look to implement when appropriate.

For the Company's derivatives, the International Swaps and Derivatives Association's (ISDA) fall back clauses were made available at the end of 2019 and the Group will begin discussion with its banks with the aim to implement this language into its ISDA agreements in early 2020.

Below are details of the hedging instruments and hedged items in scope of the IFRS 9/IAS 39 amendments due to benchmark interest rate reform, by hedge type.

Hedge Type	Instrument type	Maturing in	Nominal	Hedged item
Fair value hedges	Pay 3-month GBP LIBOR, receive sterling fixed interest rate swap	2022	£250 million	Sterling fixed rate issued subordinated debt of the same maturity and nominal as the swap
	Pay USD fixed, receive 3-month USD LIBOR interest rate swaps	2022 - 2050	US$151 million	Portfolio fair value hedge of the 3-month USD LIBOR component of US Dollar denominated fixed rate debt securities
	Pay USD fixed, receive 1-month USD LIBOR interest rate swaps	2020 - 2028	US$901 million	Portfolio fair value hedge of the 1-month USD LIBOR component of US Dollar denominated fixed rate debt securities
	Pay EURO fixed, receive 6-month EURIBOR interest rate swaps	2022 - 2040	€102 million	Portfolio fair value hedge of the 6-month EURIBOR component of Euro denominated fixed rate debt securities

3. Risk management continued

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

Property risk
This is the risk of loss arising from sensitivity of assets and financial investments to the level or volatility of market prices, rental yields, or occupancy rates of properties. At 31 December 2019, the value of land and buildings was £287.6 million (2018: £317.0 million). The land and buildings are located in the UK.

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

Exposure to currency risk is generated by the Company's investments in US dollar and euro denominated corporate bonds. The Company maintains exposure to US dollar securities through £1,366.1 million (2018: £1,699.3 million) of investments in US dollar corporate bonds and euro securities through £359.1 million (2018: £79.4 million) of euro corporate bonds. The foreign currency exposure of these investments is hedged by foreign currency forward contracts, maintaining a minimal unhedged currency exposure on these portfolios, as well as a low basis risk on the hedging contracts.

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

Currency risk is not considered to be material.

Use of derivatives
As mentioned above, the Company uses derivatives to hedge against interest rate and currency risk.

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

	Notional amounts	Maturity and fair value			
At 31 December 2019	**£m**	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	**Total £m**
Derivative assets					
At fair value through the profit and loss account:					
Foreign exchange contracts (forwards)	**2,310.3**	112.0	–	–	**112.0**
Designated as hedging instruments:					
Interest rate swaps	**277.7**	0.7	8.3	–	**9.0**
Total	**2,588.0**	**112.7**	**8.3**	–	**121.0**

	Notional amounts	Maturity and fair value			
At 31 December 2019	**£m**	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	**Total £m**
Derivative liabilities					
At fair value through the profit and loss account:					
Foreign exchange contracts (forwards)	**652.6**	10.1	–	–	**10.1**
Designated as hedging instruments:					
Interest rate swaps	**853.2**	2.6	2.8	14.8	**20.2**
Total	**1,505.8**	**12.7**	**2.8**	**14.8**	**30.3**

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3. Risk management continued

At 31 December 2018	Notional amounts £m	Maturity and fair value Less than 1 year £m	1 – 5 years £m	Over 5 years £m	Total £m
Derivative assets					
At fair value through the profit and loss account:					
Foreign exchange contracts (forwards)	1,354.6	19.2	–	–	19.2
Interest rate swaps	1,198.3	(2.7)	15.9	14.4	27.6
Total	2,552.9	16.5	15.9	14.4	46.8

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

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

	Increase / (decrease) in profit before tax[1]		Decrease in total equity[2] at 31 December[1]	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Spread				
Impact of a 100 basis points increase in spreads on financial investments and derivatives[3,4]	**–**	–	**(144.2)**	(171.1)
Interest rate				
Impact of a 100 basis points increase in interest rates on financial investments and derivatives[3,4,5]	**12.1**	15.6	**(101.4)**	(101.0)
Investment property				
Impact of a 15% decrease in property markets	**(43.1)**	(47.6)	**(43.1)**	(47.6)

Notes:

1. The sensitivities set out above have not considered the impact of the general market changes on the value of the Company's insurance liabilities. They reflect one off impacts at 31 December and should not be interpreted as a prediction.
2. The sensitivities exclude the impact of taxation.
3. The profit and loss impact of financial investments is limited to floating rate instruments and interest rate derivatives used to hedge a portion of the portfolio. The profit and loss account is not impacted in relation to fixed rate instruments, in particular AFS debt *securities, where the coupon return is not impacted by a change in prevailing market rates, as the accounting treatment for AFS* debt securities means that only the coupon received is processed through the profit and loss account with fair value movements being recognised through total equity.
4. The increase or decrease in total equity does not reflect any fair value movement in infrastructure debt, commercial real estate loans and HTM debt securities that would not be recorded in the financial statements under IFRSs. These are classified as loans and receivables and HTM respectively, which are carried at amortised cost. It is estimated that a fair value reduction in these asset categories resulting from a 100 basis point increase in spreads would have been £16.7 million (2018: £22.2 million) and a 100 basis point increase in interest rate would have been £4.9 million (2018: £5.8 million).
5. The sensitivities set out above reflect one-off impacts at 31 December with the exception of the profit and loss account interest rate sensitivity on financial investments and derivatives, which projects a movement in a full year's interest charge as a result of the increase in the interest rate applied to these assets or liabilities on those positions held at 31 December.

3. Risk management continued

The Company has a number of open interest rate and foreign exchange derivative positions. Collateral management arrangements are in place for significant counterparty exposures. At 31 December 2019 the Company has pledged £37.8 million in cash (2018: £31.8 million in cash and £2.9 million in securities) to cover initial margins and out-of-the-money derivative positions. At 31 December 2019, counterparties have pledged £8.9 million in UK Gilts (2018: £24.0 million in cash and £6.5 million in UK Gilts) to the Company to cover in-the-money derivative positions.

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

3.3.3 Credit risk

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

Counterparty Default risk

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

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

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

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

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

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

At 31 December 2019	Neither past due nor impaired £m	Past due 1 - 90 days £m	Past due more than 91 days £m	Carrying value in the balance sheet £m
Debt securities and other fixed income securities	**4,104.6**	–	–	**4,104.6**
Other loans	**483.8**	–	–	**483.8**
Derivative financial instruments	**121.0**	–	–	**121.0**
Reinsurers' share of technical provisions	**1,229.7**	–	–	**1,229.7**
Debtors	**782.4**	**38.9**	–	**821.3**
Cash at bank and in hand[1]	**798.7**	–	–	**798.7**
Total	**7,520.2**	**38.9**	–	**7,559.1**

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3. Risk management continued

At 31 December 2018	Neither past due nor impaired £m	Past due 1 – 90 days £m	Past due more than 91 days £m	Carrying value in the balance sheet £m
Debt securities and other fixed income securities	4,241.4	–	–	4,241.4
Other loans	491.2	–	–	491.2
Derivative financial instruments	46.8	–	–	46.8
Reinsurers' share of technical provisions	1,189.1	–	–	1,189.1
Debtors	815.1	35.7	–	850.8
Cash at bank and in hand[1]	869.4	–	–	869.4
Total	7,653.0	35.7	–	7,688.7

Note:
1. This includes money market funds with no notice period for withdrawal.

Within the analysis of debt securities above are bank debt securities at 31 December 2019 of £1,260.5 million (2018: £1,125.2 million), that can be further analysed as: secured £20.9 million (2018: £63.0 million); unsecured £1,073.7 million (2018: £949.8 million); and subordinated £165.8 million (2018: £112.4 million).

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

	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ and below £m	**Total £m**
31 December 2019	**119.0**	**602.1**	**1,770.9**	**1,221.8**	**390.8**	**4,104.6**
31 December 2018	194.5	725.0	1,785.0	1,143.0	393.9	4,241.4

The tables below analyse the credit quality of financial and insurance assets that are neither past due nor impaired (excluding debt securities analysed above). The tables include reinsurance exposure, after impairment provision. The Company's approach to reinsurance counterparty default risk management is detailed on page 42.

At 31 December 2019	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ & below £m	Not rated £m	**Total £m**
Other loans	–	46.6	194.7	229.0	13.5	–	**483.8**
Derivative financial instruments	–	111.2	9.8	–	–	–	**121.0**
Reinsurers' share of technical provisions	–	842.0	384.8	2.3	–	0.6	**1,229.7**
Debtors[1]	–	2.5	29.5	11.3	–	739.1	**782.4**
Cash at bank and in hand[2]	583.8	123.4	91.0	0.5	–	–	**798.7**
Total	**583.8**	**1,125.7**	**709.8**	**243.1**	**13.5**	**739.7**	**3,415.6**

At 31 December 2018	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ & below £m	Not rated £m	Total £m
Other loans	–	58.6	195.9	236.7	–	–	491.2
Derivative financial instruments	–	14.8	22.6	9.4	–	–	46.8
Reinsurers' share of technical provisions	–	837.4	347.3	3.0	–	1.4	1,189.1
Debtors[1]	–	5.9	14.7	14.3	–	780.2	815.1
Cash at bank and in hand[2]	720.3	38.4	53.5	57.2	–	–	869.4
Total	720.3	955.1	634.0	320.6	–	781.6	3,411.6

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

Notes to the financial statements
For the year ended 31 December 2019

3. Risk management continued

3.3.4 Operational risk

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

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

Technology and infrastructure risk
This is the risk that the IT infrastructure is insufficient to deliver the Company strategy.

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

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

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

The Company has in place agreed policies and standards to manage key controls relating to operational risk.

3.3.5 Liquidity risk

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

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

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

At 31 December 2019	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	**Total £m**
Debt securities and other fixed income securities	483.3	1,036.2	1,063.6	1,378.6	142.9	**4,104.6**
Other loans	59.6	152.2	71.2	95.1	105.7	**483.8**
Cash at bank and in hand[1]	798.7	–	–	–	–	**798.7**
Total	**1,341.6**	**1,188.4**	**1,134.8**	**1,473.7**	**248.6**	**5,387.1**

At 31 December 2018	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	Total £m
Debt securities and other fixed income securities	411.5	901.9	1,153.4	1,612.3	162.3	4,241.4
Other loans	31.5	101.6	140.1	94.2	123.8	491.2
Cash at bank and in hand[1]	869.4	–	–	–	–	869.4
Total	1,312.4	1,003.5	1,293.5	1,706.5	286.1	5,602.0

Notes to the financial statements
For the year ended 31 December 2019

3. Risk management continued

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

At 31 December 2019	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	**Total £m**	Carrying value £m
Subordinated liabilities	23.1	284.7	-	-	-	**307.8**	259.8
Claims outstanding[2]	1,119.5	999.0	513.6	424.1	2,000.9	**5,057.1**	3,793.8
Creditors arising out of direct insurance operations	9.7	–	–	–	–	**9.7**	9.7
Creditors arising out of reinsurance operations	43.7	–	–	–	–	**43.7**	43.7
Amounts due to Group undertakings	68.7	–	–	–	–	**68.7**	68.7
Amounts owed to credit institutions	46.7	–	–	–	–	**46.7**	46.7
Lease liabilities	12.0	24.1	24.1	44.4	94.3	**198.9**	141.1
Other creditors including taxation and social security	228.0	–	–	–	–	**228.0**	228.0
Total	1,551.4	1,307.8	537.7	468.5	2,095.2	**5,960.6**	4,591.5

At 31 December 2018[3] (restated)	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	Total £m	Carrying value £m
Subordinated liabilities	47.5	95.0	523.8	–	–	666.3	514.8
Claims outstanding[2]	1,174.3	1,024.2	546.1	449.7	2,206.2	5,400.5	3,981.7
Creditors arising out of direct insurance operations	15.2	–	–	–	–	15.2	15.2
Creditors arising out of reinsurance operations	47.4	–	–	–	–	47.4	47.4
Amounts due to Group undertakings	77.7	–	–	–	–	77.7	77.7
Amounts owed to credit institutions	55.4	–	–	–	–	55.4	55.4
Lease liabilities	11.8	23.7	23.6	45.1	102.7	206.9	144.3
Other creditors including taxation and social security	216.8	–	–	–	–	216.8	216.8
Total	1,646.1	1,142.9	1,093.5	494.8	2,308.9	6,686.2	5,053.3

Notes:
1. Includes money market funds with no notice period for withdrawal.
2. Insurance liabilities exclude reserve for unearned premiums as there are no liquidity risks inherent in them
3. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

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

At 31 December 2019	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	**Total £m**	**Carrying Value £m**
Derivative assets	115.7	5.5	-	-	-	**121.2**	**121.0**
Derivative liabilities	(15.3)	(6.8)	(5.3)	(3.7)	-	**(31.1)**	**(30.3)**
Total	**100.4**	**(1.3)**	**(5.3)**	**(3.7)**	-	**90.1**	**90.7**

At 31 December 2018	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m	Total £m	Carrying Value £m
Derivative assets	28.5	9.3	5.6	4.5	-	47.9	46.8
Derivative liabilities	(24.5)	(0.5)	(0.5)	(0.7)	-	(26.2)	(25.9)
Total	4.0	8.8	5.1	3.8	-	21.7	20.9

Notes to the financial statements
For the year ended 31 December 2019

3. Risk management continued

3.4 Capital management

The Company manages capital in accordance with the Group's capital management minimum standard, the aims of which are to manage capital efficiently and generate long-term sustainable value for shareholders, while balancing operational, regulatory, credit rating agency and policyholder requirements. The Company seeks to hold capital resources such that in the normal course of business, the Solvency II capital coverage ratio is maintained at a minimum threshold of 125% of its SCR.

The Company's regulatory capital position is assessed against the Solvency II framework. From 1 July 2016, the Company gained approval to assess its SCR using a full internal model. The model is calibrated to a 99.5% confidence interval and considers business written to date and one year of future written business over a one year time horizon, in line with Solvency II requirements.

3.5 Capital adequacy (unaudited)

Using the internal model, there is a capital surplus of approximately £0.6 billion above an estimated SCR of £1.28 billion as at 31 December 2019 (31 December 2018: £0.8 billion and £1.23 billion respectively). The Company's capital requirements and solvency position are produced and presented to the Board on a regular basis.

4. Segmental analysis

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

Motor

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

Home

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

Rescue and other personal lines

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

Commercial

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

The following table analyses the Company's technical account by reportable segment for the year ended 31 December 2019:

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	**Total £m**
Earned premiums, net of reinsurance	1,507.7	573.6	425.2	478.4	**2,984.9**
Claims incurred, net of reinsurance[2]	(1,142.7)	(268.5)	(284.2)	(256.0)	**(1,951.4)**
Net operating expenses	(385.3)	(190.8)	(112.4)	(203.2)	**(891.7)**
Balance on the technical account for general business	(20.3)	114.3	28.6	19.2	**141.8**
Movement on non-technical account					**227.7**
Profit on ordinary activities before taxation					**369.5**
Loss ratio	76%	47%	67%	54%	**65%**
Expense and commission ratio	25%	33%	26%	42%	**30%**
Combined operating ratio	**101%**	**80%**	**93%**	**96%**	**95%**

4. Segmental analysis continued

The following table analyses the Company's technical account by reportable segment for the year ended 31 December 2018[1] (restated):

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total[1] £m
Earned premiums, net of reinsurance	1,541.8	667.8	414.7	465.2	3,089.5
Claims incurred, net of reinsurance[2]	(1,067.2)	(413.3)	(277.2)	(246.1)	(2,003.8)
Net operating expenses	(376.8)	(210.0)	(107.7)	(199.4)	(893.9)
Balance on the technical account for general business	97.8	44.5	29.8	19.7	191.8
Movement on non-technical account					231.1
Profit on ordinary activities before taxation					422.9
Loss ratio	69%	62%	67%	53%	65%
Expense and commission ratio	24%	31%	26%	43%	29%
Combined operating ratio	93%	93%	93%	96%	94%

Notes
1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.
2. Includes operating expenses in respect of short-term and low value leases of £0.3 million and £nil respectively (2018: £0.3 million and £nil).

5. Net operating expenses

	2019 £m	2018[1] £m restated
Acquisition of insurance contracts	**380.2**	382.8
Change in deferred acquisition costs	**(0.4)**	(6.5)
Depreciation of right-of-use assets	**7.4**	7.2
Administration expenses	**504.5**	510.4
Total	**891.7**	893.9

Notes:
1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

Employees
The Company had no employees during the year (2018: none).

Auditor's remuneration
Fees for audit and non-audit services of the Company's financial statements, included within administration expenses, are borne and recharged by a related party, DL Insurance Services Limited.

Fees paid to the Auditor in respect of the statutory audit of the Company amount to £1,520,000 (2018: £1,390,000).

Fees in respect of the audit of the Solvency II Financial Condition Report amount to £86,000 (2018: £83,000) and fees for other services amount to £nil (2018: £nil).

Directors' emoluments
The total Directors' remuneration as disclosed in the 2019 DLIG annual report is as follows:

	2019 £m	2018 £m
Salaries, fees, bonuses and benefits in kind	**4.4**	5.5
Gains on exercise of share options	**5.3**	4.2
Total	**9.7**	9.7

At 31 December 2019, no Director (2018: none) had retirement benefits accruing under the defined contribution pension scheme in respect of qualifying service. During the year ended 31 December 2019, three Directors exercised share options (2018: four).

6. Investment income

The table below analyses Investment income by type:

	2019 £m	2018 £m
Income from land and buildings	**15.7**	15.4
Income from other investments	**127.6**	141.5
Total	**143.3**	156.9

The table below analyses the realised and unrealised gains/(losses) included in the non-technical account:

	Realised 2019 £m	Unrealised 2019 £m	Realised 2018 £m	Unrealised 2018 £m
Net gains on debt securities	**16.5**	**–**	19.5	–
Net (losses)/gains on land and buildings	**(0.7)**	**(4.5)**	–	13.1
Total	**15.8**	**(4.5)**	19.5	13.1
(Losses)/gains on derivative financial instruments				
Foreign exchange forward contracts[1]	**(56.8)**	**103.4**	(102.6)	(41.3)
Associated foreign exchange risk	**53.4**	**(123.8)**	72.6	41.3
Net losses on foreign exchange forward contracts	**(3.4)**	**(20.4)**	(30.0)	–
Interest rate swaps[1]	**(16.8)**	**(33.6)**	22.1	(1.8)
Associated interest rate risk	**10.7**	**41.4**	(24.3)	3.2
Net (losses)/gains on interest rate derivative financial instruments	**(6.1)**	**(7.8)**	(2.2)	1.4
Total (losses)/gains on derivative financial instruments	**(9.5)**	**(12.6)**	(32.2)	1.4
Total gains/(losses)on investments	**6.3**	**(17.1)**	(12.7)	14.5

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

The table below analyses investment expenses and charges:

	2019 £m	2018[1] £m restated
Impairment of financial investments	**–**	6.0
Interest expense on subordinated loan	**28.1**	47.5
Net interest received on designated hedging instrument[2]	**(3.4)**	(3.8)
Unrealised gains on designated hedging instrument[2]	**0.1**	5.0
Unrealised losses on associated interest rate risk hedged items[2]	**(0.8)**	(5.6)
Investment fees	**9.7**	12.0
Interest on lease liabilities	**5.9**	6.0
Total	**39.6**	67.1

Notes:
1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.
2. As described in note 20, on 27 April 2012, the Group issued subordinated guaranteed dated notes with a nominal value of £500 million at a fixed rate of 9.25%. On the same date, DLIG issued a loan of £500 million to the Company at a fixed rate of 9.5%. The Company also entered into a 10 year designated hedging instrument to exchange the fixed rate on the notes, issued by the Group, for a floating rate of three-month LIBOR plus a spread of 706 basis points. This increased to 707 basis points with effect from 29 July 2013. On 8 December 2017, the Company revised the hedge reflecting the repurchase by the Group of subordinated guaranteed dated notes with a nominal value of £250 million. All terms and conditions in relation to the hedge remain unchanged (note 19).

7. Other income

	2019 £m	2018 £m
Instalment income	**114.0**	119.9
Revenue from contracts with customers:		
Vehicle replacement referral income	**19.1**	17.2
Other income	**1.7**	2.4
Total	**134.8**	139.5

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8. Taxation

	2019 £m	2018[1] restated £m
Current taxation:		
Charge for the year	**74.9**	85.4
Under provision in respect of prior year	**(0.1)**	–
	74.8	85.4
Deferred taxation:		
Credit for the year	**(4.6)**	(5.2)
	(4.6)	(5.2)
Current taxation	**74.8**	85.4
Deferred taxation	**(4.6)**	(5.2)
Tax charge for the year	**70.2**	80.2

The following table analyses the difference between the actual income tax charge and the expected income tax charge computed by applying the standard rate of UK corporation tax of 19%[2] (2018: 19%).

	2019 £m	2018[1] restated £m
Profit before tax	**369.5**	422.9
Expected tax charge	**70.2**	80.3
Effects of:		
Disallowable expenses	**0.1**	–
Non taxable items	–	(0.1)
Adjustments in respect of prior year	**(0.1)**	–
Tax charge for the year	**70.2**	80.2
Effective income tax rate	**19.0%**	19.0%

Note:

1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.
2. In the Finance Act 2016 the UK Government enacted a reduction in the UK corporation tax rate from 19% to 17% effective from 1 April 2020. As a consequence the closing deferred tax assets and liabilities have been recognised at the tax rates expected to apply when the assets or liabilities are settled. The impact of these changes on the tax charge for the year is set out in the table above.

The aggregate current and deferred tax relating to items that are charged or (credited) to equity is £nil (2018: £nil).

	2019 £m	2018[1] restated £m
Per balance sheet:		
Current tax liabilities	**24.1**	23.4
Deferred tax liabilities	**15.7**	3.0

Note:

1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

8. Taxation continued

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

	Depreciation in excess of capital allowances £m	Non-distributable reserve[1] £m	Provisions and other temporary differences £m	Available for sale reserve £m	Total £m
At 1 January 2018[2]	(0.1)	18.5	(2.4)	16.0	32.0
Credit to profit and loss account	–	(4.8)	(0.4)	–	(5.2)
Credit to other comprehensive income	–	–	–	(23.8)	(23.8)
At 31 December 2018[2]	(0.1)	13.7	(2.8)	(7.8)	3.0
Charge/(credit) to profit and loss account	**0.1**	**(4.9)**	**0.2**	**–**	**(4.6)**
Charge to other comprehensive income	**–**	**–**	**–**	**17.3**	**17.3**
At 31 December 2019	**–**	**8.8**	**(2.6)**	**9.5**	**15.7**

Note:

1. The non-distributable reserve was a statutory claims equalisation reserve calculated in accordance with the rules of the PRA. With the introduction of Solvency II on 1 January 2016, the requirement to maintain the reserve ceased and the balance as at 31 December 2015 is taxed over the following six years. This is provided for in deferred tax above, as it represents the future unwind of previously claimed tax deductions for transfers into this reserve.
2. Balances as at 1 January 2018 and results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

9. Dividends

	2019 £m	2018 £m
Amounts recognised as distributions to equity holders in the period:		
First interim dividend for the year ended 31 December 2019 of 16.8p per share	**98.0**	–
First interim dividend for the year ended 31 December 2018 of 18.1p per share	–	105.0
Second interim dividend for the year ended 31 December 2017 of 51.7p per share	–	300.0
	98.0	405.0

10. Intangible assets

	2019 £m	2018 £m
Cost		
At 1 January	**8.7**	8.7
Additions	**7.0**	–
Disposals	**(8.7)**	–
At 31 December	**7.0**	8.7
Amortisation		
At 1 January	**8.3**	4.0
Charge for the year	**2.5**	4.3
Disposals	**(8.7)**	–
At 31 December	**2.1**	8.3
Carrying amount		
At 31 December	**4.9**	0.4

11. Right-of-use assets – land and buildings

	2019 £m	2018 £m
Cost		
At 1 January	**179.4**	175.4
Additions	**2.7**	4.0
At 31 December	**182.1**	179.4
Accumulated depreciation		
At 1 January	**47.8**	40.6
Charge for the year	**7.4**	7.2
At 31 December	**55.2**	47.8
Carrying amount		
At 31 December	**126.9**	131.6

12. Investments - Land and buildings

	2019 £m	2018 £m
At 1 January	**317.0**	303.9
(Decrease)/increase in fair value during the year	**(5.2)**	13.1
Disposals	**(24.2)**	–
At 31 December[1]	**287.6**	317.0

Note:
1. The cost included in carrying value at 31 December 2019 is £216.7 million (2018: £246.2 million).

Land and buildings were purchased to provide an investment return over the long term in accordance with the Company's investment strategy. These properties are managed, on behalf of the Company, by a property services company.

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

The valuation conforms to international valuation standards. The fair value was determined using a methodology based on recent market transactions for similar properties, which have been adjusted for the specific characteristics of each property within the portfolio. This approach to valuation is consistent with the methodology used in the year ended 31 December 2018.

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

13. Shares in group undertakings

	2019 £m	2018 £m
At 1 January and 31 December[1]	**11.5**	11.5

Note:
1. The cost and net book value at 31 December 2019 is £11.5 million (2018: £11.5 million).

13. Shares in group undertakings continued

The Company's subsidiaries are detailed as follows:

Name of Group undertaking	Place of incorporation and operation	Type of ownership interest (share type)	Proportion of voting power held	Principal activity
Churchill Insurance Company Limited[1]	United Kingdom	Ordinary	100%	General insurance
Direct Line Insurance Limited[1]	United Kingdom	Ordinary	100%	Dormant
The National Insurance and Guarantee Corporation Limited[1]	United Kingdom	Ordinary	100%	Dormant

Note:

1. Registered office at: Churchill Court, Westmoreland Road, Bromley, BR1 1DP.

14. Other financial investments

	2019 £m	2018 £m
Debt securities and other fixed income securities[1,2]	**4,104.6**	4,241.4
Other loans		
Infrastructure debt	**278.1**	289.6
Commercial real estate loans	**205.7**	201.6
Total other loans	**483.8**	491.2
Derivative financial instruments (note 15)	**121.0**	46.8
Other financial investments	**4,709.4**	4,779.4

Note:

1. The Company swaps a fixed interest rate for a floating rate of interest on its US Dollar and Euro corporate debt securities by entering into interest rate derivatives. The hedged amount at 31 December 2019 was £955.8 million (2018: £1,206.1 million).
2. In debt securities and other fixed income securities there are £104.0 million (2018: £101.0 million) securities classified as HTM, the remainder are classified as AFS.

15. Derivative financial instruments

	2019 £m	2018 £m
Derivative assets		
At fair value through the profit and loss account:		
Foreign exchange contracts (forwards)	**112.1**	19.2
Designated as hedging instruments:		
Interest rate swaps	**8.9**	27.6
Total	**121.0**	46.8
Derivative liabilities		
At fair value through the profit and loss account:		
Foreign exchange contracts (forwards)	**10.1**	20.6
Designated as hedging instruments:		
Interest rate swaps	**20.2**	5.3
Total	**30.3**	25.9

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16. Reinsurers' share of technical provisions

	2019 £m	2018 £m
Reinsurers' share of claims outstanding	**1,166.0**	1,135.6
Impairment provision	**(37.8)**	(49.8)
Total excluding reinsurers' unearned premium reserves	**1,128.2**	1,085.8
Reinsurers' unearned premium provision	**101.5**	103.3
Total	**1,229.7**	1,189.1

Movements in reinsurance asset impairment provision

	2019 £m	2018 £m
At 1 January	**(49.8)**	(46.7)
Additional provision	**(4.2)**	(7.4)
Release to profit and loss account	**16.2**	4.3
At 31 December	**(37.8)**	(49.8)

17. Deferred acquisition costs

	2019 £m	2018[1] restated £m
At 1 January	**171.4**	186.1
Additions	**366.9**	385.1
Recognised in the profit and loss account	**(361.2)**	(399.8)
At 31 December	**177.1**	171.4

Note:

1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28

18. Called up share capital

	2019 £m	2018 £m
Issued and fully paid: equity shares		
580.8 million Ordinary Shares of £1 each	**580.8**	580.8

The Company is a member of the Direct Line Group headed by Direct Line Insurance Group plc of which the Company is a subsidiary.

19. Other reserves

Movements in other reserves

	AFS investments revaluation reserve £m	AFS reserve transferred[1] £m	Merger reserve[1] £m	Total £m
At 1 January 2018	67.9	12.2	(12.2)	67.9
Revaluation during the year – gross	(121.4)	–	–	(121.4)
Revaluation during the year – tax	20.4	–	–	20.4
Transfer of business – realised net gains on AFS investments – gross	–	(9.2)	9.2	–
Transfer of business – realised net gains on AFS investments – tax	–	1.9	(1.9)	–
Realised net gain – gross	(10.3)	–	–	(10.3)
Realised net gain – tax	1.7	–	–	1.7
At 31 December 2018	(41.7)	4.9	(4.9)	(41.7)
Revaluation during the year – gross	**117.9**	–	–	**117.9**
Revaluation during the year – tax	**(20.0)**	–	–	**(20.0)**
Transfer of business – realised net gains on AFS investments – gross	**-**	**(2.0)**	**2.0**	–
Transfer of business – realised net gains on AFS investments – tax	**-**	**0.4**	**(0.4)**	–
Realised net gain – gross	**(14.5)**	–	–	**(14.5)**
Realised net gain – tax	**2.4**	**-**	**-**	**2.4**
At 31 December 2019	**44.1**	**3.3**	**(3.3)**	**44.1**

Note:

1. On 10 December 2011, due to the P VII transfer, Churchill Insurance Company Limited, Direct Line Insurance Limited and The National Insurance and Guarantee Corporation Limited transferred their underlying businesses into the Company, with the exception of a small amount of business which remains in Churchill. The Company has accounted for the transferred assets and liabilities using the carrying amounts of predecessor entities and in respect of AFS investments the Company has inherited the AFS reserve at the point of the transfer. Movements in respect of the AFS reserve transferred in are recognised together with other reserve movements on AFS investments. The original merger reserve transferred in is reduced and transferred directly to retained earnings upon impairment, maturity or disposal of the underlying assets.

20. Subordinated liabilities

	2019 £m	2018 £m
Subordinated loan	**259.8**	514.8

The subordinated guaranteed loan from the Company's parent, Direct Line Insurance Group plc, was issued on 27 April 2012 at a fixed rate of 9.5%.

The nominal £500 million loan has a redemption date of 27 April 2042. On 28 February 2019 the Company's Board of the passed a resolution to repay £250 million of subordinated loan and was also approved by the DLIG Board. The repayment date was 7 March 2019.

The loan is an unsecured, subordinated obligation of the Company. In the event of a winding-up or of bankruptcy, this is to be repaid only after the claims of all other senior creditors have been met.

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

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21. Claims outstanding

	2019 £m	2018 £m
Claims outstanding	**3,793.8**	3,981.7

Claims outstanding

Accident year	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m	**Total £m**
Estimate of ultimate claims costs:											
At end of accident year	3,941.7	2,717.8	2,407.5	2,211.7	2,125.5	2,157.7	2,216.0	2,299.4	2,400.4	2,222.9	
One year later	(117.1)	(99.3)	(163.3)	(117.6)	20.8	(30.0)	(86.6)	(116.2)	(62.3)	–	
Two years later	(99.2)	(94.6)	(119.0)	(152.9)	(38.5)	(143.4)	(53.3)	(103.1)	–	–	
Three years later	(50.1)	(89.4)	(49.3)	(21.0)	(144.9)	(62.4)	(82.8)	–	–	–	
Four years later	(105.5)	(60.8)	(9.8)	(102.1)	(50.2)	(22.9)	–	–	–	–	
Five years later	(57.8)	(21.2)	(79.2)	(50.8)	(51.6)	–	–	–	–	–	
Six years later	(25.9)	(60.3)	(36.2)	(27.4)	–	–	–	–	–	–	
Seven years later	(50.0)	(25.1)	(23.8)	–	–	–	–	–	–	–	
Eight years later	(17.6)	(27.9)	–	–	–	–	–	–	–	–	
Nine years later	(17.8)	–	–	–	–	–	–	–	–	–	
Current estimate of ultimate claims	3,400.7	2,239.2	1,926.9	1,739.9	1,861.1	1,899.0	1,993.3	2,080.1	2,338.1	2,222.9	
Cumulative payments to date	(3,327.6)	(2,199.2)	(1,905.6)	(1,702.7)	(1,679.1)	(1,649.8)	(1,679.6)	(1,659.9)	(1,731.4)	(1,199.2)	
Liability recognised in balance sheet	**73.1**	**40.0**	**21.3**	**37.2**	**182.0**	**249.2**	**313.7**	**420.2**	**606.7**	**1,023.7**	
2008 and prior											**748.6**
Claims handling provision											**78.1**
Total											**3,793.8**

21. Claims outstanding continued

Net claims outstanding

Accident year	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	2019 £m	**Total £m**
Estimate of ultimate claims costs:											
At end of accident year	3,901.5	2,664.1	2,306.6	2,121.7	2,002.0	1,966.3	1,980.6	2,099.0	2,226.2	2,053.7	
One year later	(124.7)	(131.5)	(146.7)	(123.6)	(29.7)	(67.0)	(18.9)	(79.7)	(41.4)	–	
Two years later	(120.5)	(82.2)	(107.9)	(134.4)	(42.1)	(77.8)	(38.2)	(65.3)	–	–	
Three years later	(44.0)	(76.5)	(35.6)	(27.8)	(100.8)	(30.4)	(43.7)	–	–	–	
Four years later	(93.5)	(48.7)	(11.6)	(64.3)	(41.3)	(24.1)	–	–	–	–	
Five years later	(52.3)	(37.3)	(54.2)	(38.9)	(52.5)	–	–	–	–	–	
Six years later	(43.9)	(37.1)	(30.4)	(17.7)	–	–	–	–	–	–	
Seven years later	(24.8)	(20.4)	(14.6)	–	–	–	–	–	–	–	
Eight years later	(17.4)	(23.0)	–	–	–	–	–	–	–	–	
Nine years later	(17.1)	–	–	–	–	–	–	–	–	–	
Current estimate of ultimate claims	3,363.3	2,207.4	1,905.6	1,715.0	1,735.6	1,767.0	1,879.8	1,954.0	2,184.8	2,053.7	
Cumulative payments to date	(3,312.2)	(2,175.6)	(1,888.0)	(1,684.1)	(1,660.9)	(1,639.2)	(1,677.8)	(1,654.1)	(1,730.5)	(1,199.6)	
Liability recognised in balance sheet	**51.1**	**31.8**	**17.6**	**30.9**	**74.7**	**127.8**	**202.0**	**299.9**	**454.3**	**854.1**	
2008 and prior											**443.3**
Claims handling provision											**78.1**
Total											**2,665.6**

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21. Claims outstanding continued

Movements in gross and reinsurance claims outstanding[1]

	Gross £m	Reinsurance £m	Net £m
Claims reported	2,984.5	(729.3)	2,255.2
Incurred but not reported	1,140.7	(336.2)	804.5
Claims handling provision	79.1	–	79.1
At 1 January 2018	4,204.3	(1,065.5)	3,138.8
Cash paid for claims settled in the year (restated)[2]	(2,277.1)	30.4	(2,246.7)
Increase /(decrease) in liabilities:			
Arising from current-year claims (restated)[2]	2,582.0	(174.2)	2,407.8
Arising from prior-year claims	(527.5)	123.5	(404.0)
At 31 December 2018	3,981.7	(1,085.8)	2,895.9
Claims reported	2,979.5	(793.0)	2,186.5
Incurred but not reported	922.3	(292.8)	629.5
Claims handling provision	79.9	–	79.9
At 31 December 2018	3,981.7	(1,085.8)	2,895.9
Cash paid for claims settled in the year	**(2,206.9)**	**25.2**	**(2,181.7)**
Increase / (decrease) in liabilities:			
Arising from current-year claims	**2,414.6**	**(169.2)**	**2,245.4**
Arising from prior-year claims	**(395.6)**	**101.6**	**(294.0)**
At 31 December 2019	**3,793.8**	**(1,128.2)**	**2,665.6**
Claims reported	**2,892.5**	**(810.5)**	**2,082.0**
Incurred but not reported	**823.2**	**(317.7)**	**505.5**
Claims handling provision	**78.1**	–	**78.1**
At 31 December 2019	**3,793.8**	**(1,128.2)**	**2,665.6**

Notes:

1. Included within the incurred but not reported claims provision is a £30 million net release (gross: £103 million release) relating to the change in the Ogden Discount Rate from -0.75% to -0.25% which has not yet been reflected in claims reported (31 December 2018: £55 million net provision decrease; £175 million gross provision decrease for an assumed change in the Ogden Discount Rate from -0.75% to 0%).
2. Balances as at 1 January 2018 and results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

The table below analyses the outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2019 and 31 December 2018. These represent the total cost of PPOs rather than any costs in excess of purely Ogden-based settlements.

At 31 December	**Discounted 2019 £m**	**Undiscounted 2019 £m**	Discounted 2018 £m	Undiscounted 2018 £m
Gross claims				
Approved PPO claims provisions	**503.5**	**1,325.2**	490.2	1,323.1
Anticipated PPOs	**270.5**	**716.8**	358.0	943.9
Total gross	**774.0**	**2,042.0**	848.2	2,267.0
Reinsurance				
Approved PPO claims provisions	**(255.5)**	**(700.0)**	(247.0)	(696.3)
Anticipated PPOs	**(185.6)**	**(529.1)**	(245.2)	(701.1)
Total reinsurance	**(441.1)**	**(1,229.1)**	(492.2)	(1,397.4)
Net of reinsurance				
Approved PPO claims provisions	**248.0**	**625.2**	243.2	626.8
Anticipated PPOs	**84.9**	**187.7**	112.8	242.8
Total net	**332.9**	**812.9**	356.0	869.6

21. Claims outstanding continued

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

In the majority of cases, the inflation agreed in the settlement is the Annual Survey of Hours and Earnings SOC 6115 inflation published by the Office for National Statistics, for which the long-term rate is assumed to be 4% (2018: 4%). The Company has estimated a rate of interest used for the calculation of present values as 4% (2018: 4%), which results in a real discount rate of 0% (2018: 0%). The Company will continue to review the inflation and discount rates used to calculate these insurance reserves.

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

22. Provision for unearned premiums

Movement in unearned premium provision

	Gross £m	Reinsurance £m	Net £m
At 1 January 2018	1,600.3	(97.1)	1,503.2
Written in the period	3,212.0	(223.4)	2,988.6
Earned in the period	(3,306.7)	217.2	(3,089.5)
At 31 December 2018	1,505.6	(103.3)	1,402.3
Written in the period	**3,203.1**	**(215.9)**	**2,987.2**
Earned in the period	**(3,202.6)**	**217.7**	**(2,984.9)**
At 31 December 2019	**1,506.1**	**(101.5)**	**1,404.6**

23. Provisions for other risks

	2019 £m	2018[1] restated £m
Provision for deferred tax	**15.7**	3.0
Other provisions	**40.0**	35.6
Total	**55.7**	38.6

Note:
1. Results for the year ended 31 December 2018 have been restated to reflect the fully retrospective adoption of IFRS 16 'Leases', see note 28.

Movements during the year in other provisions are as follows:

	Regulatory levies £m
At 1 January 2019	**35.6**
Additional provision	**57.5**
Utilisation of provision	**(53.1)**
At 31 December 2019	**40.0**

The expected timing of any resulting outflows falls within twelve months of the balance sheet date. All regulatory levies relate to insurance levies, predominantly the Financial Services Compensation Scheme and the Motor Insurance Bureau.

24. Other creditors including taxation and social security

	2019 £m	2018 £m
Other creditors	**107.8**	99.6
Current tax	**24.1**	23.4
Other taxes	**96.1**	93.8
Total	**228.0**	216.8

25. Contingencies and guarantees

The Company has guaranteed the principal and interest payments of £250 million of subordinated loan notes issued by DLIG on 27 April 2012 that have a fixed rate of interest at 9.25%. The nominal £250 million has a redemption date of 27 April 2042. DLIG has the option to repay the notes on specific dates from 27 April 2022. If the notes are not repaid on 27 April 2022, the rate of interest would be reset at a rate of the six-month LIBOR plus 8.16%. Interest is payable on the notes by DLIG on 27 April and 27 October.

At 31 December 2019, the accrued interest on DLIG's loan notes amounted to £4.2 million (2018: £4.2 million).

26. Leases

Operating lease commitments where the Company is the lessor

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

	2019 £m	2018 £m
Within one year	**13.7**	14.4
In the second to fifth years inclusive	**38.8**	42.6
After five years	**68.9**	69.9
Total	**121.4**	126.9

Other lease disclosures

The Company leases properties which are used within the Group in order to carry out it's business. Sublease income in respect of property right-of-use assets was £0.3 million during the year (2018: £0.3 million). The total lease interest expense included within finance costs for the year was £5.9 million (2018: £6.0 million). Expenses relating to short-term and variable lease payments were not included in the measurement of lease liabilities as they were not significant. Total cash outflows in respect of leases was £12.2 million (2018: £11.9 million). Expenses relating to short-term and variable lease payments not included in the measurement of lease liabilities was not significant.

27. Fair value

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

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

- Level 1 financial assets are measured in whole or in part by reference to published quotes in an active market. In an active market, quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. The Company classifies only sovereign debt securities issued by members of the G10 group of countries with the Company's AFS debt security and other fixed income securities portfolio as Level 1 as they are considered to be quoted in a deeply liquid market.
- Level 2 financial assets and liabilities are measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. These assets include AFS debt securities and other fixed income securities, for which pricing is obtained via pricing services, but where prices have not been determined in an active market, or financial assets with fair values based on broker quotes or assets that are valued using the Group's own models whereby the majority of assumptions are market-observable. Derivatives are valued using broker quotes or appropriate valuation models. Model inputs include a range of factors which are deemed to be observable, including current market and contractual prices for underlying instruments, period to maturity, correlations, yield curves and volatility of underlying instruments. All other financial assets and liabilities carried at fair value are included in level 2 as they are not considered to be quoted in a deeply liquid market.
- Level 3 fair value measurements used for land and buildings, HTM debt securities, infrastructure debt and commercial real estate loans are those derived from a valuation technique that includes inputs for the asset that are predominantly unobservable.

27. Fair value continued

Comparison of carrying value to fair value of financial instruments and assets carried at fair value
The following table compares the carrying value and the fair value of financial instruments and other assets where the Company discloses a fair value:

At 31 December 2019	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
Assets held at fair value:					
Land and buildings (note 12)	**287.6**	**–**	**–**	**287.6**	**287.6**
Derivative financial instruments (note 15)	**121.0**	**–**	**121.0**	**–**	**121.0**
Debt securities and other fixed income securities (note 14)	**4,000.6**	**94.4**	**3,906.2**	**–**	**4,000.6**
Other financial assets:					
Debt securities and other fixed income securities (note 14)	**104.0**	**–**	**14.1**	**94.0**	**108.1**
Other loans (note 14)	**483.8**	**–**	**–**	**488.6**	**488.6**
Total assets	**4,997.0**	**94.4**	**4,041.3**	**870.2**	**5,005.9**
Liabilities held at fair value:					
Derivative financial instruments (note 15)	**30.3**	**–**	**30.3**	**–**	**30.3**
Total liabilities	**30.3**	**–**	**30.3**	**–**	**30.3**

At 31 December 2018	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
Assets held at fair value:					
Land and buildings (note 12)	317.0	–	–	317.0	317.0
Derivative financial instruments (note 15)	46.8	–	46.8	–	46.8
Debt securities and other fixed income securities (note 14)	4,140.4	151.8	3,988.6	–	4,140.4
Other financial assets:					
Debt securities and other fixed income securities (note 14)	101.0	–	13.9	87.4	101.3
Other loans (note 14)	491.2	–	–	488.0	488.0
Total assets	5,096.4	151.8	4,049.3	892.4	5,093.5
Liabilities held at fair value:					
Derivative financial instruments (note 15)	25.9	–	25.9	–	25.9
Total liabilities	25.9	–	25.9	–	25.9

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

- *Debtors arising out of direct insurance operations;*
- Debtors arising out of reinsurance operations;
- Cash at bank and in hand;
- Amounts owed to credit institutions;
- Creditors arising out of direct insurance operations;
- Creditors arising out of reinsurance operations; and
- Other creditors including taxation and social security

The movements in assets classified as Level 3 in the fair value hierarchy are all within investment property and are analysed in note 12. There were no changes in the categorisation of assets between Levels 1, 2 and 3 during the year for assets and liabilities held at 31 December 2019.

27. Fair value continued

The following table shows the unobservable inputs used by the Company in the fair value measurement of its land and buildings:

2019	Fair value £m	Valuation technique	Unobservable input	Range (weighted average)
Land and buildings	287.6	Income capitalisation	Equivalent yield	3.50% - 6.88%
			Estimated rental value per sq.ft	£1.81 - £32.97 (Average £14.83)

28. First time adoption of IFRS 16

The Company adopted IFRS 16 for the first time on 1 January 2019 as explained in note 1 to the consolidated financial statements. As a result, lease liabilities in respect of property are now recognised on the balance sheet, along with corresponding right-of-use assets. The impact of the adoption of the new standard on the profit and loss account has been to replace rental expenses with a depreciation charge and a finance cost in respect of the leased assets. An element of the depreciation charge is attributed to claims handling expenses, which are included in claims costs.

The following tables reconcile the restated comparative financial statements to amounts previously presented:

Impact on the profit and loss account for the year ended 31 December 2018

Technical account – general business	Full year 2018 audited £m	IFRS 16 first time adoption £m	Full year 2018 restated £m
Earned premiums, net of reinsurance	3,089.5	–	3,089.5
Claims incurred, net of reinsurance			
Claims paid[1]			
Gross amount	(2,277.2)	0.1	(2,277.1)
Reinsurers' share	30.4	–	30.4
Net claims paid	(2,246.8)	0.1	(2,246.7)
Change in the provision for claims			
Net change in provision for claims	242.9	–	242.9
Claims incurred, net of reinsurance	(2,003.9)	0.1	(2,003.8)
Net operating expenses[2]	(897.8)	3.9	(893.9)
Balance on the technical account for general business – transferred to non-technical account	187.8	4.0	191.8
Non-technical account – general business			
Investment income	156.9	–	156.9
Realised losses on investments	(12.7)	–	(12.7)
Unrealised gains on investments	14.5	–	14.5
Investment expenses and charges[3]	(61.1)	(6.0)	(67.1)
Other income	139.5	–	139.5
Profit on ordinary activities before taxation	424.9	(2.0)	422.9
Tax on profit on ordinary activities	(80.6)	0.4	(80.2)
Profit on ordinary activities after taxation	344.3	(1.6)	342.7

Notes:
1. In prior periods, the internal cost reallocation model reflected a portion of rental expenses relating to claims handling expense in insurance claims. Under IFRS 16 rental expenses were replaced with a lower depreciation charge in operating expenses, reducing the costs recharged to claims handling after reallocations. The prior period has been restated in respect of this to improve comparability with the current period. This adjustment is also reflected in note 21.
2. Net operating expense impact of replacing rental expenses with a depreciation charge on right-of-use assets.
3. Interest expense recognised on unwinding of discounted lease liabilities.

28. First time adoption of IFRS 16 continued

Impact on the statement of comprehensive income for the year ended 31 December 2018

	2018 audited £m	IFRS 16 first time adoption £m	2018 restated £m
Profit on ordinary activities after taxation	344.3	(1.6)	342.7
Other comprehensive loss			
Items that may be reclassified subsequently to the profit and loss account:			
Fair value loss on available-for-sale investments	(121.4)	–	(121.4)
Less realised net loss on AFS investments included in the profit and loss account	(10.3)	–	(10.3)
Tax relating to items that may be reclassified	22.1	–	22.1
Other comprehensive loss for the year	(109.6)	–	(109.6)
Total comprehensive income for the year attributable to owners of the Company	234.7	(1.6)	233.1

Impact on the balance sheet as at 1 January 2018

	Notes	1 January 2018 audited £m	IFRS 16 first time adoption £m	1 January 2018 restated £m
Assets				
Right-of-use assets		–	134.8	134.8
Prepayments and accrued income				
Deferred acquisition costs		186.5	(0.4)	186.1
Other prepayments and accrued income		72.6	(2.8)	69.8
Liabilities				
Shareholders funds		1,850.7	(11.9)	1,838.8
Provisions for other risks		66.1	(2.4)	63.7
Creditors				
Lease liabilities		–	145.9	145.9

Impact on the balance sheet as at 31 December 2018

	Notes	31 December 2018 audited £m	IFRS 16 first time adoption £m	31 December 2018 restated £m
Assets				
Right-of-use assets		–	131.6	131.6
Prepayments and accrued income				
Deferred acquisition costs		172.0	(0.6)	171.4
Other prepayments and accrued income		54.1	(3.0)	51.1
Liabilities				
Shareholders funds		1,673.1	(13.5)	1,659.6
Provisions for other risks		41.4	(2.8)	38.6
Creditors				
Lease liabilities		–	144.3	144.3