Company Registration No: 02258947

Churchill Insurance Company Limited

Annual Report and Financial Statements

31 December 2020

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

Churchill Insurance Company Limited 02258947

Annual report and financial statements

Contents

Officers and professional advisers

Directors:	D Gray M J Gregory J C Hanson T W Harris P J James S R E C James A C Joseph F C McBain G N Stewart R C Ward
Secretary:	R C Clifton
Registered office:	Churchill Court Westmoreland Road Bromley BR1 1DP
Auditor:	Deloitte LLP 1 New Street Square London EC4A 3HQ United Kingdom
Company registration	Registered in England and Wales

Strategic report
For the year ended 31 December 2020

The Directors present their strategic report for the year ended 31 December 2020.

Activities and business review

Activity

The principal activity of Churchill Insurance Company Limited (the "Company") continues to be the provision of general insurance, in so far as it relates to the handling and final settlement of outstanding motor claims. The Company ceased underwriting activities on 10 December 2011. Once all motor claim liabilities have been settled, the Company will cease trading activities.

The Company is a member of the Direct Line Group (the "Group") headed by Direct Line Insurance Group plc ("DLIG"). The Company is a subsidiary of U K Insurance Limited ("UKI"). 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 matters. Key performance indicators across the Group taken as a whole are referred to in the DLIG Annual Report and Accounts 2020 ("DLIG annual report") and accordingly for an understanding of the Company's development, performance or position of the business, please refer to the DLIG annual report, alongside the Review of the year section below. Copies can be obtained from Direct Line Group Company Secretariat, Churchill Court, Westmoreland Road, Bromley, BR1 1DP, the Registrar of Companies or through the Group'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 continued to assist the Group in delivering its key priorities.

Financial performance

The Company's financial performance is presented in the profit and loss account on page 13.

The profit for the year was £556,000 (2019: loss of £16,000). The remaining claims to be settled by the Company are large bodily injury claims, which are subject to both favourable and unfavourable volatility, due to the complex nature and timescales over which such claims are handled. The majority of the outstanding claims are reinsured, and are settled by means of court-awarded periodic payment orders ("PPOs").

No interim dividend was paid during the financial year ended 31 December 2020 (2019: £nil). The Directors do not recommend the payment of a final dividend. (2019: £nil).

At the end of the year, the balance sheet showed total assets of £42,943,000 (2019: £41,685,000), including cash at bank and in hand of £18,567,000 (2019: £17,316,000). Total capital and reserves were £13,694,000 (2019: £13,138,000).

The Company's solvency capital requirement ("SCR") has been calculated as £0.9 million (2019: £0.8 million) using the standard formula approach. However, the absolute floor of the minimum capital requirement ("MCR") specified in the Solvency II Directive is €3.7 million (£3.3 million at 2020 exchange rates) (2019: €3.7 million (£3.2 million at 2019 exchange rates)). As a result of this, the Company's MCR is £2.4 million (2019: £2.4 million) higher than its SCR. The Company has a capital surplus of approximately £13.7 million (2019: £13.2 million) above its SCR and £11.3 million (2019: £10.8 million) above its MCR at 31 December 2020.

Principal risks and uncertainties

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

Presentation of financial statements

The primary financial statements are presented in accordance with Company law requirements. In addition, the Company has taken advantage of several disclosure exemptions available under Financial Reporting Standard 101 'Reduced Disclosure Framework' ("FRS 101").

Covid-19

As the Company has ceased its underwriting activities it is anticipated that any impact of the Covid-19 pandemic will be low.

Brexit

The Company is predominantly a UK business, and has minimum exposure to the EU.

Strategic report
For the year ended 31 December 2020

Section 172(1) Statement

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, invests in its employees, supports 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 arrangements for the Company's policyholders or the adoption of new Articles of Association, 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 Group's governance arrangements can be found in DLIG's annual report for the year ended 31 December 2020 on page 76. 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, suppliers, customers and others may be found in the financial statements of DL Insurance Services Limited and the DLIG annual report for the year ended 31 December 2020.

The Group's vision, purpose and values are set out in the strategic report of DLIG for the year ended 31 December 2020 on page 12 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 44 to 68 in DLIG's 2020 annual report.

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 Company's solvency capital requirement ("SCR"). Further information on the Company's SCR can be found on pages 2 and 23.

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's annual report for the year ended 31 December 2020 on page 142.

Outlook

High level strategies of the Group are determined by the Board of DLIG and these are shown in the DLIG annual report for the year ended 31 December 2020. The Directors consider that the Company's principal activities will continue unchanged for the foreseeable future.

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

P J James
Director

25 March 2021

Directors' report

For the year ended 31 December 2020

The Directors present their annual report and the audited financial statements for the year ended 31 December 2020.

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.

Directors and Secretary

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

From 1 January 2020 to date the following changes have taken place:

Director	Appointed	Resigned
M N Biggs		4 August 2020
A C Joseph	1 January 2021	

Going concern

The Company has sufficient financial resources to meet its financial needs. The Directors believe the Company is well positioned to manage its business risks successfully in the current economic climate. The Strategic report on pages 2 to 3 and Directors report on pages 4 to 5 describe the Company's business activities and financial performance for the year, together with the factors likely to affect its future development, performance and position. Additionally, note 3 to the financial statements includes the Company's objectives, policies and processes for managing its insurance and financial risks and capital which may affect the Company's financial position. The Directors have assessed the principal risks of the Company over the duration of the planning cycle. These included possible challenging market conditions due to the impact of Covid-19 on the economy and possible adverse implications of Brexit. However, as the Company's activity is to handle and settle of a small portfolio of large bodily injury claims, which are mainly UK claims and are largely covered by reinsurance, these risks are expected to have a limited impact on the Company.

Therefore, 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 25 March 2021 (the date of approval of the financial statements). The Directors reasonably expect that, although the Company has ceased underwriting activities, there will still be claims handling activities over the next 12 months. Accordingly, the Directors have adopted the going concern basis in preparing the financial statements.

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 is 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 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 has expressed its 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 provisions for the benefit of the Directors of the Company which remain in force at the date of this report.

Directors' report
For the year ended 31 December 2020

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:

P J James
Director

25 March 2021

Independent Auditor's report to the members of Churchill Insurance Company Limited

For the year ended 31 December 2020

Report on the audit of the financial statements

1. Opinion

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

- give a true and fair view of the state of the Company's affairs as at 31 December 2020 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 balance sheet;
- the statement of changes in equity; and
- the related notes 1 to 10, excluding the capital adequacy disclosure in note 3, calculated in accordance with the Solvency II regime, which is 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 matter that we have identified in the current year is the valuation of the outstanding claims reserves. Within this report, key audit matters are identified as follows: Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used was £873,000, which approximates 3% of insurance liabilities.
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.

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For the year ended 31 December 2020

4. Conclusions relating to going concern

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

Our evaluation of the directors' assessment of the Company's ability to continue to adopt the going concern basis of accounting included:

- Assessing Direct Line Insurance Group Plc's (the Group) process around the going concern assessment performed by management which covers the subsidiaries including Churchill Insurance Company Limited;
- Assessing the reasonableness of the profit forecasts used by management;
- Evaluating the Company's current year performance and year end liquidity and solvency capital position; and
- Evaluating the appropriateness of the going concern disclosures.

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

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

5. Key audit matters

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

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

5.1 Valuation of outstanding claims reserves

Refer to page 16 (Accounting Policies) and page 32 (note 9 to the Financial Statements)

Key audit matter description	The principal activity of the Company relates to the handling and final settlement of outstanding claims. The Company ceased underwriting activities on 10 December 2011. The valuation of these outstanding claims reserves has a material impact on the financial statements, with these liabilities totalling £29.1 million (2019: £28.5 million.) The majority of the outstanding claims in the Company are settled by PPOs. These liabilities total £26.8 million on a discounted gross basis which is 92% (2019: 92%) of the outstanding claims reserves. We have refined our key audit matter to relate to the assumptions used in the valuation of settled PPOs. Given the ongoing uncertainty in the UK's inflation environment and investment markets, the selection of the inflation and discount rate assumptions is highly judgemental and has a material impact on the financial statements. PPOs are sensitive to the choice of inflation and discount rate used, with small rate changes resulting in material valuation differences. As at 31 December 2020, the Company valued PPOs using an inflation rate of 3.5% (2019: 4%) and a discount rate of 3.5% (2019: 4%). While still using a net zero figure the reduction in the two rates will have the impact of reducing the net insurance liabilities. 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 the relevant controls surrounding the setting of the PPO inflation rate and discount rate, which is the challenge and approval of these assumptions by the Loss Ratio Committee and Audit Committee. We tested the relevant control 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: • The PPO inflation assumption through inquiries with the Actuarial Director, assessing relevant supporting documentation and benchmarking against market economic data, with particular reference to Covid-19 uncertainity, and other market participants; • The Company's sensitivity testing on the PPO inflation assumption;

Independent Auditor's report to the members of Churchill Insurance Company Limited

For the year ended 31 December 2020

	• The selected discount rate with reference to current and future performance of the assets backing the PPO liabilities; and • The methodology and rationale for deriving the discount rate.
Key observations	We have determined that the inflation and discount rate assumptions used in the calculation of the PPO claims reserve are reasonable.

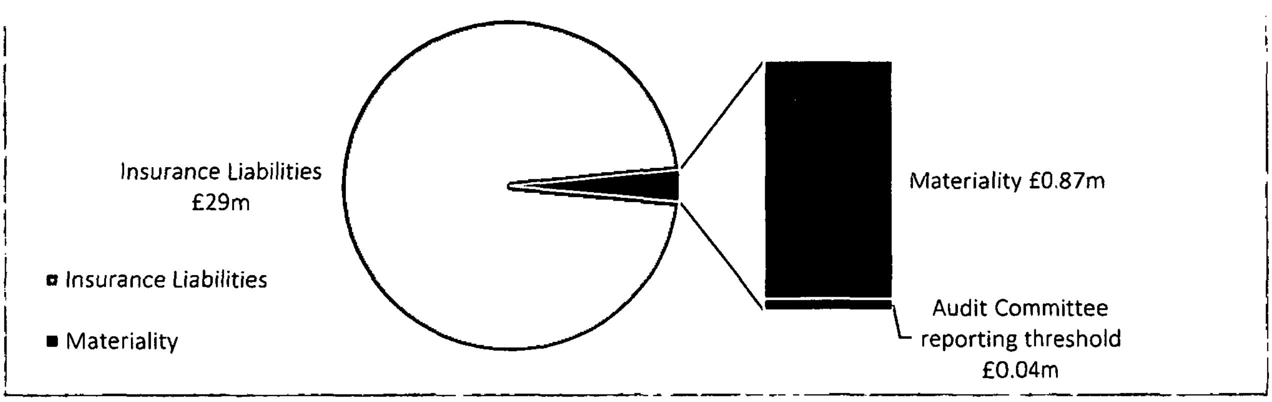
6. Our application of materiality

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	£873,000 (2019: £853,000)
Basis for determining materiality	Materiality was determined as approximately 3.0% (2018: 3.0%) of insurance liabilities.
Rationale for the benchmark applied	We determined that the critical benchmark for the Company was outstanding insurance liabilities. This measure is the total of insurance liabilities, including both claims reported and claims incurred but not reported. We considered this measure to be suitable because the Company is an insurer in run-off. As such, neither revenue nor profit measures would be appropriate given that no business is being written. Given that the Company's principal activity is the handling and final settlement of outstanding claims, we expect that insurance reserves will be the benchmark of most importance to users.



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 67.5% of Company materiality for the 2020 audit (2019: 70%). In determining performance materiality, we considered the following factors:

- Our assessment of the Company's overall control environment including the potential impact of Covid-19 and that we consider it appropriate to rely on controls over a number of business processes; and
- Our past experience of the audit, which has indicated a low number of corrected and uncorrected misstatements identified in prior periods.

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £43,650 (2019: £42,650), 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.

7.2 Our consideration of the control environment

IT Controls

In planning our 2020 audit we identified a number of systems that were material to the Company's financial reporting processes. These systems handled data relating to 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 obtain an understanding and test 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 material systems identified.

Business processes and financial reporting controls

In planning our 2020 audit, we identified four 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 investments, cash, claims and part of the reserving cycle relating to reconciliation of data. We intended to rely on the business controls associated with all of these cycles. Having completed our testing over the relevant 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 four cycles.

8. Other information

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

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

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

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether 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 this regard.

9. Responsibilities of directors

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

In preparing the financial statements, the directors are responsible for assessing the 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.

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

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

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

11.1 Identifying and assessing potential risks related to irregularities

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

- the nature of the industry and sector, control environment and business performance including the design of the 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 11 February 2021;
- results of our enquiries of management, internal audit, and the audit committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the 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;
- 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 outstanding claims reserves 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 the valuation of the outstanding claims reserves as a key audit matter related to the potential risk of fraud. 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 that key audit matter.

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;

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For the year ended 31 December 2020

- 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 this matter.

14. Other matters which we are required to address

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 Churchill Insurance Company 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).

Independent Auditor's report to the members of Churchill Insurance Company Limited

For the year ended 31 December 2020

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

25 March 2021

Profit and loss account

For the year ended 31 December 2020

Technical account – general business	Notes	2020 £'000	2019 £'000
Claims incurred, net of reinsurance			
Claims paid			
Gross amount		**(363)**	(42)
Reinsurers' share		**1,320**	37
Net claims received / (paid)		**957**	(5)
Change in the provision for claims			
Gross amount		**(661)**	532
Reinsurers' share		**346**	(677)
Net change in provision for claims		**(315)**	(145)
Claims received / (incurred), net of reinsurance		**642**	(150)
Balance on the technical account for general business – transferred to non-technical account		**642**	(150)
Non-technical account – general business			
Investment income	4	**44**	130
Profit / (loss) on ordinary activities before taxation		**686**	(20)
Tax on (profit) / loss on ordinary activities	6	**(130)**	4
Profit / (loss) and total comprehensive income for the year		**556**	(16)

There were no items of other comprehensive income in the year, therefore no separate statement of comprehensive income is required.

The attached notes on pages 16 to 26 form an integral part of these financial statements.

Balance sheet

As at 31 December 2020

	Notes	2020 £'000	2019 £'000
Assets			
Reinsurers' share of technical provisions			
Claims outstanding	7	**24,116**	23,770
Debtors			
Debtors arising out of reinsurance operations		**257**	585
Current tax asset		**–**	3
Amounts owed by Group undertakings		**3**	–
Other debtors		**–**	11
Total debtors		**260**	599
Other assets			
Cash at bank and in hand		**18,567**	17,316
Total assets		**42,943**	41,685
Liabilities			
Capital and reserves			
Profit and loss account		**13,694**	13,138
Shareholder funds		**13,694**	13,138
Technical provisions			
Claims outstanding	9	**29,118**	28,457
Provisions for other risks			
Provision for deferred tax	6	**–**	1
Creditors			
Other creditors including taxation and social security	10	**131**	89
Total liabilities		**42,943**	41,685

The Company has 100 issued and fully paid £1 ordinary shares.

The attached notes on pages 16 to 26 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 25 March 2021. They were signed on its behalf by:

P J James
Director

Statement of changes in equity

For the year ended 31 December 2020

	Retained earnings £'000	Total shareholder equity £'000
Balance at 1 January 2019	13,154	13,154
Loss for the year	(16)	(16)
Balance at 31 December 2019	13,138	13,138
Profit for the year	**556**	**556**
Balance at 31 December 2020	**13,694**	**13,694**

The attached notes on pages 16 to 26 form an integral part of these financial statements.

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

Notes to the financial statements

For the year ended 31 December 2020

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.

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 effective International Financial Reporting Standards ("IFRS") as adopted by the EU on 31 December 2020 and by the UK's Government Department of Business, Energy and Industrial Strategy ("BEIS") in 2021 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 FRS 101 disclosure exemptions:

- FRS 101.8 (g): the requirements of paragraphs 10(d), 10(f), 16, 38A, 38B, 38C, 38D, 40A, 40B, 40C, 40D and 111 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; and
- 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 which is party to a transaction is wholly owned by such a member.

The Company has sufficient financial resources to meet its financial needs. The Directors believe the Company is well positioned to manage its business risks successfully in the current economic climate. The Strategic report on pages 2 to 3 and Directors report on pages 4 to 5 describe the Company's business activities and financial performance for the year, together with the factors likely to affect its future development, performance and position. Additionally, note 3 to the financial statements includes the Company's objectives, policies and processes for managing its insurance and financial risks and capital which may affect the Company's financial position. The Directors have assessed the principal risks of the Company over the duration of the planning cycle. These included possible challenging market conditions due to the impact of Covid-19 on the economy and possible adverse implications of Brexit. However, as the Company's activity is to handle and settle of a small portfolio of large bodily injury claims, which are mainly UK claims and are largely covered by reinsurance, these risks are expected to have a limited impact on the Company.

Therefore, 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 25 March 2021 (the date of approval of the financial statements). The Directors reasonably expect that, although the Company has ceased underwriting activities, there will still be claims handling activities over the next 12 months. Accordingly, the Directors have adopted the going concern basis in preparing the financial statements.

Adoption of new and revised standards

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

None of these amendments require changes to existing accounting policies.

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

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

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

Amendments to IAS 1 and IAS 8: 'Definition of Material' clarifies and aligns the definition of 'material' and provides guidance to help improve consistency in the application of that concept whenever it is used in IFRS Standards.

1. Accounting policies continued

1.2 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.

1.3 Revenue recognition

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.

1.4 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 in respect of personal injury and may order that the damages are wholly or partly to take the form of PPOs. These are covered in more detail in note 2.1. 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. 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.

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

1.6 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.

Notes to the financial statements
For the year ended 31 December 2020

1. Accounting policies continued

1.7 Taxation

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

The current tax charge is based on the taxable profits for the year as determined in accordance with the relevant tax legislation, after any adjustments in respect of prior years. Taxable profit differs from net profit as reported in the 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 other comprehensive income.

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, in which case the deferred tax is also dealt with in other comprehensive income.

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.

1.8 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.

1.9 Amendments to IFRS 4 and adoption of IFRS 9

In July 2014, the IASB issued the final version of IFRS 9 'Financial Instruments' which replaced 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 introduces 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.

Amendments to IFRS 4: 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' was issued on 12 September 2016 and endorsed by the EU on 3 November 2017. These amendments permitted insurers who satisfied certain criteria to defer the effective date of IFRS 9 'Financial Instruments', to coincide with the expected effective date of IFRS 17 'Insurance Contracts.' The IASB permitted this option having considered potential asset and liability mismatching and temporary profit and loss volatility caused by introducing these new standards in different periods within a short period of time.

The amendments 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 when an entity's liabilities connected to insurance comprise a predominant proportion of its total liabilities as at that date. The Company concluded that it satisfied the criteria that the carrying value of its liabilities connected to insurance was greater than 90% of the carrying value its total liabilities at 31 December 2015 and that those liabilities were within the scope of IFRS 4. There have been no significant changes in its activities since this assessment to require a reassessment of the criteria, and therefore the Company continues to defer the adoption of IFRS 9.

As the effective date of IFRS 17 'Insurance Contracts' has since been delayed to 1 January 2023, 'Amendments to IFRS 4 – deferral of IFRS 9' was issued in June 2020 which delays the effective date of IFRS 9 so as to remain in line with IFRS 17. The amendments were endorsed by the BEIS in January 2021.

Notes to the financial statements
For the year ended 31 December 2020

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 underlie the preparation of its financial information. The Company's principal accounting policies are set out on pages 16 to 18. 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 IFRSs 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.

2.1 General insurance: outstanding claims provisions and related reinsurance recoveries

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

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 2020 amounted to £5,002,000 (2019: £4,687,000).

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

The corresponding reinsurance recoveries and impairment provision are calculated on an equivalent basis, with similar estimation uncertainty, as discussed in note 1.5. The reinsurance bad debt provision is mainly for expected recoveries against future PPO payments.

The table in note 9 to the financial statements provides an analysis of outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2020 and 31 December 2019 and further details on sources of estimation uncertainty. Details of sensitivity analysis to the discount rate applied to PPO claims are shown in note 3.2.

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 whole Group. Copies can be obtained from Direct Line Group Secretariat, Churchill Court, Westmoreland Road, Bromley, BR1 1DP, the Registrar of Companies or at www.directlinegroup.co.uk

The key risks applicable to the Company are detailed below:

Notes to the financial statements
For the year ended 31 December 2020

3. Risk management continued

3.2 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

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; and
- failure to recognise claims trends in the market.

Understatement of reserves may result in not being able to pay claims when they are due. Alternatively, overstatement of reserves can lead to a surplus of funds being retained resulting in opportunity cost; for example, through lost investment return.

Reserve risk is controlled through a range of processes:

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

The table below provides a sensitivity analysis of the potential net impact of a change in a single factor (discount rate used for PPOs) with all other assumptions left unchanged. Other potential risks beyond the one described could have an additional financial impact on the Company.

	Increase / (decrease) in profit before tax[1,2]	
At 31 December	**2020 £'000**	2019 £'000
PPOs[3]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	**806**	831
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	**(1,143)**	(1,184)

Notes:

1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at 31 December and should not be interpreted as predictions.
3. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0% for reserving. The PPO sensitivity has been calculated on the direct impact on the change in the real discount rate with all other factors remaining unchanged.

3. Risk management continued

In addition, 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; and
- 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.

Reinsurance risk
This is the risk of inappropriate selection and/or placement of a reinsurance arrangement, 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 credit exposure to any given counterparty. The bad debt risk in the Company (specific and general) is 100% reinsured with U K Insurance Limited;
- underwriting risk appetite and reinsurance contract terms not being aligned;
- reinsurance contract terms being inappropriate or ineffective resulting in classes or types of business not being appropriately reinsured;
- non-adherence to the reinsurance policy terms and conditions, in terms of both policy management and claims not being handled within the reinsurance contract terms and conditions or paid on an ex-gratia basis resulting in reinsurance recoveries not being made in full; and
- changes in the external legal, regulatory, social or economic environment 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.

3.3 Market risk

The Company is mainly exposed to 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 is considered to be immaterial but would arise mainly from its assets and liabilities exposed to fixed interest rates.

The Company has policies and limits approved by the Group 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 considering strategy, risk appetite and capital resources.

The Company monitors its market risk exposure on a monthly basis and, in addition, has established an aggregate exposure limit consistent with its risk objective of maintaining 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 at the Investment Committee.

Notes to the financial statements
For the year ended 31 December 2020

3. Risk management continued

3.4 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.

Counterparty default risk
This is the risk of loss from unexpected default or deterioration in the credit standing of the counterparties and debtors of Company undertakings. This risk is monitored by two forums: the Investment risk forum monitors credit spreads as indicators of potential losses on investments incurred but not yet realised; and the Credit risk forum monitors reinsurance and corporate insurance counterparty default 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 source of counterparty default risk for the Company is:

- 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 significantly increase the length of time to reach final payment. This can increase reinsurance counterparty default risk in terms of both amount and longevity.

The Company cedes away insurance risk to reinsurers but, in return, assumes back 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 counterparty exposures are reviewed on a quarterly basis.

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.

No balances are past due or impaired at the end of the current financial year.

The tables below analyse the credit quality of financial and insurance assets that are neither past due nor impaired. The table includes reinsurance exposure, after impairment provision.

At 31 December 2020	AAA £'000	AA+ to AA- £'000[1]	A+ to A- £'000[1]	BBB £'000	Unrated £'000	Total £'000
Reinsurers' share of technical provisions	–	22,267	1,849	–	–	**24,116**
Debtors	–	–	257	–	3	**260**
Cash at bank and in hand[2]	18,290	–	277	–	–	**18,567**
Total	**18,290**	**22,267**	**2,383**	**–**	**3**	**42,943**

At 31 December 2019	AAA £'000	AA+ to AA- £'000[1]	A+ to A- £'000[1]	BBB £'000	Unrated £'000	Total £'000
Reinsurers' share of technical provisions	–	21,004	2,766	–	–	23,770
Debtors	–	–	585	–	14	599
Cash at bank and in hand[2]	17,270	46	–	–	–	17,316
Total	17,270	21,050	3,351	–	14	41,685

Note:
1. 2019 comparative represented to correct credit quality analysis.
2. Includes money market funds with no notice period for withdrawal.

Notes to the financial statements
For the year ended 31 December 2020

3. Risk management continued

3.5 Operational risk

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

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.

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

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

3.6 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.

Cash at bank and in hand includes money market funds with no notice period for withdrawal. Cash at bank and in hand and total debtors are due on demand and the reinsurers' share of technical provisions match the maturity of the technical provisions.

The following table analyses the undiscounted cash flows of insurance and financial liabilities by expected maturity date.

At 31 December 2020	Within 1 year £'000	1 – 3 years £'000	3 – 5 years £'000	5 – 10 years £'000	Over 10 years £'000	**Total £'000**	Carrying value £'000
Insurance liabilities	130	1,021	1,091	3,419	79,798	**85,459**	29,118
Other creditors including taxation and social security	131	–	–	–	–	**131**	131
Total	**261**	**1,021**	**1,091**	**3,419**	**79,798**	**85,590**	29,249

At 31 December 2019	Within 1 year £'000	1 – 3 years £'000	3 – 5 years £'000	5 – 10 years £'000	Over 10 years £'000	Total £'000	Carrying value £'000
Insurance liabilities	473	1,161	1,255	3,950	95,794	102,633	28,457
Other creditors including taxation and social security	89	–	–	–	–	89	89
Total	562	1,161	1,255	3,950	95,794	102,722	28,546

Notes to the financial statements
For the year ended 31 December 2020

3. Risk management continued

3.7 Capital adequacy (unaudited)

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, rating agency and policyholder requirements.

The Company's regulatory capital position is assessed against the Solvency II framework. The Company uses the standard formula to assess its SCR.

The Company's SCR has been calculated as £0.9 million (2019: £0.8 million) using the standard formula approach. However, the absolute floor of the MCR specified in the Solvency II Directive is €3.7 million (£3.3 million at 2020 exchange rates) (2019: €3.7 million (£3.7 million at 2019 exchange rates)). As a result of this, the Company's MCR is £2.4 million (2019: £2.4 million) higher than its SCR. The Company has a capital surplus of approximately £13.7 million (2019: £13.2 million) above its SCR and £11.3 million (2019: £10.8 million) above its MCR at 31 December 2020. The Group's capital requirements and solvency position are produced and presented to the Board on a regular basis.

4. Investment income

	2020 £'000	2019 £'000
Interest income	**44**	130

5. Profit on ordinary activities before taxation

Auditor's remuneration
Fees for audit and non-audit services are borne by a fellow subsidiary company, DL Insurance Services Limited.

Fees paid to the Auditor in respect of the statutory audit of the Company amount to £33,762 (2019: £32,319).

6. Taxation

	2020 £'000	2019 £'000
Current taxation (charge) / credit for the year	**(130)**	4

The actual income tax charge in the current and prior year is the same as the expected income tax charge computed by applying the standard rate of UK corporation tax of 19% (2019: 19%).

Note:

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

	2020 £'000	2019 £'000
Per balance sheet		
Current tax assets	**–**	3
Current tax liabilities	**(131)**	–
Deferred tax liabilities	**–**	(1)

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

Deferred tax liability[1]	2020 £'000	2019 £'000
At 1 January	**1**	1
Charge to other comprehensive income	**(1)**	–
At 31 December	**–**	1

Note:

1. The deferred tax liability is a transitional relief on available for sale assets not held since 2016.

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

Notes to the financial statements
For the year ended 31 December 2020

7. Reinsurers' share of technical provisions

	2020 £'000	2019 £'000
Reinsurers' share of claims outstanding	**25,965**	26,535
Impairment provision	**(1,849)**	(2,765)
Total	**24,116**	23,770

Movements in reinsurance asset impairment provision

	2020 £'000	2019 £'000
At 1 January	**(2,765)**	(4,886)
Release to profit and loss account	**916**	2,121
At 31 December	**(1,849)**	(2,765)

8. Called-up share capital

	2020 £	2019 £
Issued and fully paid: equity shares		
100 Ordinary Shares of £1 each	**100**	100

The Company is a subsidiary of U K Insurance Limited and is a member of the Direct Line Group whose ultimate holding company is Direct Line Insurance Group plc.

9. Claims outstanding

	2020 £'000	2019 £'000
Gross insurance liabilities	**29,118**	28,457

All claims costs relate to claims incurred in accident year 2004 or earlier, hence the Company does not produce claims development tables.

Movements in gross and reinsurance claims outstanding

	Gross £'000	Reinsurance £'000	Net £'000
At 1 January 2019	28,989	(24,447)	4,542
Cash paid for claims settled in the year	(42)	37	(5)
Decrease in liabilities:			
Arising from prior-year claims	(490)	640	150
At 31 December 2019	28,457	(23,770)	4,687
Claims reported	26,184	(21,702)	4,482
Incurred but not reported	2,219	(2,068)	151
Claims handling provision	54	–	54
At 31 December 2019	28,457	(23,770)	4,687
Cash (paid) / received for claims settled in the year	**(363)**	**1,320**	**957**
Increase in liabilities:			
Arising from prior-year claims	**1,023**	**(1,666)**	**(643)**
At 31 December 2020	**29,118**	**(24,116)**	**5,002**
Claims reported	**26,799**	**(22,035)**	**4,764**
Incurred but not reported	**2,259**	**(2,081)**	**178**
Claims handling provision	**60**	**–**	**60**
At 31 December 2020	**29,118**	**(24,116)**	**5,002**

9. Claims outstanding continued

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

At 31 December	**Discounted 2020 £'000**	**Undiscounted 2020 £'000**	Discounted 2019 £'000	Undiscounted 2019 £'000
Gross claims				
Approved PPO claims provisions	**26,799**	**83,880**	26,184	100,356
Reinsurance				
Approved PPO claims provisions	**(22,035)**	**(73,144)**	(21,702)	(86,534)
Net of reinsurance				
Approved PPO claims provisions	**4,764**	**10,736**	4,482	13,822

The provisions for PPOs are for claims which have been determined by the courts as PPOs (approved PPO claims provisions). No further claims are expected to settle as PPOs. 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.

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 estimated to be 3.5% (2019: 4.0%). The Company has estimated a rate of interest used for the calculation of present values as 3.5% (2019: 4.0%), which results in a real discount rate of 0% (2019: 0.0%). The Company will continue to exercise judgement around 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 3.2.

10. Other creditors including taxation and social security

	2020 £'000	2019 £'000
Amounts owed to Group undertakings	–	89
Current tax	**131**	–
	131	89