Company Registration No: 01179980

U K INSURANCE LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2014

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

Annual report and financial statements

Contents

Officers and professional advisers

Directors:	M N Biggs P R Geddes J C Hanson S R E C James G P Jones A W Palmer A J Reizenstein C E Thompson P A Vacassin
Secretary:	R C Clifton
Registered office:	The Wharf Neville Street Leeds LS1 4AZ
Auditor:	Deloitte LLP Chartered Accountants London

Registered in England and Wales.

Strategic Report

For the year ended 31 December 2014

The Directors present their strategic report for the year ended 31 December 2014.

Activities and business review

Activity

The principal activity of U K Insurance Limited ("the Company") continues to be 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 direction and access to all central resources it needs and determines policies in all key areas such as finance, risk and human resources. For this reason, the Directors believe that key performance indicators specific to the Company are not necessary or appropriate for an understanding of the development, performance or position of the business. The annual report of DLIG reviews these matters on a group basis. Copies can be obtained from Direct Line Group Secretariat, Churchill Court, Westmoreland Road, Bromley, Kent, BR1 1DP, the Registrar of Companies or through the Group's website at www.directlinegroup.com.

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

Review of the year

Business review

The Directors are satisfied with the Company's performance in the year. The Company will be guided by its ultimate shareholder in seeking further opportunities for growth.

Financial performance

The Company's financial performance is presented in the statement of comprehensive income on page 7.

For the year 2014 net earned premium decreased by £155.5 million to £2,986.7 million, investment income increased by £20.7 million to £216.9 million and other income decreased by £10.5 million to £100.4 million. After £450.6 million of prior year releases, total net insurance claims decreased by £141.4 million to £1,756.9 million (2013: £1,898.3). Expenses decreased by £85.7 million to £1,103.1 million. The profit for the year after tax was £335.7 million (2013: £261.0 million).

The overall net loss ratio decreased from 60% in 2013 to 59% in 2014. The reduction arose from an improvement in the attritional loss ratio and higher prior-year reserve releases of £450.6 million as a percentage of net earned premium (2013: £449.6 million). The combined operating ratio in the year decreased from 98% in 2013 to 96% in 2014. Included in the 2014 ratio are one-off exceptional costs of £69.6 million (2013: £139.7 million). Excluding the one-off exceptional costs the combined operating ratio in the year was 93% (2013: 93%).

An interim dividend of £228.0 million was paid during the year ended 31 December 2014 (2013: £43.0 million). The directors recommend the payment of a final dividend £370.0 million (2013: £201.0 million).

At the end of the year, the statement of financial position reflected total assets of £9,515.6 million (2013: £10,006.4 million). Income generating assets are comprised primarily of the total assets as per the statement of financial position. Total equity was £2,127.7 million (2013: £2,177.7 million).

Principal risks and uncertainties

The Company's risk management objectives are set out in note 3.

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

John Reizenstein
Director

27th March 2015

Directors' Report

The directors present their report and the audited financial statements for the year ended 31 December 2014.

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 present Directors and secretary, who have served throughout the year except where noted below, are listed on page 1.

From 1 January 2014 to date the following changes have taken place:

	Appointed	Resigned
Directors		
M Catton		07 March 2014
S R E C James	28 August 2014	
Secretary		
H M Tomlinson		27 March 2014
R C Clifton	27 March 2014	

Going concern

The Directors, having a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future, have prepared the financial statements on a going concern basis.

Disclosure of information to auditor

Each person who was a director of the Company at the date of approval of this report confirms that:

a) so far as the director is aware, there is no relevant audit information 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 them 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 (continued)
For the year ended 31 December 2014

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 and the directors have elected to prepare them in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union. In preparing these financial statements, the directors have also elected to comply with IFRSs, issued by the International Accounting Standards Board ("IASB"). 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 at the end of the year and the profit or loss for the financial year of the Company. In preparing these financial statements, under International Accounting Standard 1, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions of the entity's financial position and performance; and
- make an assessment of the Company's ability to continue as a going concern.

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 at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the requirements of the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

John Reizenstein
Director

27th March 2015

Independent auditor's report to the members of U K Insurance Limited

We have audited the financial statements of U K Insurance Limited for the year ended 31 December 2014 which comprise the statement of comprehensive income, the balance sheet, the cash flow statement, the statement of changes in equity and the related notes 1 to 34. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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.

Respective responsibilities of Directors and auditor

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. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2014 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in Note 1 to the financial statements, the Company in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion the financial statements comply with IFRSs as issued by the IASB.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion 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.

Independent auditor's report to the members of U K Insurance Limited (continued)

For the year ended 31 December 2014

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

David Rush

Senior Statutory Auditor - for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditor

London, United Kingdom

27th March 2015

Statement of comprehensive income

For the year ended 31 December 2014

	Notes	2014 £m	2013 £m
Gross earned premium	4	**3,144.2**	3,281.1
Reinsurance premium ceded	4	**(157.5)**	(138.9)
Net earned premium	4	**2,986.7**	3,142.2
Investment return	5	**216.9**	196.2
Instalment income		**100.4**	110.9
Other operating income	6	**15.9**	15.9
Total income		**3,319.9**	3,465.2
Insurance claims	7	**(1,812.6)**	(1,886.5)
Insurance claims recoverable from reinsurers	7	**55.7**	(11.8)
Net insurance claims	7	**(1,756.9)**	(1,898.3)
Commission expenses	8	**(357.8)**	(333.0)
Operating expenses	9	**(745.3)**	(855.8)
Total expenses		**(1,103.1)**	(1,188.8)
Operating profit		**459.9**	378.1
Finance costs	10	**(37.8)**	(38.0)
Profit before tax		**422.1**	340.1
Tax charge	11	**(86.4)**	(79.1)
Profit for the year		**335.7**	261.0
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss:			
Fair value gain/(loss) on available-for-sale ("AFS") investments	26	**70.5**	(103.5)
Less: *realised net loss on AFS investments included in income statement*	26	**9.0**	6.2
Tax (charge)/credit on other comprehensive income		**(17.3)**	23.7
Other comprehensive income/(loss) for the year		**62.2**	(73.6)
Total comprehensive income for the year attributable to owners of the Company		**397.9**	187.4

The attached notes on pages 11 to 54 form an integral part of these financial statements.

Balance Sheet
For the year ended 31 December 2014

	Notes	2014 £m	2013 £m
Assets			
Intangible assets	14	**0.7**	1.0
Property, plant and equipment	15	**0.7**	0.7
Investment property	16	**301.3**	217.2
Investments in subsidiary undertakings	17	**30.0**	30.0
Reinsurance assets	18	**840.2**	779.7
Current tax assets	11	**0.1**	–
Deferred acquisition costs	19	**208.4**	223.3
Insurance and other receivables	20	**1,329.1**	1,275.4
Prepayments, accrued income and other assets		**59.5**	69.4
Derivative financial instruments	21	**24.9**	40.7
Financial investments	22	**5,956.1**	6,662.2
Cash and cash equivalents	23	**764.6**	705.8
Assets held for sale	24	**–**	1.0
Total assets		**9,515.6**	10,006.4
Equity			
Share capital	25	**580.8**	580.8
Other reserves	26	**803.7**	1,138.4
Retained earnings		**743.2**	458.5
Total equity		**2,127.7**	2,177.7
Liabilities			
Subordinated liabilities	27	**531.6**	492.7
Insurance liabilities	28	**4,644.8**	5,112.1
Unearned premium reserve	28	**1,434.2**	1,479.4
Borrowings	29	**24.9**	22.2
Derivative financial instruments	21	**29.3**	17.8
Trade and other payables including insurance payables	30	**670.1**	680.6
Deferred tax liabilities	12	**29.4**	19.9
Current tax liabilities	11	**23.6**	4.0
Total liabilities		**7,387.9**	7,828.7
Total equity and liabilities		**9,515.6**	10,006.4

The attached notes on pages 11 to 54 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 27th March 2015. They were signed on its behalf by:

John Reizenstein
Director

Statement of changes in equity

For the year ended 31 December 2014

	Notes	Share capital £m	Other reserves £m	Retained earnings £m	Total £m
Balance at 1 January 2013		580.8	1,345.4	245.9	2,172.1
Profit for the year		–	–	261.0	261.0
Other comprehensive loss		–	(73.6)	–	(73.6)
Transfer of business - realised net gain on AFS investments	26	–	–	(26.2)	(26.2)
Transfer of business - tax on realised net gain on AFS investments	26	–	–	7.4	7.4
Dividends	13	–	(163.0)	–	(163.0)
Transfer to non-distributable reserve		–	29.6	(29.6)	–
Balance at 31 December 2013		580.8	1,138.4	458.5	2,177.7
Profit for the year		–	–	**335.7**	**335.7**
Other comprehensive income		–	**62.2**	–	**62.2**
Transfer of business - realised net gain on AFS investments	26	–	–	**(25.6)**	**(25.6)**
Transfer of business - tax on realised net gain on AFS investments	26	–	–	**6.7**	**6.7**
Dividends	13	–	**(429.0)**	–	**(429.0)**
Transfer to non-distributable reserve		–	**32.1**	**(32.1)**	–
Balance at 31 December 2014		**580.8**	**803.7**	**743.2**	**2,127.7**

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

The attached notes on pages 11 to 54 form an integral part of these financial statements.

Cash flow statement
For the year ended 31 December 2014

	Notes	2014 £m	2013 £m
Profit for the year		**335.7**	261.0
Adjustments for:			
Investment income		**(178.9)**	(169.5)
Instalment income		**(100.4)**	(110.9)
Other operating losses		**6.5**	0.8
Investment property revaluations	5	**(26.7)**	(7.5)
Finance costs	10	**37.8**	38.0
Tax charge	11	**86.4**	79.1
Amortisation expenses	9	**0.3**	0.3
Impairment losses on assets held for sale	24	**0.2**	–
Impairment losses on reinsurance contracts	18	**9.0**	(7.5)
Profit on sale of AFS financial investments		**(17.9)**	(20.0)
Operating cash flows before movements in working capital		**152.0**	63.8
Movements in working capital:			
Net decrease in net insurance liabilities including reinsurance assets and deferred acquisition costs		**(567.1)**	(598.8)
Net decrease/(increase) in prepayments, accrued income and other assets		**9.9**	(5.1)
Net decrease in insurance and other receivables		**19.9**	69.2
Net (decrease)/increase in trade and other payables including insurance payables		**(10.5)**	70.5
Cash used by operations		**(395.8)**	(400.4)
Taxes paid		**(67.7)**	(59.7)
Net cash used by operating activities before investment of insurance assets		**(463.5)**	(460.1)
Interest received		**334.9**	546.3
Rental income received from investment property		**15.4**	11.2
Proceeds on disposal of investment properties		**21.1**	–
Proceeds of assets held for sale		**0.8**	–
Purchases of investment properties	16	**(76.2)**	(80.8)
Proceeds on disposal/maturity of AFS debt securities and other investment funds		**2,800.8**	2,930.4
Net decrease in loans and receivables		**304.7**	209.3
Purchases of debt securities		**(2,340.1)**	(3,207.9)
Cash generated from investment of insurance assets		**1,061.4**	408.5
Net cash generated / (used by) from operating activities		**597.9**	(51.6)
Cash flows from financing activities:			
Dividends paid	13	**(429.0)**	(163.0)
Finance costs		**(39.2)**	(39.0)
Net increase in loans to related parties		**(73.6)**	(57.9)
Net cash used by financing activities		**(541.8)**	(259.9)
Net increase/(decrease) in cash and cash equivalents		**56.1**	(311.5)
Cash and cash equivalents at the beginning of the year	23	**683.6**	995.1
Cash and cash equivalents at the end of the year	23	**739.7**	683.6

The Company classifies the cash flows for the purchase and disposal of financial assets in its operating cash flows as the purchases are funded from the cash flows associated with the origination of insurance contracts, net of the cash flows from payment of insurance claims.

The accompanying notes on pages 11 to 54 form an integral part of these financial statements.

Notes to the financial statements
For the year ended 31 December 2014

1. Accounting policies
1.1 Presentation of accounts
The accounts have been prepared on the going concern basis (see page 1 of the Directors' report) and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB as adopted by the European Union ("EU") (together IFRS). The financial statements are prepared on the historical cost basis except for AFS financial assets, investment property and derivative financial instruments, which are measured at fair value.

The Company is incorporated in the UK and registered in England and Wales.

The Company accounts are prepared in accordance with the Companies Act 2006.

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 annual report and 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 page 2 and the Directors' report on page 3. 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 following new or revised standards have been adopted in the year and have not had a material impact on the Company's financial statements:

IAS 32 (amended), 'Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities'. These amendments address previous inconsistencies when applying the offsetting criteria in IAS 32

IAS 36 (amended), 'Impairment of asset - Recoverable amount disclosures for non-financial assets'. These amendments clarify the scope of certain disclosures around the recoverable amount of impaired assets.

IAS 39 (amended), 'Financial instruments: recognition and measurement' - These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria.

IFRIC 21, 'Levies', Clarifies how an entity should account for liabilities to pay levies imposed by governments.

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 exempt under IFRS 10 Consolidated Financial Statements and 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 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 Pounds 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 rates of exchange ruling at the balance sheet date.

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

Notes to the financial statements (continued)
For the year ended 31 December 2014

1. Accounting policies

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 prior periods and that relate to periods of insurance cover after the balance sheet date. Unearned premiums are spread over the period of exposure under the policy, on a daily basis, 24ths basis or allowing for the estimated incidence of exposure under policies as appropriate.

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.

Investment return

Interest income on financial assets is determined using the effective interest rate method. The effective interest rate method is a way of calculating the amortised cost of a financial asset (or group of financial assets) and of allocating the interest income over the expected life of the asset. In the case of financial assets classified as AFS, estimates are based on the straight-line method, which is a close approximation to the effective interest rate.

Rental income from investment property is recognised in the income statement 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 income statement.

Instalment income

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

Other operating income

Other operating income includes vehicle replacement referral fee income comprises fees in respect of referral income received when a customer or a non-fault policy holder (claimant) of another insurer has been provided with a hire vehicle from a preferred supplier. Income is recognised immediately when the customer or claimant is provided with the hire vehicle.

Notes to the financial statements (continued)
For the year ended 31 December 2014

1. Accounting policies
1.6 Insurance claims
Insurance claims are recognised in the accounting period in which the loss occurs. Provision is made for the full cost of settling outstanding claims at the balance sheet date, including claims incurred but not yet reported at that date, net of salvage and subrogation recoveries. Outstanding claims provisions are not discounted for the time value of money except for claims to be settled by periodic payment orders ("PPOs") established under the Courts Act 2003. A UK 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 notes 2.1 and 3.2.1. 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 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. In addition, an allowance is made for reinsurance assets deemed not recoverable.

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 claim 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 as claims provisions.

A liability adequacy provision is made for unexpired risks arising where the expected value of net 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 Claims equalisation reserve
A statutory claims equalisation reserve continues to be included as a non-distributable reserve within other reserves in equity. This reserve is calculated in accordance with chapter 1.4 of the Prudential Sourcebook for Insurers (INSPRU).

1.8 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 accounted for in the same accounting period as the premiums for the related direct business being reinsured. Outward reinsurance recoveries are accounted for in the same accounting period as the direct claims to which they relate.

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

A reinsurance bad debt provision is assessed in respect of reinsurance recoverable, to allow for the risk that the reinsurance asset may not be collected or where the reinsurer's credit rating has been downgraded significantly. This also includes an assessment in respect of the ceded part of claims provisions to reflect the credit risk exposure to long-term reinsurance assets particularly in relation to PPOs. This is affected by the Company reducing the carrying value of the asset accordingly and the impairment loss is recognised in the income statement.

Notes to the financial statements (continued)

For the year ended 31 December 2014

1. Accounting policies

1.9 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, administration costs, commission paid and costs associated with telesales and underwriting staff.

1.10 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 income statement over the assets' economic lives using methods that best reflect the pattern of economic benefits and is included in other operating expenses. The estimated useful economic lives are as follows:

Prepaid commission up to 15 years

1.11 Property, plant and equipment

Items of property, plant and equipment (except investment property – see accounting policy 1.13) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to the income statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Estimated useful lives are as follows:

Freehold and long leasehold buildings	50 years or the period of the lease if shorter
Other equipment, including property adaptation costs	2 to 15 years

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

1.12 Impairment of intangible assets and property, plant and equipment

At each reporting date, the Company assesses whether there is any indication that its intangible assets or property, plant and equipment are impaired. If any such indication exists, the Company estimates the recoverable amount of the asset and the impairment loss, if any. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Value in use is the present value of future cash flows from the asset, discounted at a rate that reflects market interest rates, adjusted for risks specific to the asset that have not been reflected in the estimation of future cash flows.

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

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

1.13 Investment property

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

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

1.14 Investment in subsidiary undertakings

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

1. Accounting policies

1.15 Financial assets

Financial assets can be classified as held-to-maturity, AFS, designated at fair value through profit or loss, or loans and receivables. The Company only has AFS financial assets and loans and receivables.

Financial assets that are not classified as loans and receivables are classified as AFS. Financial assets can be designated as AFS on initial recognition. AFS financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Impairment losses and exchange differences resulting from retranslating the amortised cost of foreign currency monetary AFS financial assets are recognised in the income statement, together with interest calculated using the effective interest rate method. Other changes in the fair value of AFS financial assets are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in the income statement.

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on trade date.

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

The valuation methodology described above uses observable market data.

If the market for a financial asset is not active, the Company establishes the fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, 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.

The fair value of other investments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument are reliably measurable if:

(a) the variability in the range of reasonable fair value estimates is not significant for that instrument; or

(b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

Loans and receivables – Non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as AFS. 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.

Notes to the financial statements (continued)
For the year ended 31 December 2014

1. Accounting policies
1.15 Financial assets
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.

Other loans and receivables principally comprise loans to related parties and other debtors.

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

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

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

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

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

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 written off to the income statement and the bad debt provision is written back to the income statement.

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

Gains and losses arising from changes in the fair value of a derivative are recognised as they arise in the income statement unless the derivative is the hedging instrument in a qualifying hedge. The Company enters into a number of hedge relationships for cash flow and fair value 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 fair value hedge, the gain or loss on the hedging instrument is recognised in the income statement. The gain or loss on the hedged item attributable to the hedged risk is recognised in the income statement and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item.

Notes to the financial statements (continued)
For the year ended 31 December 2014

1. Accounting policies
1.15 Financial assets
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.

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

Borrowings, comprising bank overdrafts and group loans, are measured at amortised cost using the effective interest rate method.

1.17 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.

1.18 Subordinated liabilities
Subordinated liabilities comprise subordinated-dated loan 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.

1.19 Provisions
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 accrues for all insurance industry levies, such as the Financial Services Compensation Scheme and Motor Insurance Bureau.

1.20 Leases
Payments made under operating leases are charged to the income statement on a straight-line basis over the term of the lease.

1.21 Taxation
The tax expense represents the sum of the tax currently payable and deferred tax.

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

Provision for taxation is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date, and is allocated over profits before taxation 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.

Notes to the financial statements (continued)

For the year ended 31 December 2014

1. Accounting policies

1.21 Taxation

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

1.22 Dividends

Interim dividends on ordinary shares are recognised in equity in the period in which they are paid. Final dividends on ordinary shares are recognised when they have been approved at a general meeting.

1.23 Accounting developments

In July 2014, the IASB issued IFRS 9 'Financial Instruments' that will replace IAS 39 'Financial Instruments: Recognition and Measurement' in its entirety. The classification and measurement of financial assets and liabilities will be directly linked to the nature of the instrument's contractual cash flows and the business model employed by the holder of the instrument.

The standard introduces a new expected loss model that is a departure from the current incurred loss model. The model requires a 12 month expected loss to be recognised for all financial instruments when they are first originated or acquired. In subsequent periods, if there is a significant increase in credit risk of a financial instrument since it was first entered into or acquired, a full lifetime expected credit losses would then be recognised.

The standard has introduced greater flexibility in the type of transactions eligible for hedge accounting and broadened the type of instruments that qualify as hedging instruments. The hedge effectiveness test has been replaced with the principle of an 'economic relationship'.

The standard is effective for annual periods beginning on or after 1 January 2018, although early adoption is permitted.

In May 2014, IFRS 15 'Revenue from Contracts with Customers' was issued by the IASB, to establish a single comprehensive model to use in accounting for revenue recognition and measurement, from contracts (note: insurance contracts are excluded from the scope of IFRS 15) with customers. The standard provides a more perspective guidance on when and how combined contracts should be unbundled and when a transaction price includes a variable consideration element. The standard will require the Company to consider contracts with customers to determine if changes are required to existing accounting practices, but is not expected to have a material impact on the Company's financial statements.

The standard is effective for annual periods beginning on or after 1 January 2017, although early adoption is permitted.

2. Critical accounting estimates and judgements

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 11 to 18. UK company law and IFRS require 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 IFRS dealing with similar and related issues and IASB's Framework 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. The use of estimates, assumptions or models that differ from those adopted by the Company would affect its reported results.

2.1 General insurance: outstanding claims provisions and related reinsurance recoveries

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 provision. Outstanding claims provisions net of related reinsurance recoveries at 31 December 2014 amounted to £3,891.6 million (2013: £4,394.4 million).

The most common method of settling bodily injury claims is by a lump sum paid to the claimant and in the cases where this includes an element of indemnity for recurring costs such as loss of earnings or ongoing medical care, settlement normally occurs using a standardised Ogden annuity factor at a discount rate of 2.5%. This is normally referred to as the Ogden discount rate which is a prescribed rate set by the Ministry of Justice ("MoJ"). Other estimates are also required for case management expenses, loss of pension, court protection fees, alterations to accommodation and transportation fees.

Notes to the financial statements (continued)

For the year ended 31 December 2014

2. Critical accounting estimates and judgements

2.1 General insurance: outstanding claims provisions and related reinsurance recoveries

In August 2012, the MoJ announced a review of the approach to setting the Ogden discount rate within the existing legal framework. Following further consultation, in 2014 the Justice Secretary announced that a panel of three financial investment experts will be appointed to provide testimony on potential changes to the discount rate on personal injury damages.

The Company holds provisions for a reduction in the Ogden discount rate at 31 December 2014 to 1.5% (2013: 1.5%). Details of sensitivity analysis to be assumed Ogden discount rate shown in note 3.2.1.

An alternative to Ogden based lump sums paid to claimants are PPOs. PPOs give rise to additional claims costs which are in excess of those calculated based on the Ogden tables. Discounting is applied to the total cost of the PPO and not just the additional cost.

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

At 31 December	Discounted 2014 £m	Undiscounted 2014 £m	Discounted 2013 £m	Undiscounted 2013 £m
Gross claims				
Approved PPO claims provisions	**397.9**	**1,136.7**	346.6	995.5
Anticipated PPOs	**640.2**	**1,931.5**	615.2	1,896.8
Total gross	**1,038.1**	**3,068.2**	961.8	2,892.3
Reinsurance				
Approved PPO claims provisions	**196.2**	**594.0**	188.0	567.1
Anticipated PPOs	**206.5**	**809.4**	150.9	671.0
Total reinsurance	**402.7**	**1,403.4**	338.9	1,238.1
Net of reinsurance				
Approved PPO claims provisions	**201.7**	**542.7**	158.6	428.4
Anticipated PPOs	**433.7**	**1,122.1**	464.3	1,225.8
Total net	**635.4**	**1,664.8**	622.9	1,654.2

The provision for PPOs have been categorised as either claims which have already settled as PPOs (approved PPO claims provisions) and those expected to settle as PPOs in the future (anticipated PPOs). Anticipated PPOs consists of both existing large loss case reserves including allowances for development as well as 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.

In the majority of cases, the inflation index agreed in the settlement is the Annual Survey of Hours and Earnings SOC 6115 inflation, for which the long-term rate is assumed to be 4.0% (2013: 4.0%). The rate of interest used for the calculation of present values is 4.0% (2013: 4.0%), which results in a real discount rate of 0.0% (2013: 0.0%).

Details of sensitivity analysis to the discount rate applied to PPO claims are shown in note 3.2.1.

2.2 Impairment provisions – financial assets

AFS - The Company determines that AFS 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.

Notes to the financial statements (continued)

For the year ended 31 December 2014

2. Critical accounting estimates and judgements

2.2 Impairment provisions – financial assets

On a quarterly basis, the Company reviews whether there is any objective evidence that the direct investments in debt securities are impaired based on the following criteria:

- price performance of a particular debt security, or group of debt securities, demonstrating an adverse trend compared to the market as a whole;
- adverse movements in the credit rating for corporate debt;
- actual, or imminent, default on coupon interest or nominal; or
- offer on buyback of perpetual bonds below par value.

Impairment provision charges on AFS financial assets at 31 December 2014 amounted to £nil (2013: £nil).

Had all the declines in AFS asset values met the criteria above at 31 December 2014, the Company would suffer a further £15.5 million loss (2013: £34.8 million loss), being the transfer of the total AFS reserve for unrealised losses to the income statement. 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.

2.3 Fair value

Financial assets classified as AFS debt securities and derivative financial instruments are recognised in the financial statements at fair value determined using observable market input. The fair value of all AFS debt securities at 31 December 2014 amounted to £5,825.1 million (2013: £6,226.5 million). The fair value of derivative financial assets and liabilities amounted to £24.9 million (2013: £40.7 million) and £29.3 million (2013: £17.8 million) respectively.

Freehold and long leasehold properties that are classified as investment properties are recognised in the financial statements at fair value. Fair value was determined using the valuation model driven by unobservable inputs and at 31 December amounted to £301.3 million (2013: £217.2 million).

Estimation of the fair value of assets and liabilities

In estimating the fair value of financial assets and investment properties the methods and assumptions used by the Company incorporate:

Financial assets and liabilities

For fixed maturity securities, fair values are generally based upon quoted market prices. Where market prices are not readily available, fair values are estimated using either values obtained from quoted market prices or comparable securities.

Investment property

Investment property is recorded at fair value, measured by independent professionally qualified valuers who hold a recognised and relevant professional qualification. The valuation model is driven predominantly by unobservable inputs, as although in part the valuations are compared with recent market transactions for similar properties, they are adjusted for the specific characteristics of each property.

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

Level 1 financial assets are measured in whole or in part by reference to published quotes in an active market. In an active market quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Level 2 financial assets are measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. These are assets for which pricing is obtained via pricing services, but where prices have not been determined in an active market, or financial assets with fair values based on broker quotes, investments in private equity funds with fair values obtained via fund managers or assets that are valued using the Group's own models whereby the majority of assumptions are market-observable.

Level 3 fair value measurements used for investment properties are those derived from a valuation technique that include inputs for the asset that are unobservable.

Notes to the financial statements (continued)
For the year ended 31 December 2014

2. Critical accounting estimates and judgements

2.4 Deferred acquisition costs

The Company defers a proportion of acquisition costs incurred during the year to subsequent accounting periods. Management use estimation techniques to determine the level of costs to be deferred, by category of business. Judgement is used to determine the types of cost that can be deferred and these are referred to in note 1.9. The total deferred acquisition costs at 31 December 2014 amounted to £208.4 million (2013: £223.3 million). During 2014, the Company reviewed the costs included in the calculation of deferred acquisition costs and considers them to be appropriate, and has determined that they are recoverable.

2.5 Property, plant and equipment

The Company does not revalue property, plant and equipment, however it takes appropriate steps to consider whether the aggregate value of property, plant and equipment exceeds the balance sheet carrying value of such items.

The Company is satisfied that the aggregate value of property, plant and equipment are not less than their carrying value.

3. Risk management

3.1 Risk management overview

The Direct Line Insurance Group plc Board ("Group Board") has responsibility for setting and monitoring adherence to the risk strategy, risk appetite and risk framework. The Group Board has established a risk management model that separates the business's risk management responsibilities into "3 lines of defence" as set out below.

1st line of defence	- Risk ownership
2nd line of defence	- Oversight, challenge and support of 1st line
3rd line of defence	- Independent assurance

The annual report of DLIG 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 through Direct Line Insurance Group's website at www.directlinegroup.com.

The key risks applicable to the Company are detailed below.

3.2 Insurance risk

The Company is exposed to insurance risk as a primary consequence of its business. Key insurance risks focus on the inherent uncertainty around the occurrence, amount and timing of insurance liabilities arising through risks accepted during insurance operations, as defined in the ERM framework.

3.2.1 Reserving risk

Reserving risk relates to both premiums and claims. It is the risk that reserves are assessed incorrectly such that either insufficient funds have been retained to pay or handle claims as the amounts fall due, both in relation to those claims which have already been incurred (in relation to claims reserves) or will be incurred in future periods of insurance (in relation to premium reserves), or a surplus of funds has been retained resulting in opportunity costs.

Reserving risk is controlled through a range of processes:

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

The Company's reserves are particularly susceptible to potential retrospective changes in legislation and new court decisions, for example, a change in the Ogden discount rate. This is the discount rate set by the relevant government bodies and used by courts to calculate lump sum awards in bodily injury cases. The rate is currently 2.5% per annum but is under review by the MoJ. The Company has calculated its estimated reserves based on an assumed Ogden discount rate of 1.5%, in recognition of the uncertainty regarding the future rate.

Notes to the financial statements (continued)
For the year ended 31 December 2014

3. Risk management

3.2.1 Reserving risk

As referred to on page 19, uncertainty in claims reserve estimation is larger for claims such as PPOs for which annually indexed payments are made periodically over several years or even the lifetime of the injured party. Claims reserves for PPOs are held on a discounted basis and are impacted by a change to the discount rate.

The table below provides a sensitivity analysis of the potential impact 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 income statement		Increase / (decrease) in total equity at 31 December	
	2014 £m	2013 £m	**2014 £m**	2013 £m
PPOs[1]				
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points ("bps")	**86.4**	80.5	**86.4**	80.5
Impact of a decrease in the discount rate used in the calculation of present values of 100bps	**(117.5)**	(116.8)	**(117.5)**	(116.8)
Ogden				
Impact of an increase in the Ogden discount rate by 100bps	**159.6**	169.7	**159.6**	169.7
Impact of a decrease in the Ogden discount rate by 100bps	**(224.0)**	(238.2)	**(224.0)**	(238.2)

Notes:

1. The sensitivities relating to an increase or decrease in the discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 4%. An increase in the discount rate reflects a decrease in the time value of money and therefore the present value of future liabilities which increases the total equity which would be reflected in the income statement.
2. The selection of these sensitivities should not be interpreted as a prediction.
3. The sensitivities set out above reflect one-off impacts at 31 December.
4. The sensitivities set out above exclude the impact of taxation.

3.2.2 Pricing and Underwriting risk

The risk of economic loss arising from business being inappropriately accepted (i.e. outside underwriting rules/terms and conditions) and/or incorrectly priced.

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 SME 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 impose renewal terms by amending the premium or other policy terms and conditions such as the excess as appropriate.

3.2.3 Claims management risk

The risk that claims are reserved or paid inappropriately, including the timing of such activity.

Claims are managed utilising a range of IT system driven controls coupled with manual processes outlined in detailed policies and procedures to ensure claims are handled in an appropriate, timely and accurate manner.

Each member of staff has a specified handling authority, with controls preventing them handling or paying claims outside their authority, as well as controls to mitigate the risk of paying invalid claims. In addition, there are various outsourced claims handling arrangements, all of which are monitored closely by management, with similar principles applying in terms of the controls and procedures.

Loss adjustors are used in certain circumstances to handle claims to conclusion. This involves liaison with the policyholder, third parties, suppliers and the claims function.

Specialist bodily injury claims teams in the UK are responsible for handling these types of losses with the nature of handling dependent on the level and type of claim. Where applicable they are referred to the technical and large loss teams who also deal with all other claim types above defined limits or within specific criteria.

A process is in place in the UK business to deal with severe 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 impact.

Notes to the financial statements (continued)

For the year ended 31 December 2014

3. Risk management

3.2.4 Reinsurance risk

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 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 aggragate modelling); and

Changes in the external legal, regulatory, social or economic environment altering the definition and application of reinsurance policy wordings or effectiveness/value for money of reinsurance.

The Company uses reinsurance to:

- protect the insurance results against low-frequency, high-severity losses through the transfer of catastrophe claims volatility to reinsurers;
- protect the insurance results 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 retention strategy.

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

Certain reinsurance contracts have long durations as a result of PPOs, and insurance reserves therefore include provisions beyond the levels created for shorter term reinsurance bad debt.

3.2.5 Catastophe risk

The risk or loss, or of adverse change, in the value of insurance liabilities resulting from significant uncertainty of pricing and provisioning assumptions related to extreme or exceptional events.

3.2.6 Insurance concentration risk

The Company is subject to concentration risk in a variety of forms, including:

- geographic concentration risk – the Company purchases a UK catastrophe reinsurance programme to protect against a modelled 1 in 200 year combined windstorm and coastal inundation loss. The retained deductible is £150.0 million at 31 December 2014 (2013: £150.0 million).
- 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;
- sector concentration risk – the concentration of the Company to any given industry sector is monitored and analysed in respect of commercial customers; and
- reinsurance concentration risk – reinsurance is purchased from a number of providers to ensure that a diverse range of counterparties is contracted with, within the desired credit rating range.

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

Notes to the financial statements (continued)
For the year ended 31 December 2014

3. Risk management
3.2.6 Insurance concentration risk
The following table summarises earned premiums and the claims incurred together with the corresponding loss ratios for each major class of business on a gross and net of reinsurance basis for the current and prior year. In addition, the table provides an overview of the concentration of the Company's insurance risk.

		2014			2013		
		Earned premiums £m	Claims incurred £m	Loss Ratio %	Earned premiums £m	Claims incurred £m	Loss Ratio %
Motor	**Gross**	**1,372.6**	**966.0**	**70%**	1,498.4	1,010.9	67%
	Net	**1,295.9**	**897.7**	**69%**	1,444.8	967.5	67%
Home	**Gross**	**920.4**	**445.1**	**48%**	958.8	476.7	50%
	Net	**875.3**	**444.3**	**51%**	908.9	490.3	54%
Rescue and other personal lines	**Gross**	**370.5**	**211.9**	**57%**	355.3	218.9	62%
	Net	**369.1**	**211.9**	**57%**	354.1	218.0	62%
Commercial	**Gross**	**481.1**	**261.8**	**54%**	468.7	274.8	59%
	Net	**446.8**	**255.3**	**57%**	434.6	270.6	62%
Run-off	**Gross**	**(0.4)**	**(72.2)**	**-**	(0.1)	(94.8)	-
	Net	**(0.4)**	**(52.3)**	**-**	(0.1)	(48.1)	-
Total	**Gross**	**3,144.2**	**1,812.6**	**58%**	3,281.1	1,886.5	58%
	Net	**2,986.7**	**1,756.9**	**59%**	3,142.2	1,898.3	60%

3.3 Financial risk
The Company is exposed to financial risk through its financial assets and financial liabilities. The Company's financial risk is concentrated within its investment portfolio and reinsurance.

The strategic asset allocation within the investment portfolio is agreed for each legal entity by the Investment Committee. The Investment Committee determines policy and controls, covering such areas as safety, 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 various risk fora.

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

Notes to the financial statements (continued)
For the year ended 31 December 2014

3. Risk management
3.3.1 Market risk
Market risk is the risk associated with the adverse impact of the market risk factors movement on the Company's balance sheet due to changes in the fair value or cash flows of its assets or liabilities.

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

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

The Company has policies and limits approved by the Group Board 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 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 at the investment Committee.

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

Interest rate risk
The Company's interest rate risk arises mainly from its debt, floating interest rate investments and assets and liabilities exposed to fixed interest rates.

In 2012, DLIG issued £500 million of subordinated debt with a 30-year maturity and fixed rate coupon for the first 10 years. This was passed onto the Company as a subordinated loan. The cost of the fixed rate coupon has been hedged down to the three-month London Interbank Offered Rate ("LIBOR") floating rate.

The Company also invests in floating rate notes, 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.

The market value of the Company's investments in fixed coupon securities is affected by the movement of the interest rates. For the investments in US Dollar corporate bonds, the Company hedges the exposure of this portfolio to the US Dollar interest rate risk using swaps and futures. The derivatives reduce the duration of the portfolio to close to zero, eliminating its sensitivity to the US Dollar interest rate fluctuation.

Spread risk
The spread risk represents the risk of the adverse fluctuation of the values of assets and liabilities due to changes in the level of spreads. The Company is exposed to spread risk through its investments in investment grade bonds and securitised credit.

Foreign currency risk
The exposure to currency risk is generated by the Company's investments in US Dollar corporate bonds.

At 31 December 2014, the Company maintained exposure to US Dollar securities through its investments in US Dollar corporate bonds and US Dollar securitised credits. The foreign currency exposure of these investments is hedged by foreign currency forward contracts, maintaining a minimal unhedged (direct) currency exposure on these portfolios, as well as a low basis currency risk on the hedging.

Property risk
Property risk results from adverse price fluctuations on real estate investments. At 31 December 2014, the value of these investments in property was £301.3 million (2013: £217.2 million). The property investments are located in the UK and are subject to the asset admissibility rules as defined by the PRA.

Notes to the financial statements (continued)

For the year ended 31 December 2014

3. Risk management

3.3.1 Market risk

The table below provides the sensitivity analysis of the potential impact 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 income statement		Increase / (decrease) in total equity at 31 December	
	2014 £m	2013 £m	**2014 £m**	2013 £m
Spread				
Impact of an increase in AFS financial investments of 100bps movement in spreads[1]	**–**	–	**(163.5)**	(161.6)
Interest rate				
Impact on AFS financial investments and derivatives of an increase in interest rate of 100bps[1,2]	**19.1**	17.3	**(122.7)**	(144.0)
Investment property				
Impact of a decrease in property markets of 15%	**45.2**	(32.6)	**45.2**	(32.6)

Notes:

1. The income statement impact on AFS debt securities is limited to floating rate bonds and interest rate derivatives used to hedge a portion of the portfolio. The income statement is not impacted in relation to fixed rate bonds, where the coupon return is not impacted by a change in prevailing market rates, as the accounting treatment for AFS debt securities means that only the coupon received is processed through the income statement with fair value movements being recognised through total equity.
2. The sensitivities set out above reflect one-off impacts at 31 December with the exception of the income statement interest rate sensitivity on AFS debt securities, which projects a movement in a full year's interest charge as a result of the increase in the interest rate applied to the AFS debt securities and interest rate hedges on those positions held at 31 December.
3. The subordinated debt is excluded from the sensitivity analysis.
4. The selection of these sensitivities should not be interpreted as a prediction.
5. The sensitivities set out above have not considered the impact of the general market changes on the value of the Company's insurance contract liabilities or retirement benefit obligations.
6. The sensitivities set out above exclude the impact of taxation.

Notes to the financial statements (continued)
For the year ended 31 December 2014

3. Risk management
3.3.1 Market risk
The tables below analyse the maturity of the Company's derivative assets and liabilities.

At 31 December 2014	Notional amounts	Maturity of fair value			
	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	Total £m
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	**54.4**	0.3	–	–	**0.3**
Interest rate swaps	**696.6**	0.9	1.2	22.5	**24.6**
Total	**751.0**	**1.2**	**1.2**	**22.5**	**24.9**

At 31 December 2014	Notional amounts	Maturity of fair value			
	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	Total £m
Derivative liabilities					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	**1,892.3**	22.9	–	–	**22.9**
Interest rate swaps	**424.9**	1.3	0.5	4.6	**6.4**
Interest rate futures[1]	**540.5**	–	–	–	**–**
Total	**2,857.7**	**24.2**	**0.5**	**4.6**	**29.3**

Note:

1. Interest rate futures are settled daily with variation margin therefore have a fair value of zero. The notional value is included in the above table to reflect the fact that there are open positions that the Company has exposure to.

At 31 December 2013	Notional amounts	Maturity of fair value			
	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	Total £m
Derivative assets					
At fair value through the income statement:					
Foreign exchange contracts (forwards)	1,315.8	23.8	–	–	23.8
Interest rate swaps	370.1	(1.0)	1.7	8.9	9.6
Interest rate futures	561.3	7.3	–	–	7.3
Total	2,247.2	30.1	1.7	8.9	40.7

At 31 December 2013	Notional amounts	Maturity of fair value			
	£m	Less than 1 year £m	1 – 5 years £m	Over 5 years £m	Total £m
Derivative liabilities					
At fair value through the income statement:					
Interest rate swaps	739.9	(1.1)	0.4	18.5	17.8
Total	739.9	(1.1)	0.4	18.5	17.8

Notes to the financial statements (continued)
For the year ended 31 December 2014

3. Risk management
3.3.1 Market risk
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 2014 the Company has pledged £17.3 million in cash (2013: £4.9 million in cash and £20.0 million UK Gilts) to cover of the money derivative positions. At 31 December 2014 counterparties have pledged £21.5 million in UK Gilts (2013: £18.0 million in cash) to the Company to cover of 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 there has been no policy established for the disposal of assets not readily convertible into cash.

3.3.2 Counterparty risk
Counterparty risk arises from the potential that losses are incurred from the failure of counterparties to meet their credit obligations, due either to their failure and/or their inability to pay, or their unwillingness to pay amounts due.

Counterparty risk is primarily managed through the Credit Risk and Investment Forum. The main responsibility of this forum is to ensure that all material aspects of counterparty risk within the Company are identified, monitored and measured.

The main sources of counterparty risk for the Company are:

- investment counterparty – this arises from the investment of monies in the range of investment vehicles permitted by the investment policy; and
- reinsurance recoveries – counterparty exposure to reinsurance counterparties arises in respect of reinsurance claims against which a reinsurance bad debt provision is assessed. The Courts Act 2003, implemented in April 2005, gave the courts the power to award PPOs in place of lump sum awards to cover the future costs element of claims (that is, loss of future earnings and/or cost of future care). 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 has increased reinsurance counterparty risk in terms of both quantum and longevity.

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

At 31 December 2014	Neither past due nor impaired £m	Past due 1 – 90 days £m	Past due more than 91 days £m	Financial assets that have been impaired £m	Carrying value in the balance sheet £m
Reinsurance assets	**840.2**	–	–	–	**840.2**
Insurance and other receivables	**1,303.5**	24.0	1.6	–	**1,329.1**
Derivative assets	**24.9**	–	–	–	**24.9**
AFS debt securities	**5,825.1**	–	–	–	**5,825.1**
Deposits with credit institutions	**54.8**	–	–	–	**54.8**
Infrastructure debt	**76.2**	–	–	–	**76.2**
Cash at bank and in hand	**764.6**	–	–	–	**764.6**
Total	**8,889.3**	**24.0**	**1.6**	**–**	**8,914.9**

At 31 December 2013	Neither past due nor impaired £m	Past due 1 – 90 days £m	Past due more than 91 days £m	Financial assets that have been impaired £m	Carrying value in the balance sheet £m
Reinsurance assets	779.7	–	–	–	779.7
Insurance and other receivables	1,251.6	20.9	2.9	–	1,275.4
Derivative assets	40.7	–	–	–	40.7
AFS debt securities	6,222.2	–	–	4.3	6,226.5
Deposits with credit institutions	928.9	–	–	–	928.9
Cash at bank and in hand	212.6	–	–	–	212.6
Total	9,435.7	20.9	2.9	4.3	9,463.8

Notes to the financial statements (continued)
For the year ended 31 December 2014

3. Risk management
3.3.2 Counterparty risk

There were no material financial assets that would have been past due or considered for impairment had the contractual terms not been renegotiated.

Within the analysis of AFS debt securities above are bank debt securities, at 31 December 2014 of £1,328.3 million (2013: £1,366.9 million), that can be further analysed as: secured £104.1 million (2013: £106.1 million); unsecured £1,058.3 million (2013: £1,108.9 million); subordinated £165.9 million (2013: £151.9 million)

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

At 31 December 2014	AAA £m	AA + to AA - £m	A + to A - £m	BBB + to BBB - £m	BB + and below £m	**Total £m**
Corporate	235.2	556.6	2,096.5	935.2	293.6	**4,117.1**
Supranational	166.9	9.4	–	–	–	**176.3**
Local government	42.6	62.8	15.2	–	–	**120.6**
Sovereign	–	983.0	–	5.7	–	**988.7**
Securitised credit[1]	339.4	83.0	–	–	–	**422.4**
Total	**784.1**	**1,694.8**	**2,111.7**	**940.9**	**293.6**	**5,825.1**

At 31 December 2013	AAA £m	AA + to AA - £m	A + to A - £m	BBB + to BBB - £m	BB + and below £m	Total £m
Corporate	272.3	596.4	2,332.7	1,005.2	–	4,206.6
Supranational	294.6	35.8	–	–	–	330.4
Local government	75.7	44.0	14.8	–	–	134.5
Sovereign	–	1,362.8	–	5.9	–	1,368.7
Securitised credit[1]	164.0	18.0	–	–	–	182.0
Total	806.6	2,057.0	2,347.5	1,011.1	–	6,222.2

Note:

1. Securitised credit is all in the form of prime mortgage backed securities, collateralised loan obligations, securitised student loans and commercial mortgage backed securities.

Notes to the financial statements (continued)

For the year ended 31 December 2014

3. Risk management

3.3.2 Counterparty risk

The tables below analyse, by type of asset, the credit quality of financial and insurance assets that are neither past due nor impaired excluding debt securities. The table includes reinsurance exposure, after provision. Note 3.2.3 details the Company's approach to reinsurance counterparty risk management.

At 31 December 2014	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ & below £m	Not rated £m	Total £m
Reinsurance assets	–	631.9	196.3	4.3	–	7.7	**840.2**
Insurance and other receivables[1]	–	16.8	17.1	12.3	–	1,257.3	**1,303.5**
Derivative assets	–	0.8	0.8	23.3	–	–	**24.9**
Infrastructure debt	–	–	–	76.2	–	–	**76.2**
Deposits with credit institutions	624.0	54.8	–	–	–	–	**678.8**
Cash at bank and in hand	–	–	81.4	59.2	–	–	**140.6**
Total	**624.0**	**704.3**	**295.6**	**175.3**	**–**	**1,265.0**	**3,064.2**

At 31 December 2013	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ & below £m	Not rated £m	Total £m
Reinsurance assets	–	596.3	172.3	0.7	–	10.4	779.7
Insurance and other receivables[1]	–	8.8	24.9	0.4	–	1,217.5	1,251.6
Derivative assets	–	5.7	35.0	–	–	–	40.7
Deposits with credit institutions	438.2	60.0	430.7	–	–	–	928.9
Cash at bank and in hand	–	–	212.5	–	–	0.1	212.6
Total	438.2	670.8	875.4	1.1	–	1,228.0	3,213.5

Note:

1. Other loans and receivables due from policyholders, agents, brokers and intermediaries generally do not have a credit rating.

3.3.3 Liquidity risk

Liquidity risk is the potential that obligations cannot be met as they fall due as a consequence of having a timing mismatch and/or an inability to raise sufficient liquid assets or cash without suffering a substantial loss on realisation.

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 policy and supporting minimum standards. Compliance is monitored in respect of both the internal policy and the regulatory requirements of local regulators.

In the event that one or more liquidity stresses or scenarios crystallises, or should any other event that may impact liquidity occur, the Company ensures a rapid and controlled response to the event. In such an event, a liquidity crisis management team will be formed to assess the nature and extent of the threat and to develop an appropriate response.

The table below analyses AFS debt securities by maturity.

At 31 December	2014 £m	2013 £m
Within 1 year	**938.2**	946.0
1 – 3 years	**1,658.3**	1,745.0
3 – 5 years	**1,175.3**	1,685.8
5 – 10 years	**1,669.8**	1,535.2
Over 10 years	**383.5**	314.5
Total	**5,825.1**	6,226.5

In addition to the above, the Company held cash and cash equivalents at 31 December 2014 of £764.6 million (2013: £705.8 million) to cover short-term liabilities arising from insurance contracts.

Notes to the financial statements (continued)
For the year ended 31 December 2014

3. Risk management
3.3.3 Liquidity risk
The tables below analyse insurance and financial liabilities by remaining duration, in proportion to the cash flows expected to arise during that period, for each category.

At 31 December 2014	Total £m	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m
Subordinated liabilities	**531.6**	8.4	–	–	523.2	–
Insurance liabilities	**4,644.8**	1,395.6	1,177.9	649.8	527.9	893.6
Borrowings	**24.9**	24.9	–	–	–	–
Trade and other payables including insurance payables	**670.1**	670.1	–	–	–	–
Total	**5,871.4**	**2,099.0**	**1,177.9**	**649.8**	**1,051.1**	**893.6**

At 31 December 2013	Total £m	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m
Subordinated liabilities	492.7	8.5	–	–	484.2	–
Insurance liabilities	5,112.1	1,571.9	1,282.5	594.2	588.1	1,075.4
Borrowings	22.2	22.2	–	–	–	–
Trade and other payables including insurance payables	680.6	680.6	–	–	–	–
Total	6,307.6	2,283.2	1,282.5	594.2	1,072.3	1,075.4

The above tables exclude unearned premium reserves as there are no liquidity risks inherent in them.

Notes to the financial statements (continued)

For the year ended 31 December 2014

3. Risk management

3.3.4 Investment concentration risk

Concentration risk on investments arises through excessive exposure to particular industry sectors, groups of business undertakings or similar activities. The Company 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.

The table below analyses the distribution of AFS debt securities and infrastructure debt held by geographical area.

At 31 December 2014	Corporate £m	Local government £m	Sovereign £m	Securitised Credit £m	**AFS debt total £m**	Infrastructure Debt £m
Australia	120.2	–	–	–	**120.2**	–
Belgium	33.8	–	3.6	–	**37.4**	–
Canada	60.8	34.3	–	–	**95.1**	–
Cayman Islands	19.3	–	–	218.9	**238.2**	–
China	6.1	–	–	–	**6.1**	–
Denmark	25.1	–	–	–	**25.1**	–
Finland	–	14.2	–	–	**14.2**	–
France	275.1	23.4	–	–	**298.5**	–
Germany	310.3	5.0	–	–	**315.3**	–
Hong Kong	8.5	–	–	–	**8.5**	–
Italy	15.5	–	–	–	**15.5**	–
Japan	46.9	–	–	–	**46.9**	–
Luxembourg	6.8	–	–	–	**6.8**	–
Mexico	12.6	–	5.6	–	**18.2**	–
Netherlands	154.4	–	–	–	**154.4**	–
New Zealand	3.6	–	–	–	**3.6**	–
Norway	24.3	10.1	–	–	**34.4**	–
Singapore	25.5	–	–	–	**25.5**	–
South Korea	7.5	7.6	–	–	**15.1**	–
Spain	30.6	–	–	–	**30.6**	–
Sweden	73.2	12.9	–	–	**86.1**	–
Switzerland	82.6	–	–	–	**82.6**	–
UAE	–	7.0	–	–	**7.0**	–
UK	1,334.8	–	979.4	69.4	**2,383.6**	76.2
USA	1,439.6	6.0	–	134.2	**1,579.8**	–
Supranational	–	–	–	–	**176.4**	–
Total	**4,117.1**	**120.5**	**988.6**	**422.4**	**5,825.1**	**76.2**

Notes to the financial statements (continued)
For the year ended 31 December 2014

3. Risk management
3.3.4 Investment concentration risk
The table below analyses the distribution of AFS debt securities held by geographical area.

At 31 December 2013	Corporate £m	Local government £m	Sovereign £m	Securitised credit £m	Total £m
Australia	200.9	–	–	–	200.9
Belgium	35.9	–	–	–	35.9
Brazil	2.9	–	1.4	–	4.3
Canada	58.9	52.2	–	–	111.1
Cayman Islands	1.7	–	–	–	1.7
Denmark	32.5	–	–	–	32.5
France	285.1	8.1	–	–	293.2
Germany	306.2	24.4	–	–	330.6
Hong Kong	8.5	–	–	–	8.5
Italy	5.5	–	–	–	5.5
Japan	37.8	–	–	–	37.8
Mexico	9.0	–	3.0	–	12.0
Netherlands	163.1	–	–	–	163.1
New Zealand	14.8	–	–	–	14.8
Norway	23.2	24.8	–	–	48.0
Russia	5.3	–	–	–	5.3
Singapore	24.4	–	–	–	24.4
South Africa	–	–	1.4	–	1.4
South Korea	7.1	–	–	–	7.1
Spain	18.7	–	–	–	18.7
Sweden	116.3	19.1	–	–	135.4
Switzerland	99.9	–	–	–	99.9
UAE	6.6	–	–	–	6.6
UK	1,574.1	–	1,362.9	35.1	2,972.1
USA	1,172.5	5.9	–	146.9	1,325.3
Supranational	–	–	–	–	330.4
Total	4,210.9	134.5	1,368.7	182.0	6,226.5

Notes to the financial statements (continued)
For the year ended 31 December 2014

3. Risk management
3.3.4 Investment concentration risk
The table below analyses the distribution of AFS debt securities held across industry sector classifications.

At 31 December	2014 £m	2014 %	2013 £m	2013 %
Basic materials	**151.9**	**3%**	146.9	2%
Communications	**298.5**	**5%**	338.4	5%
Consumer, Cyclical	**230.7**	**4%**	162.3	3%
Consumer, Non-cyclical	**363.4**	**6%**	382.6	6%
Diversified	**65.8**	**1%**	79.6	1%
Energy	**225.7**	**4%**	234.0	4%
Financial	**1,842.4**	**32%**	1,860.6	30%
Industrial	**250.7**	**4%**	244.2	4%
Mortgage and other asset backed securities	**422.4**	**7%**	182.0	3%
Sovereign, supranational and local government	**1,285.6**	**22%**	1,833.6	30%
Technology	**67.8**	**1%**	40.5	1%
Transport	**15.2**	**1%**	18.0	0%
Utilities	**605.0**	**10%**	703.8	11%
Total	**5,825.1**	**100%**	6,226.5	100%

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

At 31 December	2014 £m	2014 %	2013 £m	2013 %
Transport	**19.6**	**26%**	–	–
Social Infrastructure	**56.6**	**74%**	–	–
Total	**76.2**	**100%**	–	–

3.4 Operational risk
Effective operational risk management requires the Company to identify, assess, manage, monitor, report and mitigate all areas of exposure. Operational risk is inherent in all of the Company's processes, systems and products, and from external events, with the Group's ERM framework detailing the minimum standards, tools, techniques and other processes used to ensure that operational risks are identified, managed and mitigated to an acceptable level and that contingency plans are in place.

There are a number of key factors that cause operational risk:

- the Company's operations support complex transactions and are highly dependent on the proper functioning of its IT and communication systems;
- a dependency on the use of third-party information technology, software, data and service providers;
- a need to adequately maintain and protect customer and employee information; and
- the ability of the Group to attract and retain key qualified personnel.

Effective operational risk management helps the Company to achieve its objectives, including:

- focus on doing things the right way, leading to fewer surprises;
- reducing operational errors and losses, leading to increased customer satisfaction and higher-quality earnings;
- informed analytical risk taking;
- increased management attention to the risks and issues that really matter; and
- lower risk-based capital due to lower expected losses.

3.5 Regulatory risk
The risk is managed by a dedicated team responsible for providing expert advice and guidance to all parts of the business on regulatory, political and legislative change, including Solvency II. Through proactive and early engagement the team raises awareness of regulatory changes, enabling management to plan for potential threats and opportunities. The team also supports the business in identifying, analysing and coordinating responses to relevant UK and European regulatory developments through to facilitating the initiation of implementation programmes.

Notes to the financial statements (continued)

For the year ended 31 December 2014

3. Risk management

3.6 Capital adequacy

The Company determines the appropriate level of capital on the basis of a number of criteria including its risk-based requirement, the maintenance of a prudent excess versus regulatory capital requirements and ensuring consistency with a credit rating in the "A" range.

The Company uses risk based capital modelling to determine how much capital it needs to maintain in order to operate in accordance with its risk strategy established within its ERM framework. The risk based capital model also supports decision making in the business. In addition, the Company also monitors financial resources with reference to its Minimum Capital Requirements ("MCR").

The Company performs an assessment of the adequacy of its overall financial resources in accordance with the PRA's ICA methodology. This is based on an internal capital model which is calibrated, as required by the PRA, to a 99.5% confidence interval over a one year time horizon. The adequacy of the future financial resources over the financial planning period is assessed using stress tests.

The Company has an adjusted solo MCR surplus as at 31 December 2014 of £1,687.0 million (2013: £1,736.1 million) based on the PRA returns.

In addition the Company is currently going through the new ICAS+ process with the PRA to assess the Company's future individual capital guidance. The ICAS+ process will also enable the Company to obtain feedback on its progress towards Solvency II. This process is more involved than previous years and includes a detailed assessment of the internal risk-based capital model.

Management information to monitor the Company's capital requirements and solvency position is produced and presented to the Asset and Liability Committee and the Company Board on a regular basis.

4. Net earned premium

	2014 £m	2013 £m
Gross earned premium:		
Gross written premium	**3,099.0**	3,194.2
Movement in unearned premium reserve	**45.2**	86.9
	3,144.2	3,281.1
Reinsurance premium ceded:		
Premium payables	**(182.5)**	(138.2)
Movement in reinsurance unearned premium reserve	**25.0**	(0.7)
	(157.5)	(138.9)
Total	**2,986.7**	3,142.2

5. Investment return

	2014 £m	2013 £m
Investment income:		
Interest income on AFS debt securities	**154.4**	150.6
Interest income from related parties (note 34)	**2.3**	1.6
Cash and cash equivalent interest income	**4.4**	6.1
Rental income from investment property	**15.4**	11.2
Interest income from infrastructure debt	**0.1**	–
	176.6	169.5
Net realised gains / (losses):		
AFS Debt securities	**16.6**	20.0
Derivatives	**(86.2)**	21.4
Investment property (note 16)	**2.3**	–
	(67.3)	41.4
Net unrealised gains / (losses):		
Impairment of AFS debt securities	**1.3**	–
Derivatives	**79.6**	(22.2)
Investment property (note 16)	**26.7**	7.5
	107.6	(14.7)
Total	**216.9**	196.2

The table below analyses the realised and unrealised derivatives included in investment return:

	2014		2013	
	Realised £m	**Unrealised £m**	Realised £m	Unrealised £m
Derivative (losses) / gains				
Foreign exchange forward contracts	**(59.3)**	**(46.4)**	21.1	12.0
Associated foreign exchange risk	**(7.4)**	**115.9**	2.0	(33.3)
Net (losses) / gains on foreign exchange forward contracts	**(66.7)**	**69.5**	23.1	(21.3)
Interest rate derivatives	**(20.4)**	**(22.1)**	(0.8)	19.6
Associated interest rate risk	**0.9**	**32.2**	(0.9)	(20.5)
Net (losses) / gains on interest rate derivatives	**(19.5)**	**10.1**	(1.7)	(0.9)
Total	**(86.2)**	**79.6**	21.4	(22.2)

Notes to the financial statements (continued)

For the year ended 31 December 2014

6. Other operating income

	2014 £m	2013 £m
Vehicle replacement referral income	**15.8**	15.7
Other income	**0.1**	0.2
Total	**15.9**	15.9

7. Net insurance claims

	2014		
	Gross £m	Reinsurance £m	Net £m
Current accident year claims paid	**1,116.5**	**–**	**1,116.5**
Prior accident years claims paid	**1,163.1**	**(20.1)**	**1,143.0**
Movement in insurance liabilities	**(467.0)**	**(35.6)**	**(502.6)**
Total	**1,812.6**	**(55.7)**	**1,756.9**

	2013		
	Gross £m	Reinsurance £m	Net £m
Current accident year claims paid	1,085.9	(0.1)	1,085.8
Prior accident years claims paid	1,382.0	(22.0)	1,360.0
Movement in insurance liabilities	(581.4)	33.9	(547.5)
Total	1,886.5	11.8	1,898.3

Claims handling expenses for the year ended 31 December 2014 of £226.3 million (2013: £240.5 million) have been included in the claims figures above.

8. Commission expenses

	2014 £m	2013 £m
Commission expenses	**267.3**	276.9
Expenses incurred under profit participations	**90.5**	56.1
Total	**357.8**	333.0

9. Operating expenses

	2014 £m	2013 £m
Marketing and administration expense	**744.8**	855.5
Amortisation of intangible assets	**0.3**	0.3
Impairment of assets held for sale	**0.2**	–
Total	**745.3**	855.8

Notes to the financial statements (continued)

For the year ended 31 December 2014

9. Operating expenses

Auditor's remuneration

Fees for audit and non-audit services, included within marketing and 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 £1,264,000 (2013: £1,172,000).

Fees in respect of the audit of the PRA Annual Insurance Return amount to £80,000 in 2014 (2013: £80,000) and fees for other services amount to £nil (2013: £nil).

Directors' emoluments
The Directors of the Company are executives of DLIG. All strategic and management decisions for the Company are made by the executive of DLIG, comprising the Board of Directors and Executive Committee. No Directors who served during this or the previous year were remunerated by the Company. The services provided by the Directors to the Company are non-executive in their nature.

The total Directors' remuneration as disclosed in DLIG is as follows:

	2014 £m	2013 £m
Salaries, fees, bonuses and benefits in kind	**3.4**	3.2
Gains on exercise of share options	**1.2**	0.5
Defined contribution pension scheme contributions	**0.1**	0.1
Total	**4.7**	3.8

At 31 December 2014, one Director (2013: one) had retirement benefits accruing under the defined contribution pension scheme in respect of qualifying service.

During the year ended 31 December 2014 two Directors exercised share options (2013: two) in relation to an RBS Group Long-Term Incentive Plan and incentive deferral plans.

The compensation of key management personnel in relation to the executive of the Group is disclosed in note 34 of these accounts.

10. Finance costs

	2014 £m	2013 £m
Interest expense on subordinated loan	**37.8**	38.0

11. Tax charge

	2014 £m	2013 £m
Current taxation:		
Charge for the year	**78.9**	72.2
(Over) / under provision in respect of prior year	**(2.0)**	0.9
	76.9	73.1
Deferred taxation (note 12):		
Charge for the year	**10.8**	6.5
Over provision in respect of prior year	**(1.3)**	(0.5)
	9.5	6.0
Current taxation	**76.9**	73.1
Deferred taxation (note 12)	**9.5**	6.0
Tax charge for the year	**86.4**	79.1

Notes to the financial statements (continued)

For the year ended 31 December 2014

11. Tax charge

The actual income tax charge differs from the expected income tax charge computed by applying the standard rate of UK corporation tax of 21.5%[1] (2013: 23.25%) as follows:

	2014 £m	2013 £m
Profit before tax	**422.1**	340.1
Expected tax charge	**90.7**	79.1
Effects of:		
Non-deductible items	**–**	0.4
Revaluation of properties	**(1.3)**	(0.1)
Effect of change in UK taxation rate	**0.4**	(0.7)
Adjustments in respect of prior year	**(3.4)**	0.4
Tax charge for the year	**86.4**	79.1
Effective income tax rate	**20.5%**	23.3%

Note:

1. The UK Government enacted a reduction in the UK corporation tax rate from 24% to 23% effective from 1 April 2013 in the Finance Act 2013 and in the Finance Act 2014 enacted further reductions to 21% effective from 1 April 2014 and 20% effective from 1 April 2015. 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.

	2014 £m	2013 £m
Per balance sheet:		
Current tax assets	**0.1**	–
Current tax liabilities	**23.8**	4.0

12. Deferred tax

The following are the deferred tax liabilities recognised by the Company, and the movements thereon, during the current and prior reporting years.

	Other temporary differences £m	Depreciation in excess of capital allowances £m	Non-distributable reserve £m	Investment property £m	Total £m
At 1 January 2013	(0.8)	(0.3)	15.0	–	13.9
Charge to income statement	0.8	0.1	3.6	1.5	6.0
Other movements	–	–	–	–	–
At 31 December 2013	–	(0.2)	18.6	1.5	19.9
(Credit)/charge to income statement	**(0.2)**	**–**	**6.4**	**3.3**	**9.5**
At 31 December 2014	**(0.2)**	**(0.2)**	**25.0**	**4.8**	**29.4**

	2014 £m	2013 £m
Per balance sheet:		
Deferred tax liabilities	**29.4**	19.9

Notes to the financial statements (continued)

For the year ended 31 December 2014

13. Dividends

	2014 £m	2013 £m
Amounts recognised as distributions to equity holders in the period:		
Final dividend for the year ended 31 December 2013 of 34.6p (2012: 20.7p) per share	**201.0**	120.0
Interim dividend for the year ended 31 December 2014 of 39.3p (2013: 7.4p) per share	**228.0**	43.0
	429.0	163.0
Proposed final dividend for the year ended 31 December 2014 of 63.7p (2013: 34.6p) per share	**370.0**	201.0

14. Intangible assets

	Prepaid commissions £m
Cost	
At 1 January, 31 December 2013 and 31 December 2014	**4.7**

	Prepaid commissions £m
Amortisation	
At 1 January 2013	3.4
Charge for the year	0.3
At 31 December 2013	3.7
Charge for the year	**0.3**
At 31 December 2014	**4.0**
Net book amount	
At 31 December 2014	**0.7**
At 31 December 2013	1.0

15. Property, plant and equipment

	£m
Cost	
At 1 January, 31 December 2013 and 31 December 2014	**0.9**

	£m
Depreciation	
At 1 January, 31 December 2013 and 31 December 2014	**0.2**
Net book amount	
At 1 January, 31 December 2013 and 31 December 2014	**0.7**

Notes to the financial statements (continued)

For the year ended 31 December 2014

16. Investment property

	2014 £m	2013 £m
At 1 January	**217.2**	128.9
Additions	**76.2**	80.8
Increase in fair value during the year	**29.0**	7.5
Disposals	**(21.1)**	–
At 31 December	**301.3**	217.2

Investment properties 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 investment properties are measured at fair value which was arrived at on the basis of a valuation carried out at the balance sheet date by independent 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 2013. There has been no change to the valuation technique during the year. All investment properties are classified as level 3 under the fair value reporting hierarchy. As described in note 2.3 fair value equates to carrying value.

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

17. Subsidiaries

	2014 £m	2013 £m
At 1 January and 31 December	**30.0**	30.0

Details of the Company's subsidiaries as at 31 December 2014 are as follows.

The Company holds 100% of the share capital of the following companies. All companies are registered in England and Wales.

Name of subsidiary	Place of incorporation and operation	Type of ownership interest (share type)	Proportion of voting power held	Principal activity
Churchill Insurance Company Limited	Great Britain	Ordinary	100%	General insurance
Direct Line Insurance Limited	Great Britain	Ordinary	100%	Non-trading
The National Insurance and Guarantee Corporation Limited	Great Britain	Ordinary	100%	Non-trading

18. Reinsurance assets

	2014 £m	2013 £m
Reinsurers' share of general insurance liabilities	**892.5**	823.0
Impairment provision	**(52.3)**	(43.3)
Total	**840.2**	779.7

Analysis of movement in impairment provision:

	2014 £m	2013 £m
At 1 January	**(43.3)**	(50.8)
Additional provision	**(9.0)**	(3.4)
Utilisation of provision	**–**	2.0
Release to income statement	**–**	8.9
At 31 December	**(52.3)**	(43.3)

Notes to the financial statements (continued)
For the year ended 31 December 2014

19. Deferred acquisition costs

	2014 £m	2013 £m
At 1 January	**223.3**	250.8
Net charge to the income statement	**(14.9)**	(27.5)
At 31 December	**208.4**	223.3

20. Insurance and other receivables

	2014 £m	2013 £m
Receivables arising from insurance and reinsurance contracts:		
Due from policyholders	**790.7**	830.4
Impairment of policyholder receivables	**(0.6)**	(0.4)
Due from agents, brokers and intermediaries	**54.3**	52.8
Impairment of agent, broker and intermediary receivables	**(0.7)**	(0.5)
Due from reinsurers	**31.0**	18.9
Other loans and receivables:		
Accrued interest	**–**	1.3
Receivables from related parties	**422.6**	340.4
Other debtors	**31.8**	32.5
Total	**1,329.1**	1,275.4

21. Derivative financial instruments

	2014 £m	2013 £m
Derivative assets		
At fair value through the income statement	**24.9**	40.7
Total	**24.9**	40.7
Derivative liabilities		
At fair value through the income statement	**29.3**	17.8
Total	**29.3**	17.8

Derivative financial instruments as shown above are all classified as level 2 under the fair value hierarchy as described in note 2.3. These are measured at fair value, which equates to carrying value.

Notes to the financial statements (continued)

For the year ended 31 December 2014

22. Financial investments

	2014 £m	2013 £m
AFS debt securities:		
Corporate	**4,117.1**	4,210.9
Supranational	**176.3**	330.4
Local government	**120.7**	134.5
Sovereign	**988.6**	1,368.7
Securitised credit	**422.4**	182.0
Total	**5,825.1**	6,226.5
AFS debt securities:		
Listed debt securities – fixed interest rate	**5,142.2**	5,761.2
Listed debt securities – floating interest rate	**682.9**	465.3
Total	**5,825.1**	6,226.5
Loans and receivables:		
Deposits with credit institutions with maturities in excess of three months:	**54.8**	435.7
Infrastructure debt	**76.2**	–
Total	**5,956.1**	6,662.2

The following table analyses of financial instruments recorded at fair value, which equates to their carrying value, by level of the fair value hierarchy:

At 31 December	2014 £m	2013 £m
Level 1[1]	**980.4**	1,362.9
Level 2[1]	**4,844.7**	4,863.6
Total	**5,825.1**	6,226.5

Notes:

1. Please refer to note 2.3 for details of the fair value hierarchy.
2. The Company held no level 3 AFS debt securities at 31 December 2014 (2013: £nil).

23. Cash and cash equivalents

	2014 £m	2013 £m
Cash at bank and in hand	**140.6**	212.6
Short-term deposits with credit institutions	**624.0**	493.2
Total	**764.6**	705.8

The effective interest rate on short-term deposits with credit institutions for the year ended 31 December 2014 was 0.59% (2013: 0.41%) and average maturity was 10 days (2013: 14 days).

The following table details cash and bank overdrafts for the purposes of the cash flow statement.

	2014 £m	2013 £m
Cash and cash equivalents	**764.6**	705.8
Bank overdrafts	**(24.9)**	(22.2)
Total	**739.7**	683.6

Notes to the financial statements (continued)

For the year ended 31 December 2014

24. Assets held for sale

	2014 £m	2013 £m
Freehold property held for sale	–	1.0

On 7 July 2014 the Company disposed of the freehold property that it no longer utilised at Lumbry Park, Alton for £0.8 million. Impairment losses recognised in the year ended 31 December 2014 amounted to £0.2 million (2013: £nil).

25. Share capital

	2014 £m	2013 £m
Issued and fully paid: equity shares		
580.8 million ordinary shares of £1 each		
At 1 January and 31 December	**580.8**	580.8

26. Other reserves

	2014 £m	2013 £m
Capital contribution reserve	**626.8**	1,055.8
Reserve for revaluation of AFS investments and merger reserve	**52.0**	(10.2)
Other non-distributable reserve	**124.9**	92.8
Other reserves	**803.7**	1,138.4

Movements in the revaluation reserve for AFS investments were as follows:

	Debt securities £m	AFS reserve transferred £m	Merger reserve £m	Total £m
At 1 January 2013	63.4	80.1	(80.1)	63.4
Revaluation during the year – gross	(103.5)	–	–	(103.5)
Revaluation during the year – tax	25.1	–	–	25.1
Transfer of business – realised net gains on AFS investments – gross	–	(26.2)	26.2	–
Transfer of business – realised net gains on AFS investments – tax	–	7.4	(7.4)	–
Realised net gains – gross	6.2	–	–	6.2
Realised net gains – tax	(1.4)	–	–	(1.4)
At 31 December 2013	(10.2)	61.3	(61.3)	(10.2)
Revaluation during the year – gross	**70.5**	**–**	**–**	**70.5**
Revaluation during the year – tax	**(15.4)**	**–**	**–**	**(15.4)**
Transfer of business – realised net gains on AFS investments – gross	**–**	**(25.6)**	**25.6**	**–**
Transfer of business – realised net gains on AFS investments – tax	**–**	**6.7**	**(6.7)**	**–**
Realised net loss – gross	**9.0**	**–**	**–**	**9.0**
Realised net loss – tax	**(1.9)**	**–**	**–**	**(1.9)**
At 31 December 2014	**52.0**	**42.4**	**(42.4)**	**52.0**

Notes to the financial statements (continued)
For the year ended 31 December 2014

26. Other reserves

On 10 December 2011, Churchill Insurance Company Limited ("CIC"), 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 remained in CIC. 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.

Movements in the other non-distributable reserve were as follows:

	2014 £m	2013 £m
At 1 January	**92.8**	63.2
Transfer from retained earnings	**32.1**	29.6
At 31 December	**124.9**	92.8

The other non-distributable reserve relates to a UK statutory claims equalisation reserve that is calculated in accordance with the rules of the PRA.

27. Subordinated liabilities

	2014 £m	2013 £m
Subordinated loan	**531.6**	492.7

The subordinated loan was issued on 27 April 2012 at a fixed rate of 9.5%. On issuance the Company entered into a 10-year hedge to exchange the fixed rate of interest for a floating rate of three-month LIBOR plus a spread of 706 basis points.

During 2013, a Credit Value Adjustment was made to the interest rate hedge to reflect the market value of counterparty credit risk resulting from the majority divestment from RBS Group. This has resulted in an increase in the floating rate to three-month LIBOR plus a spread of 707 basis points with effect from 29 July 2012.

The nominal £500 million loan has a redemption date of 27 April 2042. The Company has the option to repay the loan on specific dates from 27 April 2022. If the notes are not repaid on that date, the rate of interest would be reset at a rate of the six-month LIBOR plus 8.16%.

The loan is an unsecured, subordinated obligation of the Company, and ranks pari passu without any preference over other creditors. In the event of a winding-up or of bankruptcy, it is to be repaid only after the claims of all other creditors have been met.

There have been no defaults on the loan during the year. The Company has the option to defer interest payments on the loan but to date has not exercised this right.

The carrying value of the subordinated loan equals the fair value.

Notes to the financial statements (continued)
For the year ended 31 December 2014

28. Insurance liabilities, unearned premium reserve and reinsurance assets

	2014 £m	2013 £m
Gross insurance liabilities (including unearned premium reserve)		
Claims reported	**2,771.4**	3,105.1
Claims incurred but not reported	**1,768.8**	1,902.7
Claims handling provision	**104.6**	104.3
Total	**4,644.8**	5,112.1
Unearned premium reserve	**1,434.2**	1,479.4
Total	**6,079.0**	6,591.5
Reinsurers' share of insurance (including unearned premium reserve)		
Claims reported	**(301.6)**	(277.6)
Claims incurred but not reported	**(451.6)**	(440.1)
Total	**(753.2)**	(717.7)
Unearned premium reserve	**(87.0)**	(62.0)
Total	**(840.2)**	(779.7)
Net insurance liabilities (including unearned premium reserve)		
Claims reported	**2,469.8**	2,827.5
Claims incurred but not reported	**1,317.2**	1,462.6
Claims handling provision	**104.6**	104.3
Total	**3,891.6**	4,394.4
Unearned premium reserve	**1,347.2**	1,417.4
Total	**5,238.8**	5,811.8

Gross general insurance liabilities

Accident year	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	Total £m
Estimate of ultimate claims costs:											
At end of accident year	3,710.6	3,789.1	4,014.7	3,393.4	3,818.3	4,299.0	2,888.6	2,407.5	2,211.7	2,125.5	32,658.4
One year later	(167.6)	(256.0)	(44.7)	139.3	506.5	(172.0)	(99.3)	(163.3)	(117.6)	–	(374.7)
Two years later	(132.5)	(5.0)	67.4	481.8	(143.4)	(99.2)	(94.6)	(119.0)	–	–	(44.5)
Three years later	(54.0)	112.3	449.2	(198.9)	(13.9)	(50.2)	(89.4)	–	–	–	155.1
Four years later	18.6	261.1	(78.4)	(16.7)	(101.5)	(105.6)	–	–	–	–	(22.5)
Five years later	164.8	(111.1)	(12.1)	(55.4)	(38.8)	–	–	–	–	–	(52.6)
Six years later	(54.4)	(11.0)	(24.5)	(45.7)	–	–	–	–	–	–	(135.6)
Seven years later	8.2	(13.5)	(18.8)	–	–	–	–	–	–	–	(24.1)
Eight years later	(32.8)	2.1	–	–	–	–	–	–	–	–	(30.7)
Nine years later	1.6	–	–	–	–	–	–	–	–	–	1.6
Current estimate of cumulative claims	3,462.5	3,768.0	4,352.8	3,697.8	4,027.2	3,872.0	2,605.3	2,125.2	2,094.1	2,125.5	32,130.4
Cumulative payments to date	(3,356.8)	(3,586.4)	(4,115.1)	(3,506.9)	(3,664.3)	(3,468.8)	(2,183.7)	(1,709.3)	(1,401.2)	(986.2)	(27,978.7)
Liability recognised in balance sheet	**105.7**	**181.6**	**237.7**	**190.9**	**362.9**	**403.2**	**421.6**	**415.9**	**692.9**	**1,139.3**	**4,151.7**
2004 and prior											**388.5**
Claims handling provision											**104.6**
Total gross liability											**4,644.8**

28. Insurance liabilities, unearned premium reserve and reinsurance assets

Net general insurance liabilities

Accident year	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	**Total £m**
Estimate of ultimate claims costs:											
At end of accident year	3,038.8	3,185.3	3,467.3	3,359.2	3,797.3	4,150.6	2,810.0	2,306.6	2,121.7	2,002.1	30,238.9
One year later	(139.8)	(242.8)	(59.0)	135.3	358.8	(134.7)	(131.5)	(146.7)	(124.6)	–	(485.0)
Two years later	(122.0)	(45.2)	50.7	265.5	(61.4)	(120.5)	(82.2)	(107.9)	–	–	(223.0)
Three years later	(49.6)	84.3	210.8	(150.9)	(54.0)	(44.0)	(76.4)	–	–	–	(79.8)
Four years later	0.9	20.7	(26.3)	(45.8)	(67.0)	(93.6)	–	–	–	–	(211.1)
Five years later	37.6	22.6	(17.7)	(48.6)	(29.5)	–	–	–	–	–	(35.6)
Six years later	12.2	(19.7)	(19.6)	(30.9)	–	–	–	–	–	–	(58.0)
Seven years later	(9.5)	(13.1)	(16.0)	–	–	–	–	–	–	–	(38.6)
Eight years later	(25.4)	3.6	–	–	–	–	–	–	–	–	(21.8)
Nine years later	3.3	–	–	–	–	–	–	–	–	–	3.3
Current estimate of cumulative claims	2,746.5	2,995.7	3,590.2	3,483.8	3,944.2	3,757.8	2,519.9	2,052.0	1,997.1	2,002.1	29,089.3
Cumulative payments to date	(2,680.0)	(2,858.2)	(3,408.7)	(3,342.3)	(3,609.3)	(3,392.7)	(2,135.7)	(1,695.9)	(1,396.8)	(986.1)	(25,505.7)
Liability recognised in balance sheet	**66.5**	**137.5**	**181.5**	**141.5**	**334.9**	**365.1**	**384.2**	**356.1**	**600.3**	**1,016.0**	**3,583.6**
2004 and prior											**203.4**
Claims handling provision											**104.6**
Total net liability											**3,891.6**

Movements in insurance liabilities and reinsurance assets

	Gross £m	Reinsurance £m	Net £m
Claims reported	3,636.1	(253.4)	3,382.7
Incurred but not reported	2,053.1	(498.1)	1,555.0
Liability adequacy provision	4.3	–	4.3
At 1 January 2013	5,693.5	(751.5)	4,942.0
Cash paid for claims settled in the year	(2,467.9)	22.1	(2,445.8)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,438.3	(90.0)	2,348.3
Arising from prior-year claims	(547.5)	101.7	(445.8)
Decrease in liability adequacy provision	(4.3)	–	(4.3)
At 31 December 2013	5,112.1	(717.7)	4,394.4
Claims reported	3,105.1	(277.6)	2,827.5
Incurred but not reported	1,902.7	(440.1)	1,462.6
Claims handling provision	104.3	–	104.3
At 31 December 2013	5,112.1	(717.7)	4,394.4
Cash paid for claims settled in the year	**(2,279.6)**	**20.1**	**(2,259.5)**
Increase / (decrease) in liabilities:			
Arising from current-year claims	**2,331.6**	**(123.5)**	**2,208.1**
Arising from prior-year claims	**(519.3)**	**67.9**	**(451.4)**
At 31 December 2014	**4,644.8**	**(753.2)**	**3,891.6**
Claims reported	**2,771.4**	**(301.6)**	**2,469.8**
Incurred but not reported	**1,768.8**	**(451.6)**	**1,317.2**
Claims handling provision	**104.6**	**–**	**104.6**
At 31 December 2014	**4,644.8**	**(753.2)**	**3,891.6**

Notes to the financial statements (continued)
For the year ended 31 December 2014

28. Insurance liabilities, unearned premium reserve and reinsurance assets

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2013	1,566.3	(62.7)	1,503.6
Net movement in the year	(86.9)	0.7	(86.2)
At 31 December 2013	1,479.4	(62.0)	1,417.4
Net movement in the year	**(45.2)**	**(25.0)**	**(70.2)**
At 31 December 2014	**1,434.2**	**(87.0)**	**1,347.2**

29. Borrowings

	2014 £m	2013 £m
Bank overdrafts - third parties	**24.9**	–
Bank overdrafts - related parties	**–**	22.2
Total	**24.9**	22.2

30. Trade and other payables including insurance payables

	2014 £m	2013 £m
Due to agents, brokers and intermediaries	**20.5**	14.4
Due to reinsurers	**57.1**	41.6
Due to insurance companies	**5.1**	8.2
Due to related parties	**261.8**	265.9
Trade creditors and accruals	**155.5**	96.5
Other creditors	**95.1**	168.7
Other taxes	**44.4**	47.0
Provisions	**27.8**	35.9
Deferred income	**2.8**	2.4
Total	**670.1**	680.6

Movements during the year in provisions are as follows:

	Regulatory levies £m	Other £m	Total £m
At 1 January 2014	27.3	8.6	35.9
Additional provision	**33.4**	**–**	**33.4**
Release to income statement	**–**	**(4.2)**	**(4.2)**
Utilisation of provision	**(34.2)**	**(3.1)**	**(37.3)**
At 31 December 2014	**26.5**	**1.3**	**27.8**

The expected timing of any resulting outflows fall within twelve months of the balance sheet date.

31. Contingencies and guarantees

The Company has guaranteed the principal and interest payments of £500.0 million of subordinated loan notes issued by DLIG on 27 April 2012 that have a fixed rate of interest at 9.25%. The nominal £500.0 million have 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 7.91%.

At 31 December 2014, the accrued interest amounted to £8.3 million (2013: £8.3 million), interest is payable on the notes by DLIG semi-annually on 27 April and 27 October.

Notes to the financial statements (continued)
For the year ended 31 December 2014

32. Commitments

Operating lease commitments
The Company leases vehicles under non-cancellable operating lease agreements.

The Company also leases vehicles and other assets under cancellable operating lease agreements.

	2014 £m	2013 £m
Minimum lease payments under operating leases recognised as an expense in the year	**16.1**	13.6

At the balance sheet date, the Company had no outstanding commitments under non-cancellable operating leases, which fall due as follows:

	2014 £m	2013 £m
Within one year	**13.1**	18.3
In the second to fifth years inclusive	**51.0**	62.7
After five years	**164.7**	222.3
Total	**228.8**	303.3

Operating lease commitments where the company is the lessor

Future aggregate minimum lease payments receivable under non-cancellable operating leases are as follows:

	2014 £m	2013 £m
Within one year	**14.1**	12.4
In the second to fifth years inclusive	**50.1**	42.1
After five years	**99.1**	83.8
Total	**163.3**	138.3

Notes to the financial statements (continued)
For the year ended 31 December 2014

33. Classification of financial instruments

The following table analyses the Company's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Non-financial assets and liabilities outside the scope of IAS 39 are shown separately. Other than those financial assets and liabilities stated at fair value below, the carrying value of all other financial assets and liabilities equals their fair value.

	Financial assets / liabilities					
At 31 December 2014	At fair value £m	AFS £m	Loans and receivables £m	At amortised costs £m	Non-financial assets / liabilities £m	Total £m
Assets						
Intangible assets	–	–	–	–	0.7	**0.7**
Property, plant and equipment	–	–	–	–	0.7	**0.7**
Investment property	–	–	–	–	301.3	**301.3**
Investments in subsidiaries	–	–	–	–	30.0	**30.0**
Reinsurance assets	–	–	–	–	840.2	**840.2**
Current tax assets	–	–	–	–	0.1	**0.1**
Deferred acquisition costs	–	–	–	–	208.4	**208.4**
Insurance and other receivables	–	–	1,329.1	–	–	**1,329.1**
Prepayments, accrued income and other assets	–	–	–	–	59.5	**59.5**
Derivative financial instruments	24.9	–	–	–	–	**24.9**
Financial investments	–	5,825.1	131.0	–	–	**5,956.1**
Cash and cash equivalents	–	–	764.6	–	–	**764.6**
Total assets	**24.9**	**5,825.1**	**2,224.7**	**–**	**1,440.9**	**9,515.6**
Liabilities						
Subordinated liabilities	–	–	–	531.6	–	**531.6**
Insurance liabilities	–	–	–	–	4,644.8	**4,644.8**
Unearned premium reserve	–	–	–	–	1,434.2	**1,434.2**
Borrowings	–	–	–	24.9	–	**24.9**
Derivative financial instruments	29.3	–	–	–	–	**29.3**
Trade and other payables including insurance payables	–	–	–	642.4	27.7	**670.1**
Deferred tax liabilities	–	–	–	–	29.4	**29.4**
Current tax liabilities	–	–	–	–	23.6	**23.6**
Total liabilities	**29.3**	**–**	**–**	**1,198.9**	**6,159.7**	**7,387.9**
Total equity						**2,127.7**
Total equity and liabilities						**9,515.6**

Notes to the financial statements (continued)

For the year ended 31 December 2014

33. Classification of financial instruments

	Financial assets / liabilities				Non-financial	
At 31 December 2013	At fair value £m	AFS £m	Loans and receivables £m	At amortised costs £m	assets / liabilities £m	Total £m
Assets						
Intangible assets	–	–	–	–	1.0	1.0
Property, plant and equipment	–	–	–	–	0.7	0.7
Investment property	–	–	–	–	217.2	217.2
Investments in subsidiaries	–	–	–	–	30.0	30.0
Reinsurance assets	–	–	–	–	779.7	779.7
Deferred acquisition costs	–	–	–	–	223.3	223.3
Insurance and other receivables	–	–	1,275.4	–	–	1,275.4
Prepayments, accrued income and other assets	–	–	–	–	69.4	69.4
Derivative financial instruments	40.7	–	–	–	–	40.7
Financial investments	–	6,226.5	435.7	–	–	6,662.2
Cash and cash equivalents	–	–	705.8	–	–	705.8
Assets held for sale	–	–	–	–	1.0	1.0
Total Assets	40.7	6,226.5	2,416.9	–	1,322.3	10,006.4
Liabilities						
Subordinated liabilities	–	–	–	492.7	–	492.7
Insurance liabilities	–	–	–	–	5,112.1	5,112.1
Unearned premium reserve	–	–	–	–	1,479.4	1,479.4
Borrowings	–	–	–	22.2	–	22.2
Derivative financial instruments	17.8	–	–	–	–	17.8
Trade and other payables including insurance payables	–	–	–	644.7	35.9	680.6
Deferred tax liabilities	–	–	–	–	19.9	19.9
Current tax liabilities	–	–	–	–	4.0	4.0
Total Liabilities	17.8	–	–	1,159.6	6,651.3	7,828.7
Total equity						2,177.7
Total equity and liabilities						10,006.4

Notes to the financial statements (continued)

For the year ended 31 December 2014

34. Related parties

On 13 March 2013, The Royal Bank of Scotland Group plc ("RBSG") sold 16.8% of DLIG's shares and ceased to be the controlling shareholder of Direct Line Group. On 20 September 2013, RBSG sold a further 20.0% of DLIG's ordinary shares, which was a further step towards the complete disposal of Direct Line Group. At 31 December 2013 RBSG held 28.5% of the issued ordinary share capital and the Group was treated as an associated undertaking in the RBS Group results. On 27 February 2014, RBSG sold its remaining holding of DLIG shares. The sale marks the completion of RBS Group's EC-mandated disposal of its interest in Direct Line Group which thus ceased to be a related party of the Company.

The UK Government through HM Treasury is the ultimate controlling party of RBSG and was as a consequence a related party of Direct Line Group. This gives rise to related party transactions and balances, specifically in respect of tax with HMRC and debt security investments with the UK Government.

As at 31 December 2014 the ultimate holding company was DLIG, which is also the immediate parent company and is incorporated in the United Kingdom and registered in England and Wales.

As at 31 December 2014 DLIG heads the largest and smallest group in which the Company is consolidated. Copies of the consolidated accounts of Direct Line Insurance Group plc may be obtained from The Secretary, DLIG, Churchill Court, Westmoreland Road, Bromley, Kent, BR1 1DP.

The following transactions were with related parties, who are members of RBS Group or the Group.

Sales of insurance contracts and other services

	2014 £m	2013 £m
RBS Group	**0.3**	2.6
Total	**0.3**	2.6

Purchases of services

	2014 £m	2013 £m
RBS Group	**3.2**	56.4
Fellow subsidiaries	**1,006.8**	1,180.7
Total	**1,010.0**	1,237.1

Purchases of services also include payments made between companies determined by the level of business generated and as agreed between the parties on an arm's length basis. Purchase of services also includes profit sharing arrangements on an arm's length basis.

All employees were employed by DL Insurance Services Limited, a fellow subsidiary company. Total employee costs, including Directors' remuneration, recharged to the company by DL Insurance Services Limited during the year were £420.5 million (2013: £544.3 million).

Employee costs recharged by DL Insurance Services Limited include the full costs of key managers and other staff in respect of share-based payments.

Compensation of key management

	2014 £m	2013 £m
Short-term employee benefits	**10.2**	9.1
Post-employment benefits	**0.3**	0.2
Termination benefits	**0.4**	0.2
Share-based payments	**3.4**	1.9
Total	**14.3**	11.4

For the purposes of IAS 24 'Related party disclosures', key management personnel comprise the Directors and Non-Executive Directors of DLIG and the members of the Executive Committee.

Notes to the financial statements (continued)
For the year ended 31 December 2014

34. Related parties

Year end balances arising from cash and investment transactions with members of the RBS Group

	2014 £m	2013 £m
Cash at bank	–	59.6
Short-term bank deposits	–	–
Bank overdrafts	–	(22.2)
Derivative financial assets	–	–
Derivative financial liabilities	–	(17.0)
Term deposits	–	35.0
Total	–	55.4

Year end balances arising from sales and purchases of products and services
Receivables from related parties

	2014 £m	2013 £m
RBS Group	**0.2**	0.1
Fellow subsidiaries	**8.6**	0.1
Total	**8.8**	0.2

Movements in receivables from related parties were as follows:

	2014 £m	2013 £m
At 1 January	**0.2**	0.3
Transactions in the year	**(103.9)**	1.0
Settled in the year	**112.5**	(1.1)
At 31 December	**8.8**	0.2

Due to related parties

	2014 £m	2013 £m
RBS Group	**25.4**	56.3
Fellow subsidiaries	**250.5**	219.4
Total	**275.9**	275.7

Movements in amounts due to related parties were as follows:

	2014 £m	2013 £m
At 1 January	**275.7**	312.8
Transactions in the year	**2,524.9**	2,462.5
Settled in the year	**(2,524.7)**	(2,499.6)
At 31 December	**275.9**	275.7

Included in claims reserving are amounts due to other subsidiaries amounting to £5.0 million (2013: £11.6 million).

Loans to related parties

	2014 £m	2013 £m
Fellow subsidiaries	**413.8**	340.2

Notes to the financial statements (continued)

For the year ended 31 December 2014

34. Related parties

Movements in loans to related parties were as follows:

	2014 £m	2013 £m
At 1 January	**340.2**	282.3
Loans advanced during the year	**71.3**	56.3
Interest charged	**2.3**	1.6
At 31 December	**413.8**	340.2

The loan is unsecured and is repayable on 1 January 2017. It is subject to interest on the gross outstanding balance using the average 3 month LIBOR plus 10 basis points. The borrower may at any time at will, repay any or all outstanding amounts due and has access to a maximum drawdown facility of £500 million. The terms of the loan provide for an extension of the repayment date by 1 year on 31 December each year. This requires agreement between both parties.

Subordinated liabilities due to related parties

	2014 £m	2013 £m
Fellow subsidiaries	**508.5**	508.5
Total	**508.5**	508.5

Movement in subordinated liabilities due to related parties were as follows

	2014 £m	2013 £m
At 1 January	**508.5**	508.6
Interest charged	**47.5**	47.4
Settled in the year	**(47.5)**	(47.5)
At 31 December	**508.5**	508.5