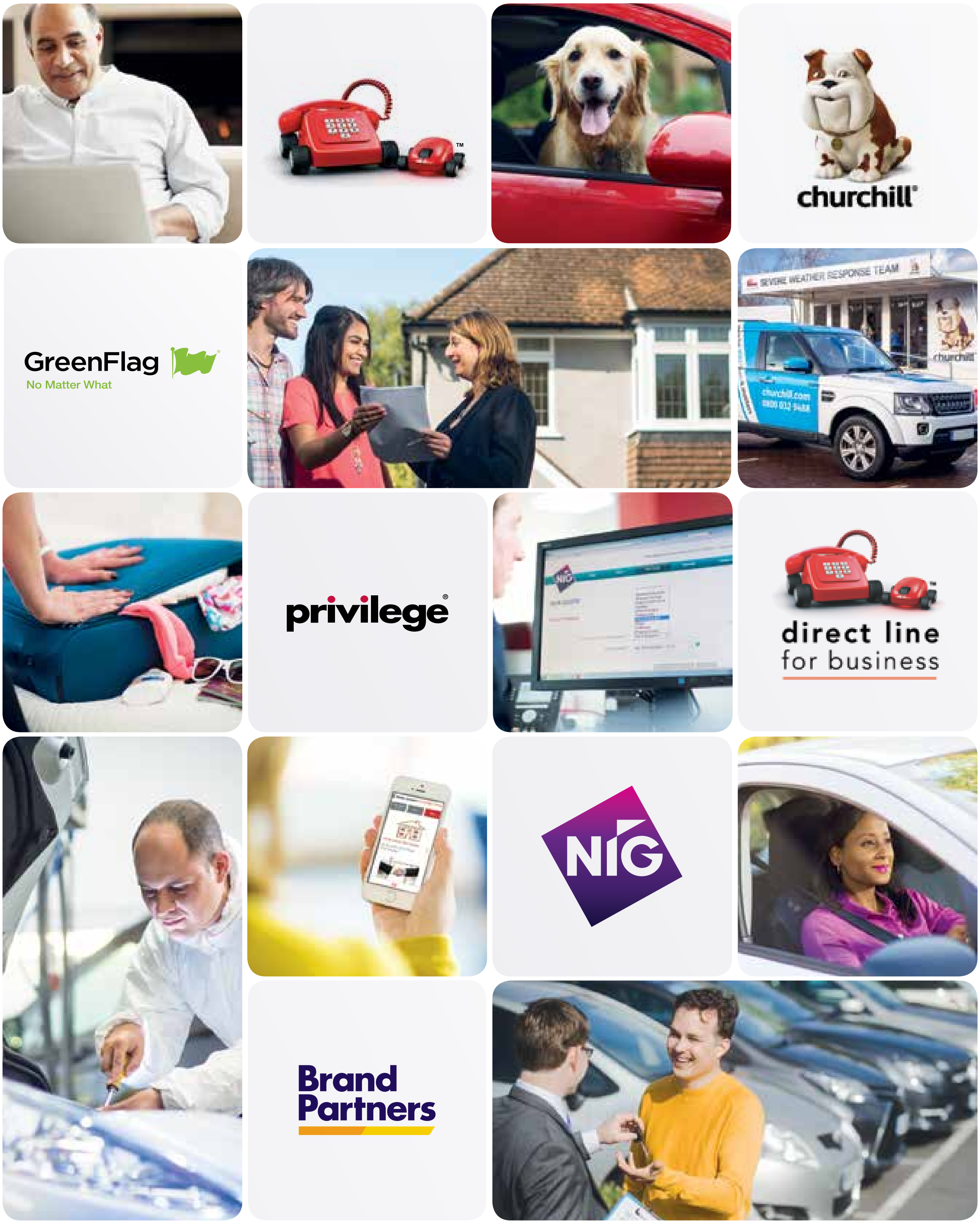


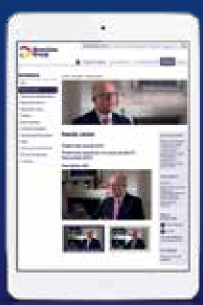
Direct Line Group

Annual Report & Accounts 2015

Our mission

To make insurance much easier and better value for our customers

Our strategy supports our aspiration to be the leading personal and small business general insurer in the UK. That is why our customers are at the centre of everything we do.



For all the latest news and announcements visit **www.directlinegroup.com**

Contents

Our strategic pillars

Delivering for our customers and shareholders

We achieved good results in 2015 while making progress on implementing our strategy. We remained focused on operating efficiency and disciplined underwriting which helped us to improve operating profit from ongoing operations.

Financial highlights

- Gross written premium from ongoing operations[1] up 1.7% to £3,152.4 million, with 4.8% growth in Motor for 2015 and 7.1% in the fourth quarter. Motor and Home own brands in-force policies[1] up 1.4%
- Operating profit from ongoing operations increased to £520.7 million for 2015 (2014: £506.0 million). Combined operating ratio[1] from ongoing operations of 94.0% for 2015, an improvement of 1.0 percentage point
- Return on tangible equity[1] of 18.5% for 2015 (2014: 16.8%). Profit before tax for continuing operations[1] increased to £507.5 million (2014: £456.8 million)
- Results benefited from our disciplined underwriting, prior-year reserve releases from ongoing operations of £378.9 million (2014: £397.6 million) which were higher than expected, together with lower costs, partially offset by higher claims from major weather events and lower volumes
- 4.5% increase in final dividend per share to 9.2 pence per share and additional special dividend of 8.8 pence per share. Total dividends for 2015, including special interim dividend of 27.5 pence per share following sale of International division, of 50.1 pence per share (2014: 27.2 pence per share)

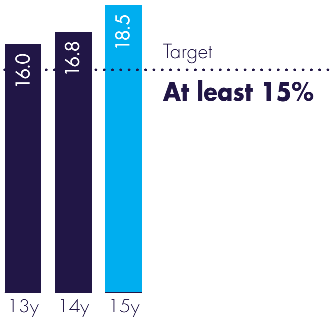
Strategic and operational highlights

- Investment in brand differentiation through further enhancements, a succession of initiatives to Direct Line proposition and improved trading capability across Churchill and Privilege, particularly on price comparison websites
- Improved customer retention rates for motor and home products, and Net Promoter Score for Direct Line brand
- Reduced total costs[1] for ongoing operations by 4.6% in 2015 while investing in technical pricing, claims management and self-service initiatives
- Doubled Motor telematics insurance in-force policies; and growth in Commercial in-force policies through eTrade and direct channels
- Invested in digital capability, including the roll out of new quote and buy journeys for Home and Green Flag insurance products, and development of next generation of customer systems

Note:
1. See glossary on pages 174 and 175

Return on tangible equity[1] (%)

18.5%



Combined operating ratio[1] Ongoing operations[1] (%)

94.0%

Gross written premium[1] Ongoing operations (£m)

£3,152.4m

Total costs[1] Ongoing operations (£m)

£884.7m

Operating profit Ongoing operations (£m)

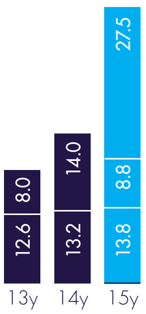
£520.7m

Profit before tax Continuing operations[1] (£m)

£507.5m

Dividend per share[2] (pence)

50.1p

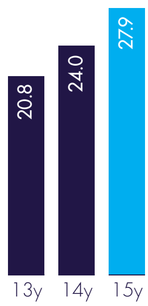


Adjusted diluted earnings per share[1] (pence)

26.6p

Basic earnings per share Continuing operations (pence)

27.9p



Notes:
1. See glossary on pages 174 and 175
2. The Board is proposing a final dividend of 9.2 pence per share, making a total regular dividend for 2015 of 13.8 pence per share. A first special dividend of 27.5 pence per share was paid in relation to the sale of the International division. In addition, the Board has resolved to pay a further special interim dividend of 8.8 pence per share.

Protecting our customers

We have multiple brands, products and distribution channels. Each allows our customers to choose the right cover to protect their cars, homes, holidays, businesses and pets.

Personal lines

Motor

We are Britain's leading personal motor insurer measured by in-force policies[1], mainly represented through our highly recognised brands Direct Line, Churchill and Privilege, and also through our partners. We insure around one in seven cars on the road, representing 3.7 million in-force policies.

£1,406.7m
Gross written premium

3.7m
In-force policies

92.4%
Combined operating ratio

£338.0m
Operating profit

Home

We are Britain's leading personal home insurer measured by in-force policies[1]. We reach our customers by selling home insurance products through our brands, Direct Line, Churchill and Privilege, and our partners – Sainsbury's Bank, RBS, NatWest and Prudential.

£866.3m
Gross written premium

3.4m
In-force policies

92.2%
Combined operating ratio

£109.9m
Operating profit

Rescue and other personal lines

We are one of the leading providers of rescue and other personal lines insurance in the UK[2,3] with 8.3 million in-force policies. This includes providing roadside assistance and recovery for customers through Green Flag, the UK's third-largest roadside recovery provider[2]. We also offer customers protection for their pets and holidays, and we are the third largest insurer in the UK for these insurance products[3].

£394.1m
Gross written premium

8.3m
In-force policies

91.2%
Combined operating ratio

£52.0m
Operating profit

Commercial

We protect small and medium-sized enterprises ("**SMEs**") through our brands, NIG, Direct Line for Business and Churchill, and through our partners RBS and NatWest. NIG sells its products exclusively through brokers operating across the UK. Direct Line for Business provides business, van and landlord insurance products direct to customers. Churchill sells van insurance direct to customers and through price comparison websites ("**PCWs**").

£485.3m
Gross written premium

655k
In-force policies

104.5%
Combined operating ratio

£20.8m
Operating profit

Notes:
1. Includes Direct Line, Churchill, Privilege and partner brands: RBS, Nationwide (home only), NatWest, Prudential and Sainsbury's © GfK Financial Research Survey (FRS) 6 months ending December 2015, 13,729 adults interviewed for motor insurance and 13,148 for home insurance
2. Mintel Vehicle Recovery – UK, September 2015
3. Mintel Pet Insurance – UK, August 2015 and Mintel Travel Insurance – UK, February 2015

Our brands

Direct Line has maintained its brand heritage by selling products direct to customers exclusively by phone and internet. We target customers with a high affinity to the brand, and focus on providing a fast and straightforward service.

www.directline.com

Churchill is a household name. We market our products by phone and internet, including PCWs. We target customers who have a high affinity to the brand, and who need an extra helping hand.

www.churchill.com

Privilege targets customers who mainly buy through PCWs. We focus on making sure they experience a quick service at the best price.

www.privilege.com

Green Flag is our roadside rescue and recovery provider. We sell it as a standalone service and an additional optional product alongside motor insurance.

www.greenflag.com

Direct Line for Business is an extension of our Direct Line brand. It is our direct commercial insurance brand for small businesses that have straightforward commercial insurance requirements.

www.directlineforbusiness.co.uk

NIG is our specialist commercial insurance brand, focused on SMEs. We sell our products through brokers, including an in-house intermediary that arranges RBS[1] and NatWest commercial insurance.

www.nig.com

Brand Partners is the Group's partnerships arm. We specialise in providing personal lines insurance, and roadside rescue and recovery products to some well-known brands.

Note:
1. The Royal Bank of Scotland Group plc, including National Westminster Bank plc

Our changing environment

We operate in a dynamic environment and the way we interact with customers is evolving. Customer expectations of insurance are being shaped by changes both inside and outside the industry with technology and regulation important parts of this. Providing excellent customer service and managing claims remain key aspects.

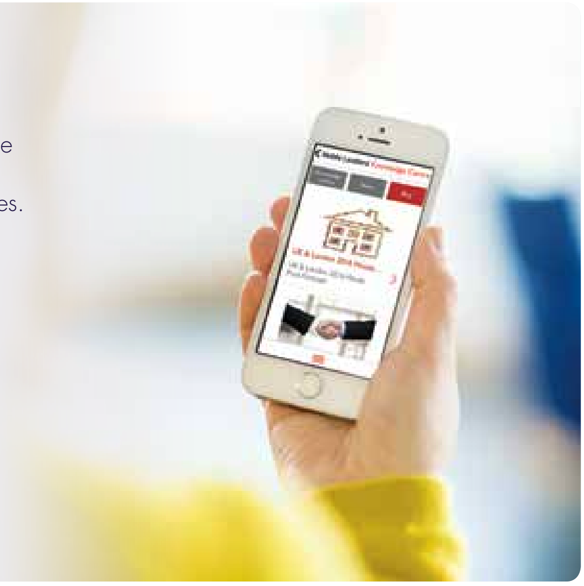
Digitalisation

New services and escalating risk

The retail world continues to digitalise. Insurance needs to keep pace with customers who expect great service using different types of devices, and to interact directly with products and services themselves. Customers are willing to buy multiple products from one source, where businesses can provide what the customer needs and wants.

The digital economy creates new data sources. These are useful for marketing and underwriting, but come with new risks. Cyber risk affects insurers like any other online business. However, it also gives the industry new protection product opportunities.

77% of 25 to 34 year olds willing to buy insurance via smartphone[1]



Motor claims trends

Managing bodily injury claims costs remains key

UK road accidents have fallen for a number of years, but this trend has recently reversed. The cost per claim is also climbing, with bodily injury and repair costs being aspects of this increase. The UK still has one of the highest whiplash claims rates in Europe, over double that of many other European countries. This raises the potential for claims fraud. Insurers need to keep focusing on anti-fraud activities, without compromising service for genuine claimants. Civil justice reforms in 2013 have helped, but the industry and Government need to do more to tackle this fully. The recently announced Government intention to change the approach to soft tissue injury claims should be a step in the right direction.

3% reduction of casualties from all severities[2]

Notes:
1. Deloitte report – UK Insurance Disrupted
2. Department for Transport – Statistical Release published on 4 February 2016 for year ending September 2015

Customer expectations

Every customer is different

Some see buying motor insurance as a way of staying on the right side of the law. Others see it as vital for protecting their livelihoods. People tend to view home and pet insurance as a more personal purchase, and the flooding in December has shown that home insurance can be invaluable. Whatever customers' needs, it is essential we offer them the best products and services, at the right price.

90% UK households with one or more insurance products[1]

Regulation

The pace of change remains rapid

The regulatory environment has changed significantly over the last few years. We expect this to continue. Solvency II's arrival, changes to add-on selling practices and Flood Re's expected introduction in 2016 are major developments for the industry. The Financial Conduct Authority ("**FCA**") has indicated that consumer data will be an area of interest in the future. It remains important for us to continue communicating with regulatory bodies and to be ready to adapt in our changing world.

£3bn industry expenditure on Solvency II[2]

Car technology

Disruptive technologies emerging now and in the future

This is an exciting time for the motor industry, creating opportunities and challenges for supporting companies. Telematics and diagnostics products are available through third-party and manufacturer-produced devices. The cost of these devices continues to drop as take-up increases. Advanced safety technologies, such as autonomous emergency braking, are here today and will advance in the next few years. Connected car technologies are still developing and are likely to become more common in future models. In time, the world may see fully autonomous cars. The insurance industry will need to be ready.

41% of new vehicles on sale have the available option of an autonomous emergency braking system[3]

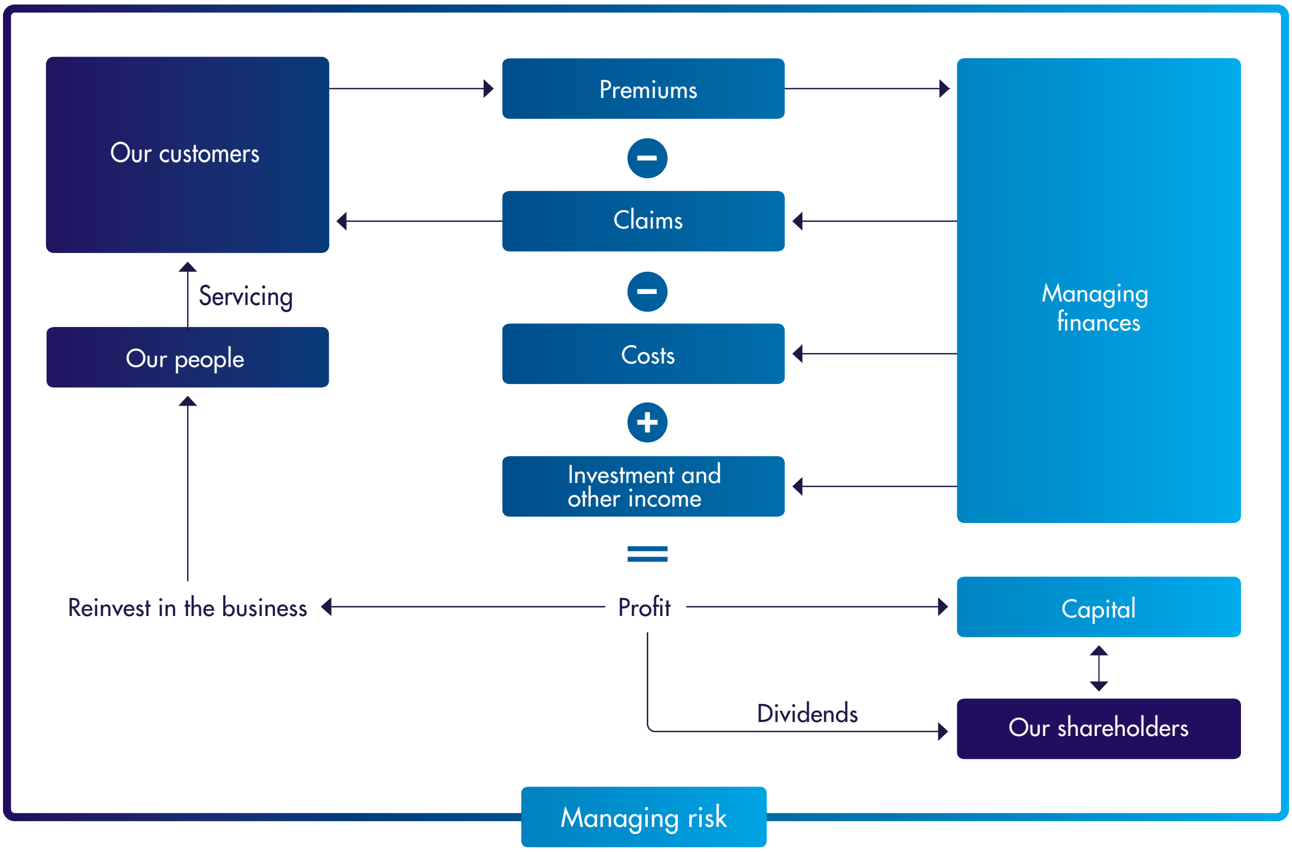
Notes:
1. Association of British Insurers ("**ABI**") Agenda 2015-2020 Insurance matters
2. ABI news release 18 December 2015
3. Thatcham, Autonomous Emergency Braking: The Facts, January 2016

Creating value for our customers

Our multi-brand, multi-product and multi-distribution channel business offers different propositions to distinct customers. We believe this approach should enable us to generate value for customers and sustainable returns for our shareholders.

Read more about our key performance indicators on page 24

Read more about our risk management on page 26



Making insurance much easier and better value for our customers

Customers are at the centre of our business model. So our mission is clear: we want to make insurance much easier and better value for them. We aspire to give them products that best suit their needs, and exceptional service throughout their relationship with us. We also strive to adapt to their changing needs. From the moment customers choose our products, to the time they claim or need to resolve an event, we treat every step of the customer journey as an opportunity to provide excellent service and outcomes.

Everyone, from our front-line staff to employees in support and central functions, helps ensure we meet customers' needs. Without our people, we could not generate value for customers and sustainable returns for our shareholders.

Our shareholders are a big part of our business model. They invest in the business expecting to achieve a good level of return. So we aim to give our shareholders value by generating sustainable business profits. We reinvest part of this profit in the business or add to capital and, where appropriate, distribute the remainder to shareholders as dividends.

Our focused processes

We aim to make it easy for our customers to access our products, and to give them what they are looking for. We want to make sure they have appropriate cover to protect against the unexpected.

Customers can buy products online – including through PCWs – by phone, and indirectly through our partners. In our Commercial business, they also buy our products through brokers.

Each brand provides products for one or more insurance segments: motor, home, rescue, pet, travel and commercial. By tailoring the mix of distribution channels for each product, we offer customers a blend of brands, products and services that best suit their needs.

Our business has operated on a large scale for almost 30 years, giving us a deep insight into the risks we underwrite. This insight enables us to make our pricing more accurate. It also allows us to invest substantially in data and increase efficiencies. Again, this means we are better able to set accurate prices for the risks we underwrite.

Customers experience the value of their cover when they come to claim. So we aim to settle claims as quickly and easily as possible by engaging closely with our customers. This helps us demonstrate why our products and services are valuable, and to manage our claims costs.

Our disciplined approach

We seek to make sure our business is well governed and controlled. We manage our finances carefully and balance this with targeting a suitable and sustainable return for our shareholders.

We hold assets that exceed our expected liabilities as capital. This is intended to absorb unexpected losses that might occur and is important to meet our regulatory capital requirements.

We prefer to adopt a conservative approach to claims reserving in order to hold sufficient funds to pay customer claims. This may result in subsequent releases from these reserves, which contribute to our annual profit.

We ensure our products meet regulatory standards and that customers understand what they are buying from us. We also aim to price our policies accurately and invest our assets appropriately to minimise potential losses.

We transfer insurance risk through reinsurance in our normal business activities. External experts review our insurance claims reserves regularly. We mitigate risks by implementing our Group policies and minimum standards. These are reviewed regularly to ensure we are in line with the risk appetite that the Board sets.

Focused on creating long-term value

"Returns to shareholders remained a key priority for the Board. Cumulative dividends represent approximately 60% of the share price at the initial public offering."

Mike Biggs
Chairman

Dear shareholders,

The Group achieved another good set of results in 2015, through our focus on operating efficiency and our disciplined approach to underwriting in competitive markets. This enabled us to deliver an improvement in operating profit from ongoing operations to £520.7 million (2014: £506.0 million). This was despite higher than normal claims from major weather events following three storms in December.

Strategy update

Our mission is to make insurance much easier and better value for our customers. During 2015, our business progressed on delivering its strategic objectives and building future capability in line with this mission. We recognise that the changes we have planned are ambitious. They require substantial investment to deliver a step change in our digital capability together with an enhancement of core systems, which combined will be for our customers' benefit.

Dividends

Under our progressive dividend policy, see page 96, we aim to increase the dividend annually in real terms. This aim reflects the potential of the Company's cash-flow generation and long-term earnings. We are recommending a final dividend of 9.2 pence per share. If approved, the total regular dividend of 13.8 pence per share would represent 4.5% growth on 2014's regular dividend (13.2 pence per share), which is consistent with this policy.

Earlier in 2015, the Group completed the sale of its International division to Mapfre, S.A. and shareholders approved an 11-for-12 consolidation of the Company's shares. This consolidation was to maintain comparability of share price and earnings per share before and after the payment of a special interim dividend. A special interim dividend of 27.5 pence per share, being substantially all of the net proceeds from the sale, was then paid on 24 July 2015. In addition, the Board has resolved to pay a further special interim dividend of 8.8 pence per share. This takes the total special interim dividends for 2015 to 36.3 pence per share.

Linking remuneration to performance

The Executive Directors guided the business in achieving another good performance in 2015, with operating profit from ongoing operations ahead of our financial targets. The Group has also made progress on its strategic objectives, including improving customers' satisfaction with the service they experience. The delivery of these objectives is linked to the Executive Directors' 2015 annual incentive plan ("**AIP**") awards.

The Group achieved a return on tangible equity ("**RoTE**") of 18.5% for 2015. An increase of 39.9% in the share price to 407.5 pence at 31 December 2015, together with dividend payments, provided a total shareholder return ("**TSR**") of 46.9% for the year. Since the initial public offering ("**IPO**"), the Group has delivered good results each year, enabling the Board to declare cumulative dividends, including special interim dividends, equivalent to approximately 60% of the IPO price. The delivery of this level of return to shareholders is reflected in the level of awards vesting under the long-term incentive plan ("**LTIP**"). More information on awards is given in the letter from the Chair of the Remuneration Committee, see page 70.

Solvency II

We are assessing the Group's solvency capital requirements ("**SCR**") using the standard formula until such time that the Group-wide partial internal model is approved by the Prudential Regulation Authority ("**PRA**"). At 31 December 2015, the Group held a capital surplus of £794.6 million above its capital requirements. This was equivalent to a pro forma[1] Solvency II capital coverage ratio of 147.4%. Following approval, which is expected in mid-2016, we will disclose the recalibrated risk appetite range based on our Solvency II internal model which will take into account the sensitivities of the Group's capital position on this basis. Whilst receiving internal model approval will remove a key uncertainty in relation to the Group's capital position, the Board does not currently expect the recalibration of the risk appetite range to lead to a step change in the appropriate level of capital to be held.

Migrating IT infrastructure

The migration of our IT infrastructure away from RBS Group, while giving rise to many challenges, is now essentially complete. Your Board provided oversight of this substantial change. Ongoing focuses of the Board's supervision include the development of future capability and the monitoring of risks associated with IT systems' stability, cyber security and the internal control environment.

Regulation, conduct and culture

We maintain active relationships with our regulators. Your Board oversees the Group's conduct risk policy and culture, which aim to ensure that we treat customers appropriately and that employees behave with integrity. We recognise that we have more to do to improve processes for our customers; however, your Board is pleased with improvements derived from our customer programmes. We continue to focus on this, as we develop new digital capabilities, core systems and new ways of interacting with our customers.

Board and Committee membership changes

Glyn Jones, our former Senior Independent Director ("**SID**"), stood down as a Director after the Company's 2015 Annual General Meeting ("**AGM**"), having decided to reduce the number of his non-executive directorships after becoming Chairman of a second listed company. I wish Glyn well and thank him for his dedicated commitment and excellent contribution to the Board.

I am grateful to Andrew Palmer, an Independent Non-Executive Director ("**NED**") and Chair of our Audit Committee, for having agreed to act as our SID while a search for a new SID was undertaken. At the same time, Priscilla Vacassin, NED and Chair of the Remuneration Committee, was appointed as a member of the Nomination Committee. Clare Thompson, NED and Chair of the Corporate Social Responsibility ("**CSR**") Committee, was appointed as Chair of the Investment Committee, of which she was already a member.

On 18 January 2016, I was delighted to welcome Dr Richard Ward to the Board as our new SID. Your Board will benefit from his deep knowledge of the insurance industry and his experience as Chairman and NED of other firms in the sector. Further details about Richard are to be found on page 49.

Governance highlights

Leadership

Your Board seeks to ensure that decisions are of the highest standard. It challenges strategic proposals, performance delivery and management responsibilities. See page 51.

Effectiveness

The effectiveness of your Board's and its Committees' performance is considered annually in effectiveness reviews. See page 53.

Accountability

Your Board provides shareholders with an assessment of the Group's position and prospects. We monitor and review the effectiveness of the Group's risk management and internal control systems. See pages 26 and 56.

Remuneration

Your Remuneration Committee ensures a close correlation between creating value for shareholders, and remunerating Executive Directors and senior executives appropriately. See pages 57 and 70.

Engagement

Your Board maintains strong relationships and regular interaction with our shareholders. Their continued support for our strategic aims is important. See page 57.

As we announced on 16 February, Priscilla Vacassin has decided to step down from the Board with effect from 1 March 2016. Priscilla has made a crucial contribution to the Board, exercising effective stewardship of the Group's executive remuneration arrangements, and I wish her every success for the future. Clare Thompson has agreed to act as interim Chair of the Remuneration Committee from 1 March. At the same time she will step down as Chair and member of the CSR Committee and the Investment Committee and as a member of the Board Risk Committee. Andrew Palmer will be appointed as Chair of the Investment Committee and Sebastian James as Chair of the CSR Committee with effect from the same date.

Employees

I would also like to thank our employees for their hard work and commitment this year. I am always struck by their positive attitudes and energy. Their pride and dedication to supporting our customers helped our business progress in 2015, and has put us in a strong position.

Michael N Biggs
Chairman

Building our future capability

"Our customers are benefiting from the many improvements we've been making including new propositions and enhanced customer service. This has resulted in more customers coming to our brands and renewing with us."

Paul Geddes
Chief Executive Officer

Overview of financial performance

As we celebrate our third year as a listed company, I am pleased with our performance in 2015. A focus on operating efficiency and disciplined underwriting in competitive markets enabled us to deliver an improved performance. Operating profit from ongoing operations increased 2.9% to £520.7 million, despite higher than normal claims following the floods that hit northern parts of the UK towards the end of 2015. This result included prior-year reserve releases of £378.9 million (2014: £397.6 million) which were higher than expected.

Desmond, Eva and Frank storms

We recognise that events like the flooding across the North of England and parts of Scotland are a reminder of just how important it is to have the right insurer and it gives us the opportunity to show our customers the benefit of being insured by one of our brands. When the floods hit we immediately put our emergency response plan into action. We had a visible presence on the ground with a network of almost 200 claims advisers and loss adjustors assessing damage, distributing emergency payments and putting customers in alternative accommodation as quickly as possible. Following the efforts of our people, who worked tirelessly on the ground and on the phones to process over 5,000 claims, the cost to our business was approximately £130 million, but I am very proud of the way we responded and supported our customers during this time.

Being a great retailer

Throughout 2015 we have focused on differentiating our brands and improving our propositions. Customers have responded well to the Direct Line brand's new positioning and propositions and helped strengthen our retention rates, which are over 80%.

We also refreshed the Churchill brand, emphasising the 'depend on the dog' strapline in new TV advertisements. The refresh also highlighted its protective nature, such as the promise to pay a claim even if our customers are hit by an uninsured driver.

Additionally, we have improved our trading capability. This boosted our competitiveness significantly, including on PCWs. Together, this activity has led to us improving performance, with Motor and Home in-force policies up 1.4% in 2015 in our own brands.

Operating as a smart and efficient manufacturer

We know that staying efficient and flexible is key to increasing our competitiveness and improving our customers' experience. Everyone working together to improve efficiency reduced our costs by 4.6% this year. Furthermore, our strategic leaders are spearheading a programme that will get the entire organisation thinking differently about how we spend our money.

We have also simplified and improved our claims services. For example, customers can now upload images of damage in their homes for assessors; track vehicle repairs on an online portal; and use Direct Line's seven-day car repair service.

Additionally, we invested in our pricing capabilities across our Personal Lines and Commercial businesses. This is aimed at broadening our footprint and improving our competitiveness.

Leading and disrupting our marketplace

We have a strong heritage in leading and disrupting our marketplace, and we want to build on our strong market positions. We will do this by identifying and investing in market developments that we believe can drive future growth.

We have continued growing our telematics offering, more than doubling our policy numbers in 2015. Our work analysing data for over 400 million miles of motoring is giving us pricing insights, which we expect will benefit us and our customers.

Within Commercial, we have been recognised for our leading capabilities in eTrade and direct. To meet our customers' evolving needs, we have launched Professional Indemnity cover for Direct Line for Business and a cyber insurance product through NIG.

We believe we are making great progress, but know we have more to do to stay at the front of our markets.

Investing in data and technology

Consumers are surrounded by emerging technologies. So we want to make sure our systems can support future developments. We have now essentially finished the migration of our IT systems from RBS Group. This has been a complex and challenging programme, and we are still working to improve the performance of our IT systems across the board. At the same time, we are building the next generation of systems that can help us interact with our customers in a digitally efficient way. Furthermore, like businesses worldwide, we are increasing our focus on cyber security.

Developing our culture and capability

Our people continue to be a foundation of our business. They have been instrumental in delivering the changes we needed to realise our goals. In 2014, to mark three years since our IPO and recognise their dedication, we told our employees that they would receive free shares, on top of the shares they received at the time of the IPO. In view of our performance in 2015, we made a further award of around £250 of free shares to all eligible employees. We are pleased that overall our people are engaged in developing our business and can share in its success.

Our latest total engagement levels have risen to 60%, which is a 15 percentage points rise compared to 2014. We have a series of action plans evolving, so we will continue gathering feedback from our people to ensure we are focusing on areas where we need to improve.

We have also invested in training and developing our customer-facing employees, helping them interact with customers in a new and refreshing way. This is delivering good results and resonating well with our customers. Our satisfaction rating tool, MyCustomer, has shown an improvement of 23% and our Net Promoter Score for the Direct Line brand has increased by 7.5 points, a good reflection of this success.

Our people are working hard and providing benefits for our business and customers. We have continued recognising their outstanding achievements through our Chief Executive Awards.

We also introduced a new initiative which rewards employees for proposing ideas that reduce Group costs or make insurance easier for customers. This has generated excitement throughout the organisation and, to date, we have received over 4,000 entries.

Strategic priorities for 2016

Following the rearticulation of our strategy in 2015, many of our 2016 priorities build on initiatives begun in 2015. Improving customer experience remains key, with a focus on cross channel distribution, while reducing complaints and improving the customer renewal process. We will continue to strive to improve operating efficiency.

Outlook

Our markets remained highly competitive during 2015 and in early 2016. While premium rates in the motor market have increased, this should be viewed in the context of rising claims costs and higher levels of insurance premium tax ("**IPT**"). The home market experienced premium deflation in 2015 overall, although underlying market pricing was broadly stable towards the end of 2015 as IPT increases were reflected. Overall, the increase in IPT has seen shopping in the market increase modestly. The rescue and commercial markets also experienced increased competitor activity during the year.

Against this backdrop, we continue to adopt a disciplined approach to managing the trade-off between margin and volumes, whilst continuing to seek opportunities to improve efficiency. We aim to reduce total costs in absolute terms in 2016 compared to 2015. The rate of reduction is expected to be lower in 2016 than in 2015 due in part to the cost of the Flood Re levy. Meanwhile, we are continuing to invest in building future capability.

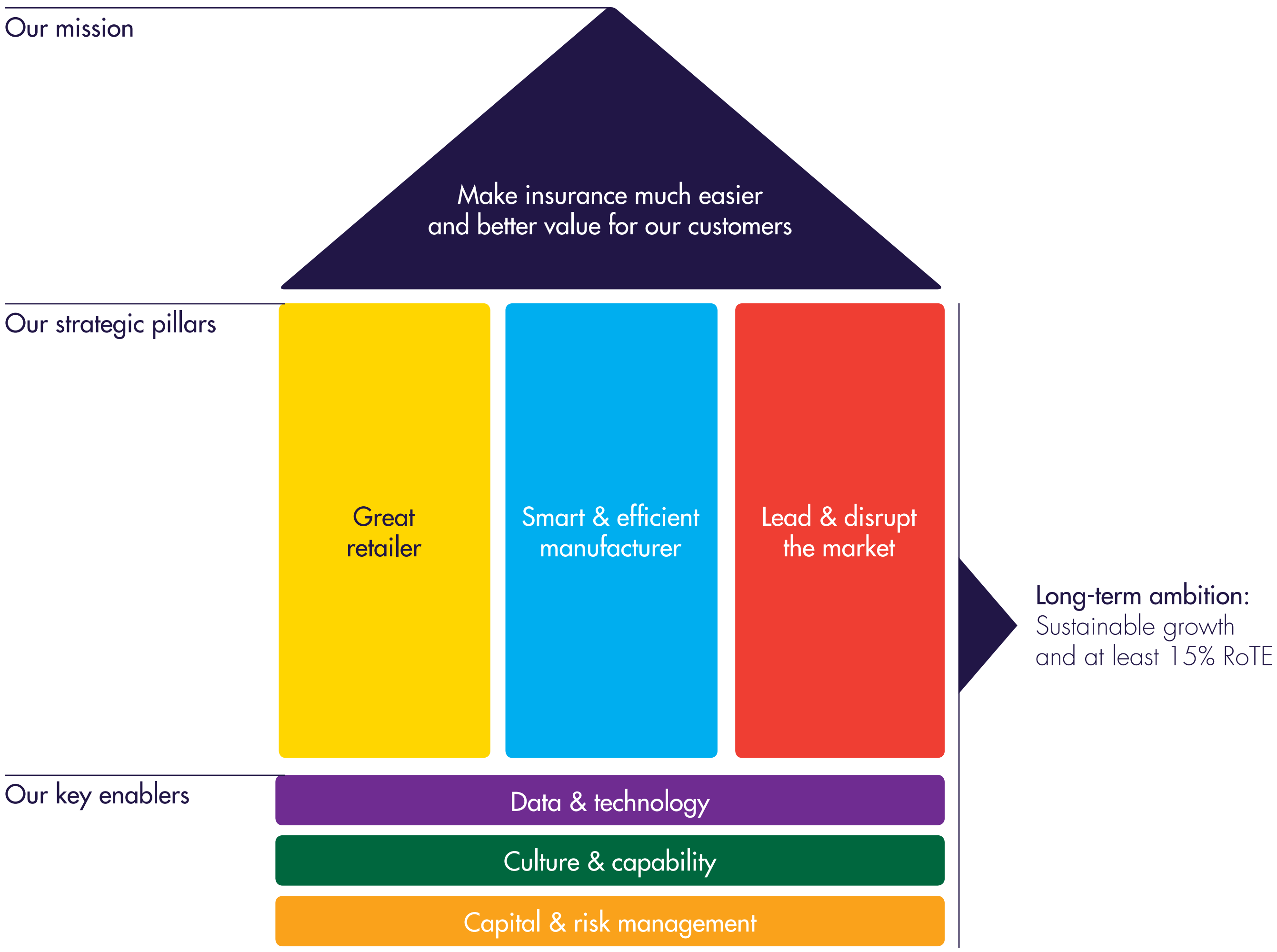
For 2016, we expect to achieve a COR in the range of 93% to 95% for ongoing operations, assuming a normal annual level of claims from major weather events.

My thanks go to our people for their hard work and support throughout the year. I am excited by their passion and dedication, and by how everyone works tirelessly to make insurance much easier and better value for our customers.

Paul Geddes
Chief Executive Officer

Our clear and concise strategic direction

We have articulated our strategy around a simple mission: to make insurance much easier and better value for our customers. We believe that delivering this strategy will allow us to grow sustainably, whilst targeting at least a 15% return on tangible equity.



Great retailer

Compelling brands, propositions and customer experience to meet diverse and long-term customer needs

We aim to make it easy for our customers to access our products and services at every stage. This includes increasing online servicing for customer policies and claims, and evolving telephone sales and servicing by investing in next-generation customer systems. We focus on training our contact centre employees to understand customer needs better.

How we performed in 2015

Work to differentiate our brands has continued with enhancements for the Direct Line brand's customers. Following a succession of initiatives during 2015, Direct Line customers now benefit from a seven day car repair service, guaranteed hire car as standard on comprehensive motor policies, an eight hour turnaround to dispatch certain lost or damaged household goods and the removal of amendment fees from all Direct Line branded products.

Churchill's branding has also been refreshed with a campaign to highlight its dependability. We have reinforced the product and service to differentiate it from other brands, including on PCWs. This, together with an increased trading capability across Churchill and Privilege, has contributed to an improvement in Motor and Home own brands PCW sales.

These improved propositions, as well as a focus on improving customer experience and reducing complaints, have contributed to an increase in our Direct Line brand's Net Promoter Score, along with further improvements in retaining customers in our Motor and Home own brands.

Our investment in digital capability continued with the roll out of smartphone and tablet optimised websites, including new quote and buy journeys, for Home and Green Flag insurance products. These have built on last year's successful implementation of a new quote and buy journey for Motor. Quote and buy journeys have continued to be optimised to take account of customer preferences depending on brand and distribution channel.

Our objectives for 2016

Improving customer experience remains a key target, with a focus on cross-channel distribution, while reducing complaints and improving the customer renewal process.

Smart & efficient manufacturer

Efficiency and flexibility to deliver better claims and customer service at lower cost

We aim to improve efficiency and effectiveness across the organisation. We intend doing this by delivering transformational initiatives, and making sure we provide quality and value for money every day. This goes beyond reducing costs. We always seek to design and deliver new capabilities in a cost-efficient way.

How we performed in 2015

We continued to improve efficiency in 2015 with a reduction in total costs of 4.6% while continuing to invest in capability. Reductions in underlying costs have been achieved in a number of areas including marketing, technology and property.

New pricing projects have been implemented which aim to broaden our competitive quote footprint for Motor and Home products. We continue to invest in and to evolve the sophistication of our telematics pricing.

We have given our customers additional self service options within claims management where certain stages of Motor, Home, pet and travel claims can be managed online. This has improved efficiency and led to faster settlement times. We're continuing to aim to beat market claims inflation.

We are importing relevant Personal Lines capabilities into our Commercial operations, including improved Van technical pricing and the launch of webchat for the broker market.

Our objectives for 2016

We continue to strive to improve operating efficiency and aim to reduce total costs in absolute terms in 2016 compared to 2015. The rate of reduction will be lower in 2016 than in 2015 due in part to the cost of the Flood Re levy.

Partnerships remain strategically important and we will look to build on our improving manufacturing capability to deliver what we aim to be market leading propositions to current partners, as well as to build relationships with future partners.

Lead & disrupt the market

Maximise existing growth opportunities while creating and driving future areas of value

We aim to remain a leading competitor in our chosen markets by providing quality propositions and value for money. Where there are opportunities, we will look to launch new and exciting products and services. These will aim to put us at the forefront of disruptive market changes.

How we performed in 2015

We continue to build on our current strong market position by identifying and investing in market developments we believe can contribute to future growth. In particular, we're focusing on growing our telematics-based motor insurance product, more than doubling our telematics customers in the year to 78,000. As of the fourth quarter of 2015, 28% of our under 25 year olds' driver Motor premium was from telematics products. This growth has been achieved with the help of wider market appreciation of the benefits of telematics for younger drivers, recognition of our straightforward, self-install product and improved distribution through PCWs. Retention has proved strong amongst better drivers. Furthermore, the Group has launched an app-based over 25s offering and has supported a major motor manufacturer by using telematics as a key part of a new car customer proposition.

In Commercial, we continue to be recognised for our leading capabilities in eTrade and direct Commercial insurance, both of which are expected to be growing parts of the commercial market place. Commercial products are now more widely available to customers directly, with the launch of Churchill Van on two of the major PCWs. Commercial's product offering has been extended with the roll-out of professional indemnity for Direct Line for Business and cyber cover for NIG's customers distributed through the broker channel. These new products are fully reinsured.

Our objectives for 2016

New car technology centred on improving safety is emerging at a fast pace and the Group aims to take a lead by becoming the insurer of choice for the owners of these cars. The Group is the insurance partner to the Move UK research consortium which is looking at analysing the development and deployment of automated driving systems, as well as investigating the motor liability legal framework in the future.

In Commercial, the Group is looking at ways to leverage its leading capabilities in eTrade and direct Commercial insurance as these markets adapt to evolving distribution trends.

Data & technology

Harness the power of technology and scale of our data

We aim to harness the power of technology to make things easier for our customers and our people. By implementing integrated systems that are flexible and efficient, we can reduce costs while improving customer interactions such as self-service. We also enjoy a wealth of data from being a major insurer for a number of years, which we can use to make our business better for our customers.

How we performed in 2015

We have now essentially finished the migration of our IT systems from RBS. This has been a complex and challenging programme for the business.

Our investment in digital capability continued with the build, roll out and support of smartphone and tablet optimised websites for our Home and Green Flag insurance products. These have built on last year's successful implementation and support of a new website for Motor.

Consumers are surrounded by emerging technologies, so we continued to develop our next generation of systems that can help us interact with our customers in a digitally efficient way.

Our objectives for 2016

We are targeting improved performance and cost effectiveness from our IT systems.

Culture & capability

Unlock and accelerate our people's potential

We are continuing to invest in our employees' skills. This will help us to improve effectiveness and customer experiences, and get the best from our new systems. We aim to create excellent Group-wide employee engagement by focusing on leadership and people management at all levels. This has helped improve our employee engagement metrics year on year.

How we performed in 2015

Our people engagement scores improved during 2015 and we made progress in preparing our staff for new systems and processes. We launched a number of people engagement events over the course of the year, including:

- 'Launch pad' event, communicating our new strategy framework to our people managers
- 'Idea Lab' launched with more than 6,000 employees active on it. They submitted more than 1,500 business development ideas in the first month alone and 4,000 entries have been received to date

Our objectives for 2016

We will aim to sustain high performance whilst building on our improvements in people engagement in 2015. Improving efficiency and effectiveness across the organisation will also be an important part of our 2016 plans.

Capital & risk management

Sound foundation of capital and risk management

Our capital management policy seeks to maintain an appropriate level of capital and solvency to support our business, whilst growing dividends annually in real terms.

How we performed in 2015

Our hard work throughout 2015 meant we were well positioned for Solvency II's introduction at the start of 2016. We submitted an application to the PRA for the Group's principal underwriter, U K Insurance Limited ("**UKI**"), to use its internal economic capital model, validated by external experts, as part of a Group-wide partial internal model.

We have a strong culture of considering customers' perspectives.

Our objectives for 2016

We aim to embed further and build on our risk management decision-making processes developed in 2015, and to continue to identify and mitigate risks. Additionally, and subject to PRA approval, we plan to operate from mid-2016 using our internal model for calculating solvency capital requirements.

Our strategic pillars

Great retailer

We're delivering improved customer **experience and satisfaction**

This year, we built on Direct Line's new positioning. For example, we made the bold move to include a guaranteed hire car as standard for all Direct Line Motor customers, a benefit that customers can only get with our motor insurance product.

In addition, we introduced or continued the following Direct Line propositions: the proposition to repair vehicles within seven days; replace stolen or damaged essential household items with cash or a brand new replacement within eight hours; and remove amendment fees.

These initiatives have helped strengthen retention of customers.

Aside from introducing new propositions, we were also there for our customers at their time of need during the floods that hit homes in the northern parts of England and in parts of Scotland towards the end of 2015. The robust plans that we have in place for handling these types of events meant we were able to respond quickly to the needs of our customers.

96,000
social media interactions

1,100
homes affected by floods visited

Our strategic pillars

Smart & efficient manufacturer

We're delivering efficiency and improving processes for **our customers**

We aim to reduce costs by improving and embedding efficiency throughout the business.

Delivering efficiency in our claims methods and processes benefits us and our customers. This year, we introduced new propositions that helped us drive down claims inflation and improve efficiency.

Motor customers can now upload images of damage to their vehicles and track repairs on an online portal, plus we have also introduced a service to repair cars within seven days for Direct Line customers.

10%

increase in productivity from nitro-thermal painting spraying system

300,000

vehicle repair SMS text updates sent

Our strategic pillars

Lead & disrupt the market

We're focused on delivering innovation to meet **customer needs**

Direct Line for Business targets the UK's growing number of small businesses. It appeals to customers who want to buy robust and clear cover quickly and easily.

Our award-winning Landlord Insurance is delivering on this promise.

This highly flexible cover for landlords and buy-to-let owners gives them the confidence of knowing their properties are protected.

Customers also receive support from a dedicated claims handler, who manages claims efficiently from start to finish.

71,000
new Landlord insurance in-force policies

4,000
downloads of smartphone Landlord app

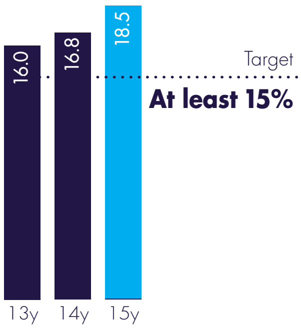
Defining and measuring our performance

These key performance indicators assess our performance against our strategy.

Read more about our rewards for performance on page 70, and for definitions see the glossary on pages 174 and 175.

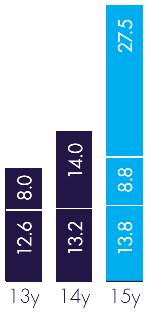
Return on tangible equity
(%)

18.5%



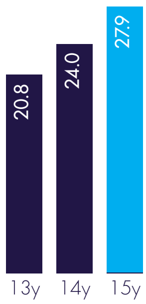
Dividend per share[1]
(pence)

50.1p



Basic earnings per share
Continuing operations
(pence)

27.9p



Combined operating ratio
Ongoing operations (%)

94.0%

	Return on tangible equity	Dividend per share	Basic earnings per share	Combined operating ratio
Definition	The return generated on the capital that shareholders have in the business. This is calculated by dividing adjusted earnings by average tangible equity.	The amount of cash paid to shareholders from the Group's profit.	This is calculated by dividing the earnings attributable to shareholders by the weighted average number of Ordinary Shares in issue.	A measure of financial year underwriting profitability. It is the sum of the claims, commissions and expenses divided by net earned premium. This excludes instalment and other operating income, and investment return. A COR of less than 100% indicates profitable underwriting.
Aim	We aim to achieve at least a 15% RoTE. We achieved this in 2015.	We have a progressive dividend policy and aim to grow the dividend in real terms each year. Additionally, we look to return surplus capital to shareholders when appropriate.	We have not set a target. However, growing earnings per share is considered an indicator of a healthy business.	We aim to make an underwriting profit. For 2016, we expect to achieve a COR in the range of 93% to 95% for ongoing operations, assuming a normal annual level of claims from major weather events.
Performance	See Finance review page 41.	See Finance review page 42.	See Finance review page 41.	See Finance review page 39.
Link to Directors' remuneration	We base LTIP awards partly on RoTE over a three-year performance period.	We base LTIP awards partly on relative TSR performance, which includes dividends. Directors also receive dividends on their beneficial shareholdings and accrue these on unvested LTIP awards.	This is a broad measure of earnings and reflects the results of the Run-off segment and restructuring and other one-off costs, in addition to underlying operating profit. The AIP awards have a weighting to these other financial measures.	We base part of the AIP awards on ongoing operating profit. COR is closely linked to this.

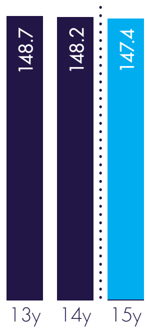
Note:
1. See note 2 on page 3.

Total costs
Ongoing operations (£m)

£884.7m

Capital coverage[1]
Total Group (%)

147.4%



Net Promoter Score[2]
Direct Line brand (points)

7.5 pts increase

Complaints
Principal underwriter[3] (%)

0.33%

	Total costs	Capital coverage	Net Promoter Score	Complaints
Definition	The cost of doing business, including paying our people, marketing expenses, and spending on infrastructure and IT. This includes the costs we incur handling claims, but excludes any commissions we pay to brokers or partners, and restructuring and other one-off costs.	A measure to show the level of capital held compared to the level that is required, taking into account the risks we face.	Net Promoter Score is an index that measures the willingness of customers to recommend products or services to others. It is used to gauge customers' overall experience with a product or service and the customer's loyalty to a brand.	The number of complaints we received during the year as a proportion of the average number of in-force policies.
Aim	Our aim for 2015 was to reduce the level of overall costs by improving efficiency, which we achieved. We will continue to strive to improve operating efficiency and aim to reduce total costs in absolute terms in 2016 compared to 2015. The rate of reduction will be lower than previous years, due in part to the cost of the Flood Re levy.	We target capital coverage to remain within our risk appetite. We also aim to maintain a rating in the 'A' range from our credit rating agencies. Both of these aims were satisfied in 2015.	Our aim is to improve this incrementally to achieve high levels of customer loyalty and retention rates.	This measure indicates the level of customer service we provide. We aim to improve this over time.
Performance	See Finance review page 40.	See Finance review pages 44 and 45.	Customer claims experience programmes and improved propositions have contributed to an increase in our overall brand score.	While the proportion of complaints received improved on 2014, we recognise that we have more to do to reduce these.
Link to Directors' remuneration	AIP awards relating to 2015 include a weighting relating to cost targets.	Risk management within risk appetite, which includes an assessment of capital strength, acts as a gateway for the AIP awards.	The AIP awards include a weighting to a balance of customer metrics.	The AIP awards include a weighting to a balance of customer metrics.

Notes:
1. Pro forma based on Solvency II standard formula estimated preliminary regulatory returns for 31 December 2015 and adjusted for final and second special interim dividends.
2. On an aggregated 12 months rolling basis, with 2013 rebased to 100.
3. For the Group's principal underwriter, U K Insurance Limited; it excludes discontinued operations.

Managing our risks

Our business is risk, so managing this effectively and efficiently is critical to the success of our strategy.

Managing risk in line with our strategy

Management, and ultimately the Board, are responsible for developing our strategy. Our strategic planning process aims to ensure we have developed clear objectives and targets, and identified the actions needed to deliver them, including the management of risks. These clear objectives are consistent with our overall long-term ambition of sustainable growth and at least a 15% RoTE within our risk appetite. To find out more about our strategy, see page 14.

Our risk governance structure

The Board sets and monitors adherence to the risk strategy, risk appetite and risk framework. It has established a risk management model that separates responsibilities into Three Lines of Defence.

Our First Line of Defence is responsible for ownership and management of risks to the achievement of business objectives on a day-to-day basis. The Second Line of Defence is responsible for the provision of proportionate oversight and challenge of risks, events and management actions.

Group Audit are the Third Line of Defence and provides an independent view of the effectiveness of risk management and controls – see diagram below.

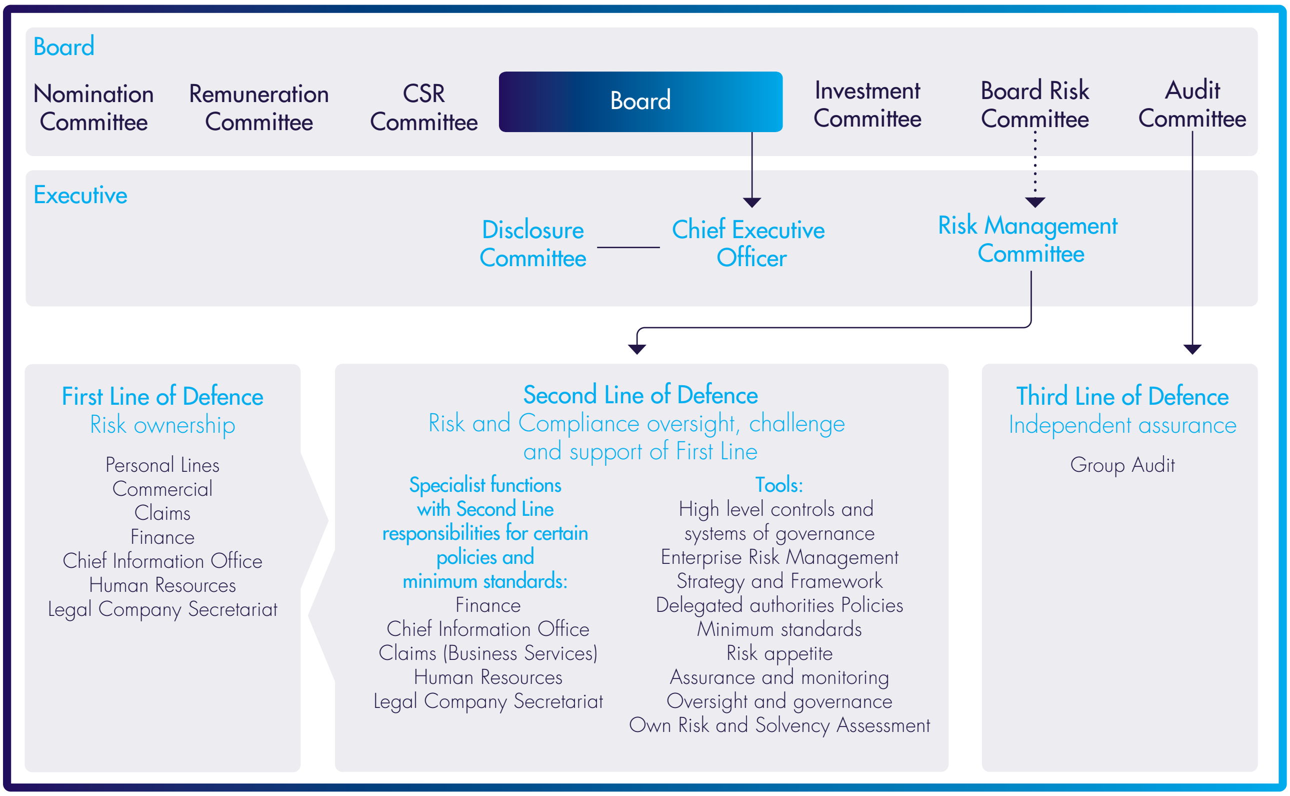
Risk appetite

Our risk appetite statements define the opportunities and associated risks we are prepared to accept to achieve our business objectives – see table on the next page. To monitor whether the business remains within risk appetite, the statements are aligned to key risk indicators ("**KRIs**") which are used to drive risk-aware decision making.

These KRIs are qualitative and quantitative, and both forward and backward looking. We review our risk appetite statements and KRIs annually, using outputs from the internal economic capital model.

The Group is recalibrating its risk appetite range in relation to the Solvency II internal model and expects to disclose the output of this later in 2016.

Our risk governance structure



Our risk objectives and appetite

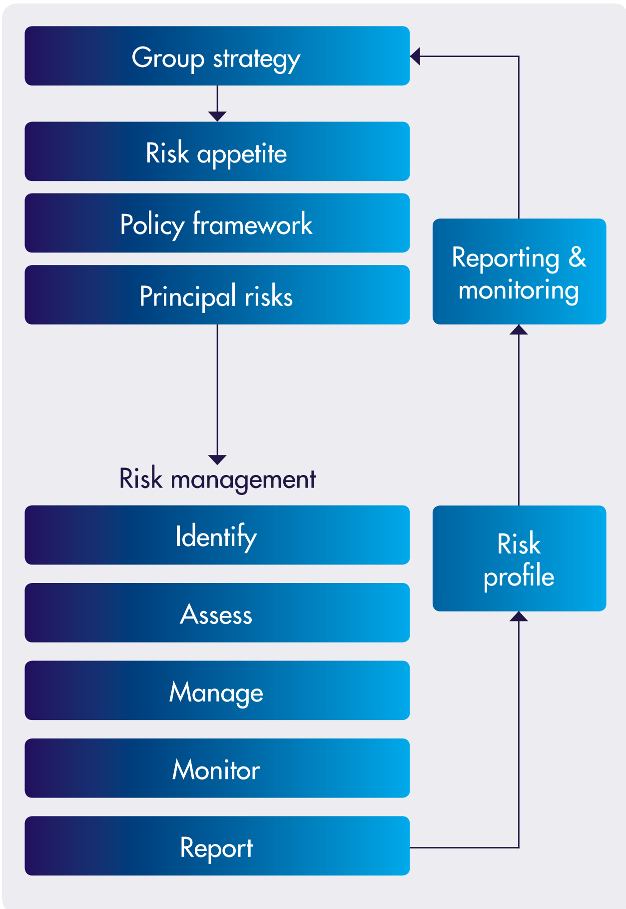
Risk objective	Risk appetite statement
Overarching risk objective	The Group recognises that its long-term sustainability is dependent on having sufficient economic capital to meet its liabilities as they fall due, thus protecting its reputation and the integrity of its relationship with policyholders and other stakeholders. As part of this, its appetite is for general insurance risk, focusing on personal lines retail and SME insurance in the UK. The Group has appetite for non-insurance risks, as appropriate, to enable and assist it to undertake its primary activity of insurance.
1. Maintain capital adequacy	The Group seeks to maintain sufficient economic capital consistent with our strategic aim of achieving a standalone credit rating in the 'A' range.
2. Stable and efficient access to funding and liquidity	The Group aims to meet both planned and unexpected cash outflow requirements, including those requirements that arise following a one-in-200 years insurance, market or credit risk event.
3. Maintain stakeholder confidence	The Group has no appetite for material risks resulting in reputational damage, regulatory or legal censure, fines or prosecutions and other types of non-budgeted operational risk losses associated with Group conduct and activities. The Group will maintain a robust and proportionate internal control environment.

Our Enterprise Risk Management Strategy and Framework

This sets out, at a high level, our approach to setting risk strategy and the Enterprise Risk Management Framework ("**ERMF**") for managing risks. It documents the high-level principles and practices to achieve appropriate risk management standards, and demonstrates the inter-relationships between components of the ERMF – see diagram.

The ERMF enables us to run the business with the requisite understanding of our risks and controls, as well as having appropriate oversight in place to manage risks proactively. It is aligned to the Three Lines of Defence model and is intended to provide a coherent, robust, fit for purpose, end-to-end approach for managing all material risks. A central component of the ERMF is our policy framework, which includes policies and minimum standards. These inform the business how it needs to conduct activities to remain within risk appetite.

The Board approves our strategy, risk appetite and policies, and the Board Risk Committee approves the Enterprise Risk Management Strategy and Framework.



Our risk culture

Our risk culture underpins our business and decision-making, and helps us embed a robust approach to risk management. Our risk culture is demonstrated in the understanding and business-wide use of the risk management systems and processes, and through risk-aware decision making. The Board is committed to promoting a culture of high standards of corporate governance, business integrity, ethics and professionalism in all of our activities.

Principal risks and uncertainties

We carry out a robust assessment of the principal risks facing us. Principal risks are defined as having a residual risk impact of £40 million or more on profit before tax or net asset value on a one-in-200 years basis, taking into account customer, financial and reputational impacts. We believe that the risk profile remains broadly unchanged over the last year.

Principal risks	Owner	Management and mitigation examples
Insurance risk • Reserve • Underwriting • Distribution • Pricing • Reinsurance The risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting. See pages 123 to 124.	Chief Financial Officer, Managing Directors of Personal Lines and Commercial	• We estimate technical reserves using various actuarial and statistical techniques. Management's best estimate of total reserves is set at not less than the actuarial best estimate • Third parties carry out reviews of our reserves • Underwriting guidelines are set for all transacted business and pricing refined by analysing comprehensive data • Catastrophe and motor excess of loss reinsurance limits our exposure to events and large losses • We invest in enhanced external data to analyse and mitigate exposures
Market risk • Spread • Interest rate • Property The risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments. See pages 124 to 126.	Chief Financial Officer	• We manage and control the risks in our investment portfolio through: – investment strategy approved by the Board – diversification of the types of assets, limits on the amount of illiquid investments, and tight control of individual credit exposures – risk-reduction techniques, such as hedging foreign currency exposures with forward contracts and hedging exposure to US interest rates with swap contracts
Credit risk • Counterparty default • Concentration The risk of loss resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which we are exposed. See pages 126 to 130.	Chief Financial Officer	• Credit limits are set for each counterparty and we actively monitor credit exposures • We only purchase reinsurance from reinsurers with at least an 'A-' rating
Operational risk • Information security • IT and business continuity • Partnership contractual obligations • Change • Financial reporting • Model • Outsourcing The risk of loss due to inadequate or failed internal processes, people, systems or from external events.	Specific members of the Executive	• We have appropriate operational processes and systems, including detection systems for fraudulent claims • We are working to improve the performance of our IT systems across the board, while focusing on the development of future systems capability. With significant change underway, we are monitoring risks associated with our IT systems' stability, cyber security and the internal control environment • Our risk management system is designed to enable us to capture risk information in a robust and consistent way • We monitor performance of outsourced activities

Principal risks	Owner	Management and mitigation examples
Regulatory and conduct risk • Regulatory • Conduct • Compliance The risks leading to reputational damage, regulatory or legal censure, fines or prosecutions and other types of non-budgeted operational risk losses associated with our conduct and activities.	Chief Financial Officer, Chief Risk Officer and Managing Director of Personal Lines	• We maintain a constructive and open relationship with our regulators • Specific risk management tools and resources are used to help manage our exposure to regulatory risk • Risk-based monitoring is designed to ensure we use our resources effectively • We have a strong culture of considering customers' perspectives, and delivering the right outcomes for our customers is central to how we operate • Robust customer conduct risk management is intended to minimise our exposures
Strategic risk • Strategy formulation • Strategy implementation The risk of direct or indirect adverse impact on the earnings, capital, or value of our business as a result of the strategies not being optimally chosen, implemented or adapted to changing conditions.	Chief Executive Officer	• We agree, monitor and manage strategic targets • An annual strategy process is run which considers our performance, competitor positioning and strategic opportunities • Emerging risks are identified and managed using established governance processes and fora

Brand and reputational risk is now considered within the drivers of other risk types such as regulatory and conduct, operational and strategic risks.

Emerging risks

Our definition of emerging risk is newly developing or changing risks that are often difficult to quantify, but may materially affect our business. We have further defined emerging risks as highly uncertain risks that are external to our business. We record emerging risks within an Emerging Risk Register. These are reported to the Risk Management Committee and Board Risk Committee for them to review, challenge, approve and feed into the Board's strategic planning process.

Our emerging risks processes aim to:

- Achieve 'first mover advantage' by recognising risks and associated opportunities early
- Reduce the uncertainty and volatility of our business's results
- Manage emerging risks proactively

We consider our main emerging risks to be the following:

Technological change in driving habits reduces consumer need for motor insurance

New car technologies, such as crash-prevention technologies and driverless cars, could significantly affect the size and nature of the insurance market, and the role of insurers.

Changes to traditional insurance business models

New market entrants and changes in consumer expectations could result in significant changes to the structure of the general insurance market and require us to update our business model.

New methods of gathering and using customer data

Using 'big data' as part of our strategy could create new data management risks and issues; for example, complying with regulations relating to third-party access to telematics data.

Connecting with society

We seek to serve our customers in a way which recognises our wider commitment to society. We do this both through providing insurance and other services and through an understanding of the different ways in which our business connects with society.

Approach

Our CSR strategy provides the framework for managing the different ways we connect with society. The strategy has four strands. As shown in the graphic, they are 'Helping to make our society safer', 'Proud to be here', 'Recognised as part of our communities' and 'Reduce, Reuse and Recycle'.

We manage our strategy through our CSR Advisory Group, which comprises senior managers from across the business. Our sustainability team supports the Advisory Group. Individual members of our Executive Committee are accountable for each strand of the strategy. The CSR Committee's role is to oversee our approach. See page 63.

You can find more details of our approach, including our CSR Charter, policy framework, performance against last year's targets, and targets for 2016, on the Group's website at www.directlinegroup.com.

To find out more about our CSR Committee, see page 63.

Helping to make our society safer

We recognise that our products, services and operations affect our many stakeholders, and we seek to make our society safer for everyone. We contribute to many aspects of the road safety agenda, and aim to inspire a generation of safer young drivers.

Road safety

Despite increasing traffic on our roads, the number of serious accidents has reduced significantly since the turn of the century. Unfortunately, this trend has stalled in 2014. As Britain's biggest car insurer, we believe we can have a vital role to play in making our roads safer.

During 2015, we worked with various partners to address road safety.

Brake

We have worked with Brake, the road safety charity, for 13 years. In this time, we have produced survey reports on driver behaviour, attitudes and understanding, and released the results to the media to raise awareness of safe driving. This year's reports have covered 'driving offences and deterrents', 'crash protection and vehicle selection', 'winter driving' and 'use of head restraints'. Brake uses this research for its wider campaigning, education, community and professional engagement activities. We held an event in Westminster with parliamentarians to showcase this research. We also sponsored Brake's Parliamentarian of the Year Awards, which recognise Members of Parliament who have campaigned on road safety issues.

PACTS

We launched the Road Safety Dashboard with the Parliamentary Advisory Council for Transport Safety ("**PACTS**"). This pioneering tool uses Department of Transport statistics to produce an index that ranks the road safety record of individual parliamentary constituencies. This is the first time the data has been used to this level. We aim to encourage Members of Parliament to do more for road safety in their local constituencies.

We also sponsored PACTS' Road Safety Summit. This saw practitioners, civil servants, academics and enforcement services discussing changes to the law associated with drink, drugs and using mobile phones while driving. Additionally, policymakers and campaigners attended the annual PACTS Westminster lecture.

Department for Transport

We have proactively engaged with the Department for Transport on various topics, including telematics technology, driverless cars and the concept of a graduated driving licence.

Young drivers

Last year, the CSR Committee held a strategy session to consider how we might best use our expertise and experience to reduce deaths and life-changing injuries on the UK's roads.

In the UK, 490,000 drivers pass their test each year. It is still a significant rite of passage for many young people. However, it is also often a time when young drivers are at their most vulnerable.

Our data shows that accident rates among young drivers spike during their first year of driving, with one in four young drivers crashing in this time. Young drivers are also hugely over-represented in the most serious accidents. The impact on them, their passengers, their families and other road users can last a lifetime and has a huge effect on society generally.

There are various reasons why young drivers crash. These include over-confidence, a natural human urge to test personal boundaries and take risks, and hidden hazards. Using road-safety data and our knowledge of driver behaviour collected through telematics, we've identified contextual speed as a significant cause of fatal crashes involving young drivers.

New drivers only tend to fine-tune their decision-making when they no longer have an instructor in the car. In particular, deciding how fast they should or can go relies on experience of road conditions and predicting how other road users behave.

Young drivers' first 1,000 miles are key. This is when the gap between perceived and actual driving competence, and hence risk, is greatest. So we have set ourselves the ambitious goal of cutting deaths in the first 1,000 miles to zero.

The biggest barrier to addressing this issue is that young drivers may feel immune to the risks. Our goal of inspiring a generation of safe careful drivers sits at odds with many of their motivations. They are pro-risk (although less than previous generations), competitive and relish the freedom of being a new driver. They may believe that most people drive faster than the speed limit and that good driving means travelling as fast as you can. To change behaviour, we have to change this perspective.

Manifesto

Safer young drivers

We want to cut deaths in the first 1,000 miles of driving to zero

Young drivers have an unacceptably high risk of death when they first take to the road:

- 1.5% of drivers are 17 to 19 years old, but they are involved in 12% of all fatal crashes
- A typical new driver becomes more dangerous in their first 1,000 miles of driving, even though they feel invincible

As Britain's biggest motor insurer, we believe that every driver in Great Britain should have a safe first 1,000 miles. We are planning to:

- Proactively use our brands, knowledge and expertise to find new ways to fix this problem
- Find ways to engage all audiences that can influence the situation including young drivers, parents, carmakers, road safety educators and policymakers, traffic planners and other insurers

We'll start by developing a behavioural change campaign aimed directly at young drivers in 2016.

We believe talking at young people or trying to shock them does not work. To engage them we need to find a way to add to their driving experience. So we are looking to use our telematics technology to produce a smartphone app. We will support this with a communication and reward campaign that leverages peer pressure. It will also engage young drivers by making road safety conversations more relevant to them. If successful, we aim to make the app available to all newly-qualified young drivers in the UK.

Reduce, Reuse and Recycle

We aim to manage our operations sustainably. As outlined below, we have progressed well. Looking ahead, we are focusing on our property and claims supply chain, where there is potentially more opportunity to improve.

Emissions

You can find information on Group-wide greenhouse gas ("**GHG**") emissions in the chart – and more details of our emissions in the Directors' report on page 98. We were delighted to win two awards at the Carbon Disclosure Project UK Results event last year. The awards recognised how we improved our performance and enhanced our disclosure of our emissions-related information.

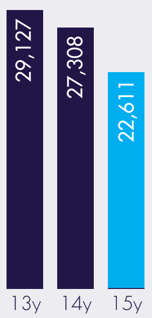
Energy use is the main cause of our emissions. In absolute terms, we have reduced our emissions following the exit of several office buildings. Furthermore, our Property Management team has developed an energy-saving plan. This seeks to optimise our buildings' heating, ventilation and air-conditioning systems, and invest in energy-efficient devices, such as lighting. Throughout 2015, 100% of the Group's UK electricity was purchased on a green tariff.

Waste

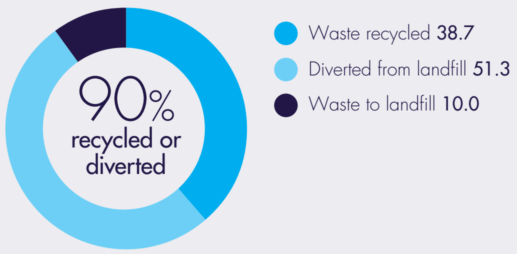
Our system of sorting waste at source and introducing new signage has helped us increase the waste we recycle. In 2015, we recycled approximately 40% of waste from our office sites. We also recycled 54% of waste from our UK Accident Repair Centres. By the end of 2015, we were diverting 100% of waste away from landfill including recycling.

Greenhouse gas emissions[1] (tonnes)

↓ 17.2%



Office waste (%)



Paper use

We have used new technology to reduce the amount of printer and copier paper we use. Our office paper is made from recycled material.

We are now focusing on reducing the paper we use to produce customer policy documents and are looking at ways to send customers these documents electronically. In 2015, we used 829 tonnes of paper for policy documents.

Suppliers

Our Ethical Code for Suppliers sets out our approach to managing CSR-related matters across our supply chain. For example, we have developed our partnership with 'Anyjunk'. Following a claim, Anyjunk provide a waste-collection service that seeks to recycle household waste and is currently recycling almost 90% of waste that it collects from our customers.

Proud to be here

We approved a new people strategy in 2015. This supports our new business strategy, particularly regarding culture and our employees' capabilities. In 2015, we focused on pride in Direct Line Group, encouraging and celebrating the strength of our workforce.

Engagement

In 2015, we continued developing and championing our various volunteer groups, such as Employee Representative Bodies, Community and Social Committees ("**CASCs**"), Local Coordination Teams, Health and Safety Representatives, and the Diversity Network Alliance. This has helped increase our employees' voice and enabled the Group to serve customers better.

Employee feedback remains an important gauge of how our many varied initiatives affect change. In 2014, we began using a new and more challenging methodology that is aligned to our ambition to be a top employer.

In 2015, our people managers created over 460 individual action plans to improve their teams' experience. This has played a major part in significantly improving our engagement score from 45% in 2014 to 60%. The percentage of our employees who are proud to work for the Group also increased from 68% in 2014 to 80%, while 70% tell others that the Group is a great place to work (up from 55% in 2014).

Note:
1. Emissions for continuing operations. This excludes discontinued operations, the Group's former International division. Total Group scope 1 and 2 emissions including discontinued operations were 23,143 tonnes (2014: 28,759 tonnes; 2013: 30,624 tonnes).

Diversity, inclusion and human rights

We continue to work towards an environment based on meritocracy and inclusion, where every employee can achieve their full potential, whatever their characteristics.

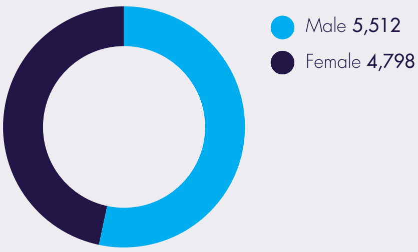
Our diversity and inclusion practices are in line with the Universal Declaration of Human Rights. Our Ethical Code for Suppliers requires that all our suppliers adhere to the core International Labour Organization standards.

During 2015, our Diversity Network Alliance became more visible throughout the business and externally. The team had a branded presence at various Pride events and a week-long internal focus on work-life balance. It also placed articles on our intranet and discussions on other internal platforms covering many diversity and inclusion issues. Many of our locations organised health and wellbeing events to advise on health and raise mental health awareness.

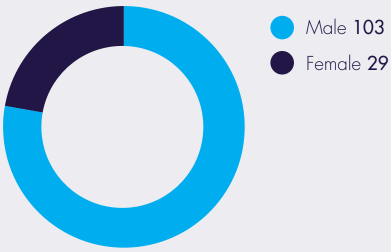
You can find the ratio of female-to-male employees at 31 December 2015 in the charts below.

To make it easier for our deaf and profoundly deaf customers to communicate with us, we introduced a Video Relay Service. This enables customers to connect to a sign interpreter. The interpreter then contacts our call centre and relays the conversation.

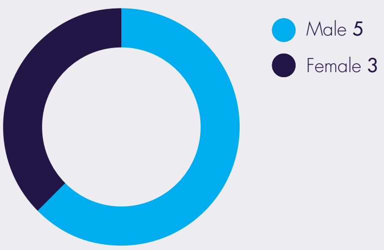
Gender diversity of all employees



Gender diversity of senior managers



Gender diversity of Board of Directors



Living wage

We comply with the principles of the Living Wage Foundation, relating to our employees.

Recognised as part of our communities

We believe that our people's feelings about working for the Group link to our reputation in the community. So we seek to align our giving with our employees' interests.

Community and social committees

To engage our people, we run a network of CASCs, which comprise local volunteers. The CASCs receive central funding and support. Within an agreed framework, they are free to create their own programme of events and activities at their sites. They are also free to build relationships with local charities and voluntary organisations. Examples of events include:

- 450 employees from seven offices spending an evening manning phone lines for Comic Relief, taking 8,000 calls. Hundreds more fundraised on the day
- A masquerade ball in Leeds in aid of Cancer Research, Leeds MIND, Sue Ryder and Leeds Haven
- 50 employees from Manchester running 10 kilometres around the city centre to raise £5,000 for various local causes

Volunteering

We encourage all employees to volunteer individually or as a team through our 'One Day initiative'. For example, our Finance team supported the Brook Lane Community Garden in Bromley. The team spent a day renovating the open space. This supported the Garden's aim to enable people of all ages to learn cultivation skills and manage habitats that support wildlife. Our Employee Opinion Survey revealed that 32% of staff volunteered or fundraised in company time last year.

Matched giving and grants

In 2015, our employees donated £144,000 through our payroll giving scheme and we donated a further £97,000 in matched giving. We also provided £51,000 in grants to organisations for which our employees fundraise or volunteer.

Personal lines

Motor

Highlights

- Retained position as Britain's leading personal motor insurer ranked by in-force policies
- In-force policies increased by 1.0% during 2015 with growth in each quarter following enhancement to own brands propositions
- Gross written premium increased by 4.8% as premium inflation returned to the motor market, with growth accelerating during the year
- COR improved by 3.8 percentage points reflecting a better current-year attritional loss ratio from a refinement in the risk margin approach and reduced large bodily injury claims
- Operating profit improved by 13.8% to £338.0 million

Performance highlights

	2015	2014
In-force policies (thousands)	**3,707**	3,672
Gross written premium	**£1,406.7m**	£1,342.0m
Loss ratio	**63.6%**	67.0%
Commission ratio	**2.6%**	3.2%
Expense ratio	**26.2%**	26.0%
Combined operating ratio	**92.4%**	96.2%
Operating profit	**£338.0m**	£297.1m

Performance

Total in-force policies increased by 1.0% during 2015. Own brands grew by 1.3% whilst partner in-force policies fell by 3.5%. Gross written premium increased by 4.8% in comparison to 2014, as premium inflation returned to the market alongside ongoing claims inflation.

Effect on premium income of changes in price and risk mix[1]

	Q4 2015	Q3 2015	FY 2015
Change in price	**7.7%**	7.0%	**5.8%**
Change in risk mix	**(1.0%)**	0.1%	**(0.7%)**

Improvements in the Group's trading capability across Churchill and Privilege, and better price competitiveness in an inflating market all contributed to the improved performance. The growth in gross written premium accelerated during the year with growth of 7.1% in the fourth quarter. Risk-adjusted prices increased by 7.7% compared with the fourth quarter of 2014, whilst for the full year risk-adjusted prices were 5.8% higher than in 2014. Annual premium inflation in 2015 reflected expected claims inflation in addition to a catch up for higher than expected claims inflation during the previous period.

The market experienced continued high levels of shopping behaviour, especially during the fourth quarter following the rise in IPT. In this context, Motor's retention ratio remained strong and for 2015 was 1.0 percentage point higher than for 2014.

One of Motor's partners, Sainsbury's, has reviewed its insurance arrangements and Motor will no longer write new business from February 2017. Arrangements for the Sainsbury's renewal book will follow contractual terms. In 2015, Sainsbury's accounted for 3.5% of Motor's gross written premium.

The COR for the Motor division improved by 3.8 percentage points reflecting a better loss ratio while the expense and commission ratios were stable. The loss ratio improvement was due to a lower current-year attritional loss ratio. Stable prior-year reserve releases represented a similar percentage of net earned premium, and primarily relate to large bodily injury claims. Prior-year reserve releases in 2015 were £266.8 million (2014: £278.4 million) and are expected to be lower in 2016.

The current-year attritional loss ratio improved by 3.5 percentage points to 85.0%. Of this improvement, 2.0 points related to the refinement in approach to determining the level of risk margin above the actuarial best estimate for the current year. The underlying loss ratio, excluding the change in risk margin, improved by 1.5 points compared to last year, primarily arising from lower levels of large bodily injury claims which were elevated in 2014. Motor's experience in relation to large bodily injury claims has improved during the second half of 2015 versus 2014 and the first half of 2015, but remains elevated versus 2013. In addition, Motor has experienced a modest increase in accident frequency during the second half of 2015. Operating profit improved by 13.8% to £338.0 million in 2015, reflecting better underwriting performance on lower net earned premium.

Regulatory

During November, the Government announced plans designed to reduce the cost of soft tissue damage whiplash claims. These plans, which will be subject to consultation, include increasing the value of claims settled through the small claims track and removing general damages for certain claims. The Group has been calling for reform in this area for some time and is working with the Government and industry bodies on how these reforms should be implemented. The reforms are not expected to be in place before 2017.

Outlook

The market remained highly competitive during 2015 and in early 2016. While premium rates in the market have increased, this should be viewed in the context of rising claims costs and higher levels of IPT. Against this backdrop, Motor continues to adopt a disciplined approach to managing the trade-off between margin and volumes, whilst continuing to identify opportunities to improve efficiency. Meanwhile, Motor is continuing to invest in building future capability.

Note:

1. Risk mix reflects the expected level of claims from the portfolio. It measures the estimated movement based on risk models used in that period and is revised when risk models are updated.

Home

Highlights

- Britain's leading home insurer ranked by in-force policies
- In-force policies overall decreased 3.1% following a reduction in partner in-force policies, while own brands increased by 1.5% with strong retention
- Gross written premium was 3.6% lower primarily due to partnerships, while own brands fell 1.9%
- COR improved by 0.5 percentage points, despite higher than normal claims from major weather events, and current-year attritional loss ratio improved 3.5 percentage points
- Operating profit was broadly stable at £109.9 million, despite higher than normal claims from major weather events

Performance highlights

	2015	2014
In-force policies (thousands)	3,418	3,526
Gross written premium	£866.3m	£898.6m
Loss ratio	51.5%	50.8%
Commission ratio	20.9%	21.7%
Expense ratio	19.8%	20.2%
Combined operating ratio	92.2%	92.7%
Operating profit	£109.9m	£113.9m

Performance

In-force policies for Home own brands increased by 1.5% to 1.7 million over 2015, while partner in-force policies reduced by 7.3%. Gross written premium was 3.6% lower than for 2014 primarily due to partnerships which were 5.1% lower, while own brands experienced a smaller reduction of 1.9%.

Effect on premium income of changes in price and risk mix – own brands

	Q4 2015	Q3 2015	FY 2015
Change in price	(3.0%)	(1.6%)	(2.4%)
Change in risk mix	(2.6%)	(0.5%)	(1.1%)

Home's strong own brands maintained their competitiveness in a deflationary market supported by previous investments in claims and pricing initiatives. Risk-adjusted Home prices decreased by 3.0% in the fourth quarter of 2015 compared with the same quarter last year, while risk mix decreased by 2.6%. Own brands retention continued to be strong, supported by previous investments in propositions.

Two of the Group's Home partners, Nationwide Building Society ("**NBS**") and Sainsbury's have recently reviewed their insurance arrangements. In respect of NBS, Home will no longer underwrite home insurance for its customers from early 2017, while in respect of Sainsbury's, Home will no longer write new business from February 2017. Arrangements for the Sainsbury's renewal book will follow contractual terms. Whilst these developments are disappointing, it is the nature of the partnership market that relationships will be reviewed periodically and in the case of Sainsbury's, it is reviewing its current insurance operating arrangements. In 2015, NBS and Sainsbury's accounted for 25.5% of Home's gross written premium, albeit they contributed a considerably lower proportion of Home's operating profit.

Partnerships remain strategically important and Home will look to build on its improving manufacturing capability to deliver what it aims to be market leading propositions to current partners, as well as to build relationships with future partners. Consistent with this, Home is in discussion with RBS on a three-year extension to its insurance partnership, which includes the RBS and NatWest brands.

In Home, the COR improved to 92.2% despite higher than normal claims costs from major weather events. The weather impact in 2015 was higher than expected with claims costs from major weather events of approximately £90 million (2014: £63 million). The Home division normally expects in the region of £80 million of annual claims from major weather events. Prior-year reserve releases were lower than last year at £41.9 million (2014: £49.8 million).

The current-year attritional loss ratio, excluding claims costs from major weather events, improved by 3.5 percentage points on 2014. This reflected the strength of Home's pricing approach and retention performance. Home claims trends remained benign with 2015 underlying inflation, excluding major weather events, lower than the long-term average. In particular, claims from accidental damage and theft remained low.

Operating profit of £109.9 million was broadly stable in comparison to the prior year, despite a deflationary market and higher than normal claims from major weather events.

Flood Re

From 1 April 2016, Flood Re, the Government and industry-backed scheme to provide affordable home insurance to households at high risk of flooding, is planned to become operational. The Group has supported Flood Re's formation and is expected to be ready to cede chosen risks to Flood Re on its inception. Home's share of the annual levy, based on its market share, is expected to be in the region of £24 million for 2016 and will be charged to operating expenses.

Outlook

The market remained highly competitive during 2015 and in early 2016. The market experienced deflation in 2015 overall, although underlying market pricing was broadly stable in the fourth quarter after adjusting for the change in IPT. Overall, the increase in IPT has increased shopping in the market modestly. Home continues to adopt a disciplined approach to managing the trade-off between margin and volumes, and the effect on retention.

Rescue and other personal lines

Highlights

- Retained position as one of the UK's leading providers of rescue and other personal lines insurance ranked by in-force policies
- In-force policies for Rescue declined by 3.5% to 3.9 million through lower partner volumes and packaged bank account volumes
- Gross written premium for Rescue and other personal lines experienced growth of 6.0%, mainly due to Green Flag direct sales, and travel partnerships pricing and cover levels
- COR for Rescue and other personal lines was stable at 91.2%
- Operating profit increased by 8.3% to £52.0 million

Performance highlights

	2015	2014
In-force policies (thousands)		
Rescue[1]	3,932	3,976
Other personal lines	4,356	4,517
Total in-force policies	8,288	8,493
Gross written premium	£394.1m	£371.8m
Loss ratio	59.9%	57.4%
Commission ratio	6.4%	9.4%
Expense ratio	24.9%	25.2%
Combined operating ratio	91.2%	92.0%
Operating profit	£52.0m	£48.0m

Performance

In-force policies for Rescue declined by 1.1% to 3.9 million in comparison to the prior year through lower partner volumes. The reduction in in-force policies for other personal lines of 3.6% across 2015 primarily reflected lower packaged bank account volumes.

Gross written premium for Rescue and other personal lines experienced growth of 6.0% compared with 2014. Rescue gross written premium increased by 4.1% compared with 2014, mainly due to Green Flag direct sales. Refreshed web content, a new quote and buy journey and additional PCW distribution, together with take up of higher levels of cover and competitive propositions, supported this. Gross written premium for other personal lines rose 7.4% compared to 2014, driven primarily by pricing and upgraded levels of cover on travel partnerships.

The COR for Rescue and other personal lines was stable at 91.2% (2014: 92.0%). The Rescue COR was 82.3% (2014: 81.5%) with a higher loss ratio reflecting changes in the partner channel following favourable experience in the prior year being broadly offset by an improvement in the commission ratio.

Operating profit increased by 8.3% to £52.0 million. Within Rescue and other personal lines, Rescue operating profit improved to £42.2 million (2014: £41.5 million).

Outlook

Rescue and other personal lines continued to create additional value for the Group and represent an opportunity to meet customers' broader insurance needs. While competition was recently stronger in the rescue market, initiatives aim to position Green Flag well for 2016. We also aim to roll out improvements to our claims capability in Pet and Travel to enhance our service while updating our customer propositions.

Note:

1. Rescue in-force policies have been revised to exclude partner post-accident vehicle recoveries.

Commercial

Highlights

- Commercial in-force policies grew by 7.2% and Direct Line for Business in-force policies now exceed 400,000
- Gross written premium was broadly stable reflecting competitive pressures. Direct Line for Business gross written premium surpassed £100 million
- COR increased by 5.7 percentage points and operating profit decreased by £26.2 million, both impacted by higher than normal claims from weather
- Adjusting for a normal level of claims from weather and other large claims, COR was approximately 99%

Performance highlights

	2015	2014
In-force policies (thousands)	**655**	611
Gross written premium	**£485.3m**	£487.0m
Loss ratio	**62.7%**	57.1%
Commission ratio	**19.6%**	19.7%
Expense ratio	**22.2%**	22.0%
Combined operating ratio	**104.5%**	98.8%
Operating profit	**£20.8m**	£47.0m

Performance

Commercial in-force policy growth across 2015 was achieved by increased sales through the Direct Line for Business and eTrade channels. Gross written premium was broadly stable at £485.3 million in comparison to 2014. In the first half of 2015, gross written premium decreased following competitive pressures in the regional broker market, while growth of 1.9% was achieved in the second half primarily through the eTrade and direct channels.

Premium rates have been under pressure from a competitive market place across all channels, especially during the fourth quarter following the rise in IPT. Commercial continues to maintain its underwriting discipline and seeks to balance the retention of customers with rate inflation.

Commercial has further enhanced its product coverage with the launch of Professional Indemnity cover for Direct Line for Business's customers, and Cyber cover for NIG's customers distributed through the broker channel. These products are fully reinsured.

The Commercial COR of 104.5% was 5.7 percentage points higher than 2014 and affected by above average claims from weather events, including those in December which cost approximately £40 million. Overall, weather-related claims and large claims were approximately £25 million more than expected. Adjusting for this, the COR would have been 99% as underlying claims and the loss ratio have remained broadly stable in comparison to the previous year. Prior-year reserve releases of £56.6 million increased on the previous year (2014: £53.7 million).

Overall, operating profit was £20.8 million, a reduction of £26.2 million compared with 2014, as higher than normal claims from weather impacted profitability. Adjusting for weather-related claims and large losses, operating profit would have been similar to 2014.

Regulatory

The Insurance Act 2015 will come into effect on 12 August 2016, which represents a significant change to commercial insurance contract law. Commercial is working through the requirements of the Act and aims to deliver these appropriately for customers and brokers.

Outlook

The Commercial market became more competitive during the year. In the fourth quarter, rate increases on renewed business across the division's main lines were at the lowest level for a number of years. The market trend towards direct and etrade channels for small business insurance is expected to continue and Commercial is well placed to take advantage of this.

Improved operational efficiency

John Reizenstein
Chief Financial Officer

Highlights

- Operating profit from ongoing operations[1] increased to £520.7 million for 2015 (2014: £506.0 million). COR[1] from ongoing operations of 94.0% for 2015, an improvement of 1.0 percentage point
- Return on tangible equity[1] of 18.5% for 2015 (2014: 16.8%). Profit before tax for continuing operations increased to £507.5 million (2014: £456.8 million)
- Results benefited from disciplined underwriting, prior-year reserve releases from ongoing operations of £378.9 million (2014: £397.6 million) which were higher than expected, together with lower costs, partially offset by higher claims from major weather events and lower volumes
- Reduced total costs[1] by 4.6% in 2015 while building on technical pricing and claims management initiatives
- 4.5% increase in final dividend per share of 9.2 pence per share and additional special dividend of 8.8 pence per share. Total dividends for 2015, including special interim dividend of 27.5 pence per share following sale of International division, of 50.1 pence per share (2014: 27.2 pence per share)

	2015 £m	2014 £m
Ongoing operations[1]		
In-force policies[1] (thousands)	16,068	16,302
Gross written premium[1]	3,152.4	3,099.4
Net earned premium[1]	2,920.8	2,987.1
Underwriting profit	175.2	148.1
Instalment and other operating income	150.8	147.3
Investment return[1]	194.7	210.6
Operating profit[1] – ongoing	520.7	506.0
Run-off[1]	73.1	55.3
Restructuring and other one-off costs	(48.7)	(69.6)
Operating profit	545.1	491.7
Finance costs[1]	(37.6)	(37.2)
Gain on disposal of subsidiary	–	2.3
Profit before tax	507.5	456.8
Tax	(108.3)	(97.5)
Profit from discontinued operations, net of tax	181.2	13.3
Profit after tax	580.4	372.6
Of which is ongoing operations	385.3	368.0
Key metrics		
Loss ratio[1]	59.5%	59.6%
Commission ratio[1]	10.9%	11.8%
Expense ratio[1]	23.6%	23.6%
COR[1]	94.0%	95.0%
Investment income yield[1] – continuing operations[1]	2.4%	2.4%
Investment return[1] – continuing operations	2.9%	2.9%
Basic earnings per share – continuing operations (pence)	27.9	24.0
Adjusted diluted earnings per share[1] (pence)	26.6	25.5
Return on tangible equity[1]	18.5%	16.8%
Net asset value per share (pence)	192.2	188.2
Tangible net asset value per share (pence)	153.8	153.1
Dividend per share		
– interim (pence)	4.6	4.4
– final (pence)	9.2	8.8
– regular (pence)	13.8	13.2
– first special (pence)	27.5	10.0
– second special (pence)	8.8	4.0
– total (pence)	50.1	27.2

Note:
1. See glossary on pages 174 and 175

Performance

Operating profit – ongoing operations

	2015 £m	2014 £m
Underwriting profit	175.2	148.1
Instalment and other operating income	150.8	147.3
Investment return	194.7	210.6
Operating profit	520.7	506.0

In 2015, operating profit from ongoing operations increased to £520.7 million (2014: £506.0 million) primarily due to an improvement in the underwriting result, while the investment return decreased. The underwriting result improved significantly to £175.2 million (2014: £148.1 million) principally due to a better current-year attritional claims performance and reduced costs, partially offset by a higher level of claims costs from major weather events and lower volumes. This result included higher than expected prior-year reserve releases of £378.9 million (2014: £397.6 million). Investment return was lower primarily due to lower assets under management ("**AUM**") impacting investment income and a reduction in net realised and unrealised gains.

In-force policies and gross written premium

In-force policies – ongoing operations (thousands)

At 31 December	2015	2014 Revised[1]
Own brands	3,459	3,415
Partnerships	248	257
Motor total	3,707	3,672
Own brands	1,719	1,693
Partnerships	1,699	1,833
Home total	3,418	3,526
Rescue	3,932	3,976
Other personal lines	4,356	4,517
Rescue and other personal lines	8,288	8,493
Commercial	655	611
Total ongoing	16,068	16,302

Gross written premium – ongoing operations

	2015 £m	2014 £m
Own brands	1,307.5	1,248.4
Partnerships	99.2	93.6
Motor total	1,406.7	1,342.0
Own brands	408.4	416.2
Partnerships	457.9	482.4
Home total	866.3	898.6
Rescue	163.3	156.9
Other personal lines	230.8	214.9
Rescue and other personal lines	394.1	371.8
Commercial	485.3	487.0
Total ongoing	3,152.4	3,099.4

Total in-force policies for ongoing operations during 2015 reduced by 1.4% to 16.1 million (31 December 2014: 16.3 million). The fall primarily related to other personal lines, within the Rescue and other personal lines division, and Home partnerships. Commercial grew in-force policies by 7.2% across the period, while Motor increased marginally. Gross written premium of £3,152.4 million increased by 1.7% compared with 2014 (£3,099.4 million).

Underwriting profit – ongoing operations

	2015	2014
Underwriting profit (£ million)	175.2	148.1
Loss ratio	59.5%	59.6%
Commission ratio	10.9%	11.8%
Expense ratio	23.6%	23.6%
COR	94.0%	95.0%

The COR for ongoing operations improved by 1.0 percentage point to 94.0% (2014: 95.0%). The loss and expense ratios were stable, whereas the commission ratio decreased by 0.9 percentage points.

At the start of the year, the Group set 2015 COR guidance for ongoing operations in the range of 94% to 96%. This assumed a normal level of claims from major weather events. The range reflected uncertainty surrounding claims inflation versus motor market pricing. This guidance, which assumed normal weather, was subsequently updated in the year to between 92% and 94%. Following higher than expected prior-year reserve releases, a COR of approximately 93%, normalised for weather, was achieved.

Within the stable headline loss ratio, the attritional loss ratio improved, but this was offset by a lower contribution from prior-year reserve releases and higher weather-related claims. The reduction in the commission ratio primarily reflected lower payments to partners, particularly in Home, following higher weather-related claims.

The Group's expense ratio remained stable at 23.6%, with the effect of the reduction in operating expenses offset by the impact of lower net earned premium.

Current-year attritional loss ratio – ongoing operations

	2015	2014
Reported loss ratio	59.5%	59.6%
Prior-year reserve releases	13.0%	13.3%
Major weather events – Home[2]	(3.1%)	(2.1%)
Current-year attritional loss ratio	69.4%	70.8%

Notes:

1. Rescue in-force policies have been revised to exclude partner post-accident vehicle recoveries.
2. Home claims from major weather events, including inland and coastal flooding, and storms.

Analysis by division

	Motor	Home	Rescue and other personal lines	Commercial	Total ongoing
For the year ended 31 December 2015					
COR	92.4%	92.2%	91.2%	104.5%	94.0%
Current-year attritional loss ratio	85.0%	45.8%	63.5%	75.5%	69.4%
Prior-year reserve releases (£ million)	266.8	41.9	13.6	56.6	378.9
For the year ended 31 December 2014					
COR	96.2%	92.7%	92.0%	98.8%	95.0%
Current-year attritional loss ratio	88.5%	49.3%	61.7%	69.2%	70.8%
Prior-year reserve releases (£ million)	278.4	49.8	15.7	53.7	397.6

The movement in the current-year attritional loss ratio is a key indicator of underlying accident year performance as it excludes prior-year reserve movements and claims from major weather events in the Home division. The Group's current-year attritional loss ratio improved by 1.4 percentage points to 69.4% in 2015 (2014: 70.8%) with improvements in Motor and Home partially offset by a deterioration in Rescue and other personal lines, and in Commercial primarily because of higher weather claims.

Prior-year reserve releases from ongoing operations continued to be significant at £378.9 million (2014: £397.6 million) and were equivalent to 13.0% of net earned premium (2014: 13.3% of net earned premium). Reserve releases were higher than expected in 2015 and the overall level for 2016 is expected to remain significant, albeit lower than in 2015.

By division, the COR improved in Motor, Home and Rescue and other personal lines compared with 2014, but deteriorated in Commercial, primarily due to the December 2015 storms.

Total costs

	2015 £m	2014 £m
Staff costs	254.2	247.6
Other operating expenses	219.0	244.9
Marketing	117.8	123.9
Amortisation and impairment of other intangible assets	67.4	66.4
Depreciation	30.7	22.6
Total operating expenses	689.1	705.4
Claims handling expenses	195.6	222.3
Total costs	884.7	927.7

The total costs for ongoing operations of £884.7 million were 4.6% lower than the previous year (2014: £927.7 million). The Group's expense ratio was stable at 23.6%, with the effect of the reduction in operating expenses offset by the impact of lower net earned premium. Reductions in underlying costs have been achieved in a number of areas including marketing, technology and property. The reduction in claims handling expenses was primarily as a result of improved efficiencies in a number of areas, including head office functions that support claims operations. Costs in the second half of 2015 were lower than the prior year, but higher than in the first half. This was mainly due to write offs on redundant software, property, plant and equipment.

Instalment and other operating income – ongoing operations

	2015 £m	2014 £m
Instalment income	100.1	100.4
Other operating income:		
Vehicle replacement referral income	12.5	15.8
Revenue from vehicle recovery and repair services[1]	15.5	18.0
Other income	22.7	13.1
Other operating income	50.7	46.9
Total ongoing	150.8	147.3

Instalment and other operating income from ongoing operations of £150.8 million increased 2.4% on the prior year (2014: £147.3 million). Other operating income increased, while instalment income was stable. The increase in other income was due primarily to the inclusion of a full year of legal services income in 2015.

Investment return – ongoing operations

	2015 £m	2014 £m
Investment income	165.6	171.7
Net realised and unrealised gains	29.1	38.9
Investment return – ongoing	194.7	210.6

The total investment return for ongoing operations decreased to £194.7 million compared to £210.6 million in 2014. This was driven by a decrease in net realised and unrealised gains and a small reduction in investment income. Investment income was £165.6 million, a 3.6% decrease from 2014, primarily as a result of lower average AUM (31 December 2015: £6,818.7 million; 31 December 2014: £7,051.3 million).

Net realised and unrealised gains for ongoing operations of £29.1 million were lower than the comparative period (2014: £38.9 million) due primarily to lower realised gains on disposals of fixed income debt securities and a small decrease in unrealised property gains, which were £24.2 million for the year (2014: £25.9 million).

Note:
1. Vehicle recovery includes post-accident and pay-on-use recovery. Repair services constitute the provision of non-insurance related repairs.

Investment yields – continuing operations

	2015	2014
Investment income yield[1]	2.4%	2.4%
Investment return[2]	2.9%	2.9%

The investment income yield for continuing operations in 2015 was 2.4%, in line with the yield achieved in 2014. Portfolio actions to diversify the portfolio in 2015 and prior years, including infrastructure debt, commercial property and high yield debt instruments, have helped offset yield pressure from the continuing low interest rate environment. The Group will continue to diversify its investment portfolio appropriately and based on current yield curves, which reflect delays in market expectations for a base rate rise, the Group currently forecasts an investment income yield of 2.5% for 2016 and 2.6% for 2017.

Operating profit – ongoing operations

	2015 £m	2014 £m
Motor	338.0	297.1
Home	109.9	113.9
Rescue and other personal lines	52.0	48.0
Commercial	20.8	47.0
Total ongoing	520.7	506.0

All divisions were profitable in 2015, with Motor and Rescue and other personal lines improving operating profit on 2014. Home operating profit was broadly stable, while Commercial reduced compared to the previous year, primarily due to the storms in December.

Reconciliation of operating profit

	2015 £m	2014 £m
Operating profit – ongoing operations	520.7	506.0
Run-off	73.1	55.3
Restructuring and other one-off costs	(48.7)	(69.6)
Operating profit	545.1	491.7
Finance costs	(37.6)	(37.2)
Gain on disposal of subsidiary	–	2.3
Profit before tax	507.5	456.8
Tax	(108.3)	(97.5)
Profit from discontinued operations, net of tax	181.2	13.3
Profit after tax	580.4	372.6

Run-off

The Run-off segment generated a profit of £73.1 million in 2015 compared with £55.3 million in 2014. Improved experience from large bodily injury claims led to higher prior-year reserve releases in comparison to the previous year. It is expected that the Run-off segment will continue to contribute positively to operating profit in future years, albeit at a lower level than in 2015.

Restructuring and other one-off costs

Restructuring and other one-off costs for 2015 of £48.7 million (2014: £69.6 million) primarily reflected the costs associated with the exit of one location announced at the beginning of the year and IT migration. Over the three-year period 2015 to 2017, the Group expects cumulative restructuring and other one-off costs to continue to be substantially offset by the operating profit from the Run-off segment.

Finance costs

Finance costs remained stable at £37.6 million (2014: £37.2 million).

Gain on disposal of subsidiaries

The gain on disposal of £2.3 million in 2014 relates to the sale of the Group's stolen vehicle recovery business, Tracker.

Taxation

The effective tax rate for continuing operations in 2015 was 21.3% (2014: 21.3%), which was higher than the standard UK corporation tax rate of 20.25% (2014: 21.5%), primarily due to disallowable expenses.

Discontinued operations

On 29 May 2015, the Group completed the sale of its International division, which comprised its Italian and German operations, to Mapfre, S.A. Accordingly, this division is treated as discontinued operations. The gain on disposal of £167.1 million is included in profit after tax from discontinued operations of £181.2 million. Operating profit includes £29.9 million of realised net gains on divisional available-for-sale ("**AFS**") investments reclassified through the income statement on disposal. Further details on discontinued operations are presented in note 5 to the consolidated financial statements, see page 136.

Profit for the year and return on tangible equity

Profit for the year amounted to £580.4 million (2014: £372.6 million), a significant increase on the previous year following the gain on the disposal of the Group's International division.

RoTE increased to 18.5% (2014: 16.8%) due to a lower equity base, from the sale of the Group's International division, and higher profit from ongoing operations.

Earnings per share

Basic earnings per share for continuing operations of 27.9 pence increased by 16.3% (2014: 24.0 pence). This reflected the reduction in restructuring and other one-off costs and the improved operating profits from the Run-off segment and ongoing operations.

Adjusted diluted earnings per share, from ongoing operations, increased by 4.3% to 26.6 pence (2014: 25.5 pence) reflecting the increase in operating profit.

Notes:

1. Investment income yield excludes net gains and is calculated on income divided by the average AUM based on the opening and closing balance for Group – continuing operations.
2. Investment return includes net gains and is calculated on income divided by the average AUM based on the opening and closing balance for Group – continuing operations.

Dividends

The Board is proposing a final dividend of 9.2 pence per share making the total regular dividends for 2015 13.8 pence per share. This represents 4.5% growth over the 2014 regular dividends and is in line with the Group's aim to grow the regular dividends annually in real terms, see page 96 for the Group's dividend policy.

In addition, the Board has resolved to pay a further special interim dividend of 8.8 pence per share. This takes the total special interim dividends for 2015 to 36.3 pence per share and includes the 27.5 pence per share dividend in relation to the sale of the International division.

Cash flow

Net cash generated from operating activities totalled £42.6 million (2014: £410.6 million used by operating activities). This reflected an increase in cash generated from operations to £149.8 million (2014: £315.2 million used by operations), primarily due to a decrease in insurance payables of current and prior-year claims.

The movement in net cash generated from investing activities in 2015 of £190.8 million from £216.0 million used in 2014 primarily represented the sale of discontinued operations.

Dividends paid amounted to £666.0 million (2014: £401.1 million) resulting in net cash used by financing activities of £722.0 million (2014: £443.4 million).

Overall, cash and cash equivalents increased by £14.0 million (2014: £51.1 million increase) across the year to £902.4 million (31 December 2014: £898.2 million).

Net asset value

At 31 December	2015 £m	2014 £m
Net assets	2,630.0	2,810.5
Goodwill and other intangible assets	(524.8)	(517.5)
Disposal group – intangible assets	–	(5.6)
Tangible net assets	2,105.2	2,287.4
Net asset value per share (pence)	192.2	188.2
Tangible net asset value per share (pence)	153.8	153.1

The net asset value at 31 December 2015 was £2,630.0 million (31 December 2014: £2,810.5 million) with a tangible net asset value of £2,105.2 million (31 December 2014: £2,287.4 million). The decrease since the beginning of the year reflected the payment of dividends and reduction of the AFS investments reserve, partially offset by profit in 2015.

Financial management

Accessing sufficient funding as liabilities fall due is central to the Group's long-term sustainability. The Group's integrity and brand reputation for customers and other stakeholders relies on this sustainability. The Group's key financial risks are reserving for insurance liabilities and market risk connected to the investment portfolio.

Reserving

Financial management includes the central aspect of estimating claims reserves. Uncertainty is an inherent part of insurance and requires judgement when assessing claims liabilities. The Group considers the class of business, the length of time to notification of a claim, the validity of the claim against a policy, and the claim value. Claims reserves could settle at a range of outcomes, and settlement certainty increases over time. However, for bodily injury claims, the uncertainty is greater due to the length of time taken to settle these claims. Annuity payments for injured parties also increase this uncertainty.

The Group seeks to adopt a conservative approach to assessing liabilities, as evidenced by the favourable development of historical claims reserves. Reserves are based on management's best estimate which incorporates a prudent margin in excess of the internal actuarial best estimate. This margin is made in reference to a range of actuarial scenario assessments and percentiles and also considers other short and long-term risks not reflected in the actuarial inputs. For more information, see pages 152 to 154.

The significant level of prior-year reserve releases in recent years (2015: £378.9 million; 2014: £397.6 million) has arisen primarily from reductions in the actuarial best estimate. Over these time periods, the percentage margin above actuarial best estimate has been broadly maintained or increased. Looking forward, the Group will continue to set its initial management best estimate for future accident years conservatively, and provided that the risk outlook remains stable, it does not expect to need to increase the overall margin further. Over time, the share of the Group's underwriting profit attributable to current year is expected to increase. Assuming current claims trends continue, the contribution from prior-year reserve releases is expected to remain significant, albeit lower than in 2015.

Claims reserves net of reinsurance

At 31 December	2015 £m	2014 £m
Motor	2,125.9	2,355.1
Home	387.7	335.2
Rescue and other personal lines	79.3	77.0
Commercial	627.3	607.5
Total ongoing	3,220.2	3,374.8
Run-off	382.4	523.8
Discontinued operations	–	393.6
Total Group	3,602.6	4,292.2

Reinsurance

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

- Catastrophe reinsurance to protect against an accumulation of claims arising from a natural peril event. The retained deductible is £150 million and cover is purchased up to a modelled one-in-200 years loss event of £1,350 million
- Motor reinsurance to protect against a single or an accumulation of large claims. The retained deductible has been reduced to an indexed level of £1 million per claim providing an enhanced and substantial level of protection against large motor bodily injury claims
- Commercial risk reinsurance to protect against large individual claims with a retained deductible of £4 million

Taxation

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

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

Investment portfolio

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

- To ensure there is sufficient liquidity available within the investment portfolio to meet stressed liquidity scenarios determined by the Risk function
- To duration match non-PPO liabilities
- To back inflation-linked PPO liabilities with growth assets and other appropriate long-term assets expected to generate long-term returns in line with the inflating cost of claims
- To deliver a suitable risk adjusted investment return commensurate with the Group's risk appetite

Asset and liability management

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

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

Asset allocation and benchmarks

The current strategic asset benchmarks for the Group are detailed in the following table:

At 31 December	Current benchmark holding	2015
Investment-grade credit	54.0%	59.5%
High yield	6.0%	4.8%
Investment-grade private placements	4.0%	0.2%
Credit	64.0%	64.5%
Securitised credit	5.0%	5.2%
Sovereign	9.0%	6.5%
Total debt securities	78.0%	76.2%
Infrastructure debt	6.0%	4.8%
Commercial real estate loans	3.0%	–
Cash and cash equivalents	7.0%	13.9%
Investment property	6.0%	5.1%
Total	100.0%	100.0%

At 31 December 2015, total investment holdings of £6,818.7 million were 3.3% lower, reflecting operating cash flows and dividends paid. Total debt securities were £5,194.4 million (31 December 2014: £5,802.5 million), of which 14.6% were rated as 'AAA' and a further 59.4% were rated as 'AA' or 'A'. Corporate, supranational and local government debt securities account for 64.5% of the portfolio. The average duration at 31 December 2015 of total debt securities was 2.3 years (31 December 2014: 2.1 years).

At 31 December 2015, total unrealised gains, net of tax, on AFS investments were £5.4 million (31 December 2014: £94.4 million). Due to the reduction in unrealised gains, net realised gains from the fixed income debt securities portfolio for 2016 are expected to be lower than in 2015.

During 2015, the Group reviewed its investment strategy resulting in approval to implement mandates in commercial real estate loans, subordinated financial debt and global credit. The subordinated debt mandate replaces holdings of similar securities previously contained in the Group's general investment grade mandates. All new mandates will be investment grade. In addition, a further 2% allocation to the existing high-yield mandate was approved, increasing this to a maximum of 6%. The mandates are funded primarily from reductions in government debt securities and existing holdings in investment grade securities. In 2015, the primary addition to the investment portfolio was the £253.4 million further investment in infrastructure debt. Given market pricing, additional investment in commercial property during 2015 was limited to one property acquisition.

Investment risk is, in part, mitigated by the following characteristics within the investment portfolio:

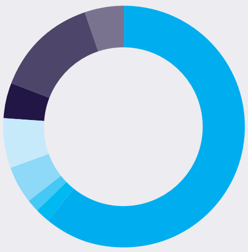
- All holdings within the short duration US Dollar high-yield portfolio have a credit rating of BB or B. The Group's strategy does not permit any debt securities to be held below B-. At year end, actual exposure to the energy and midstream sector was 8.4% of the high-yield portfolio
- The infrastructure debt portfolio is made up of UK assets only, which are purchased via the secondary market post the construction phase of the project concerned.

The portfolio is weighted heavily towards social infrastructure with 88% of the year-end portfolio invested in projects across this sector (38% in healthcare, 45% in education and 5% in other). At year end, 88% of investments were underpinned by availability based payment schedules

- The investment property portfolio consists presently of 26 UK based properties. The Group's strategy does not permit any overseas holdings. The portfolio is predominantly based in the South East and invested mainly in the prime (rather than secondary) sector of the market. The mandate targets a real return objective resulting in 41% of current leases producing inflation-linked rental income
- The securitised credit portfolio was restructured in 2015 in line with Solvency II risk retention requirements. At year end, 88% was invested in AAA tranches, 7% in AA tranches and 5% held in cash. The primary sectors the portfolio was invested in were mortgage backed securities (46%), collateralised loan obligations, where the underlying borrowers are rated sub-investment grade (30%), and asset backed securities secured on Federal Family Education Loan Program student loans (14%)

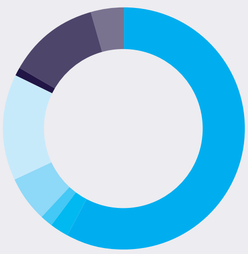
Derivatives are permitted only for risk mitigation and efficient portfolio management within the investment portfolio. Derivatives used include interest rate swaps, for example to hedge exposure to US Dollar interest rate movements, and forward currency contracts to hedge assets denominated in US Dollars back to Sterling. Separately, interest rate swaps have also been used to change the interest rate liability on the Group's debt issuance to a floating-rate basis.

Investment portfolio at 31 December 2015
(%)



- Corporate debt securities 60.9
- Supranational 2.1
- Local government 1.5
- Securitised credit 5.2
- Sovereign 6.5
- Infrastructure debt 4.8
- Cash and cash equivalents 13.9
- Investment property 5.1

Investment portfolio at 31 December 2014
(%)



- Corporate debt securities 58.0
- Supranational 2.5
- Local government 1.7
- Securitised credit 6.0
- Sovereign 14.1
- Infrastructure debt 1.1
- Cash and cash equivalents 12.3
- Investment property 4.3

Investment holdings and yields – total Group

	2015		2014	
£m	Allocation	Income[1]	Allocation[1]	Income[1]
Corporate[2]	4,155.9	117.1	4,092.7	118.2
Supranational[2]	140.1	2.6	176.2	4.9
Local government[2]	104.9	1.7	120.3	2.4
Credit	4,400.9	121.4	4,389.2	125.5
Securitised credit[2]	350.8	6.0	419.6	6.1
Sovereign[2]	442.7	12.7	993.7	22.4
Total debt securities	5,194.4	140.1	5,802.5	154.0
Infrastructure	329.6	4.4	76.2	0.1
Cash[3]	947.3	6.8	865.4	5.2
Investment property	347.4	17.8	307.2	16.2
Total Group	6,818.7	169.1	7,051.3	175.5

	Weighting	Yield	Weighting	Yield
Corporate	60.9%	2.8%	58.0%	2.8%
Supranational	2.1%	1.7%	2.5%	1.9%
Local government	1.5%	1.5%	1.7%	1.9%
Credit	64.5%	2.8%	62.2%	2.8%
Securitised credit	5.2%	1.6%	6.0%	2.0%
Sovereign	6.5%	1.8%	14.1%	1.9%
Total debt securities	76.2%	2.6%	82.3%	2.6%
Infrastructure	4.8%	2.2%	1.1%	0.3%
Cash	13.9%	0.8%	12.3%	0.5%
Investment property	5.1%	5.4%	4.3%	6.1%
Total Group	100.0%	2.4%	100.0%	2.4%

Capital management

Capital management policy

The Group seeks to manage its capital efficiently, maintaining an appropriate level of capitalisation and solvency, while aiming to grow its dividend annually in real terms.

In determining the appropriate level of capitalisation and solvency, the Group considers capital across a number of metrics. These include economic capital, regulatory capital and rating agency capital. The Group targets holding capital sufficient to maintain a credit rating in the 'A' range.

Where the Board believes the Group has capital that is surplus to requirements, it looks to return it to shareholders.

Solvency II

Solvency II is the new solvency framework of the capital adequacy regime for the European insurance industry. It establishes a revised set of EU-wide capital requirements and risk management standards with the aim of increasing protection for policyholders. Solvency II was implemented on

Notes:

1. Continuing operations
2. Asset allocation at 31 December 2015 includes investment portfolio derivatives, which have been netted and have a mark-to-market liability value of £45.7 million of which £40.0 million is in corporate debt securities, £0.4 million in local government and £5.3 million in securitised credit (31 December 2014: mark-to-market liability value of £27.8 million of which £24.4 million is in corporate debt securities, £0.1 million in supranationals, £0.4 million in local government, £2.8 million in securitised credit and £0.1 million in sovereign). This excludes non-investment derivatives that have been used to hedge subordinated debt, operational cash flows and the disposal of the International division.
3. Net of bank overdrafts and including term deposits with financial institutions with maturities exceeding three months.

1 January 2016 and the Group is presenting pro forma information at 31 December 2015 for the first time on that basis.

The Group is regulated by the PRA on both a Group basis and, for the Group's principal underwriter, UKI, on a solo basis.

Initially, the Group (including UKI) will assess its capital requirements using the standard formula. UKI has applied for its internal economic capital model to be approved as its internal model and approval is expected from the PRA in mid-2016. From this point, UKI will calculate its capital requirement using the internal model which will form part of a Group-wide partial internal model.

Capital position

At 31 December 2015, the Group held a capital surplus of £794.6 million above its pro forma[1] regulatory capital requirements on a Solvency II standard formula basis. This was equivalent to a pro forma capital coverage ratio of 147.4%. Comparative figures are on a risk-based capital basis.

At 31 December	Solvency II[2] 2015	Risk-based capital 2014
Pro forma[1] solvency capital requirement (£ million)	1,676.2	n/a
Capital surplus above pro forma solvency capital requirement (£ million)	794.6	n/a
Pro forma capital coverage ratio	147.4%	n/a
Risk-based capital coverage ratio (adjusted for dividends[3])	n/a	148.2%

Tier 1 capital after foreseeable dividends represents 72.8% of own funds and 107.2% of pro forma solvency capital requirement ("**SCR**"). Tier 2 capital relates solely to the Group's £500 million subordinated debt issue in 2012.

Notes:

1. Calculated on a pro forma basis, assuming expected changes to hedging arrangements were in effect at 31 December 2015
2. Figures are estimated and based on preliminary regulatory returns for 31 December 2015.
3. Adjusted for final and second special interim dividends
4. Total financial debt as a percentage of capital employed

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

At 31 December	2015[2] £m
Tier 1 capital before foreseeable dividends	2,045.2
Foreseeable dividends	(247.5)
Tier 1 capital	1,797.7
Tier 2 capital	614.9
Tier 3 capital	58.2
Own funds	2,470.8

Reconciliation of IFRS shareholders' equity to Solvency II own funds

At 31 December	2015[2] £m
Shareholders' equity	2,630.0
Goodwill and intangible assets	(524.8)
Change in valuation of technical provisions	202.9
Other asset and liability adjustments	(262.9)
Foreseeable dividends	(247.5)
Tier 1 capital	1,797.7
Tier 2 capital: subordinated debt	614.9
Tier 3 capital: deferred tax asset	58.2
Own funds	2,470.8

Leverage

The Group's financial leverage continues to be conservative. During 2015, the leverage increased from 15.8% to 16.5% due mainly to the sale of the Group's International operations and subsequent special dividend which reduced shareholders' equity.

At 31 December	2015 £m	2014 £m
Shareholders' equity	2,630.0	2,810.5
Financial debt – subordinated guaranteed dated notes	521.1	526.3
Total capital employed	3,151.1	3,336.8
Financial-leverage ratio[4]	16.5%	15.8%

Credit ratings

Standard & Poor's and Moody's Investors Service provide insurance financial-strength ratings for UKI. UKI is currently rated 'A' (strong) with a stable outlook by Standard & Poor's and 'A2' (good) with a stable outlook by Moody's.

Statement of the Directors in respect of the Strategic report

The Board reviewed and approved our Strategic report on pages 1 to 45 on 29 February 2016.

By order of the Board

Paul Geddes
Chief Executive Officer
29 February 2016

John Reizenstein
Chief Financial Officer
29 February 2016

Corporate governance

Mike Biggs
Chairman

Dear shareholders and other stakeholders

Our commitment to good corporate governance

An important part of the Board's role and mine as Chairman is to oversee the good governance of the Group. It is now more than three years since the Group was floated through an IPO. In that time, we have continued developing and refining our governance processes and procedures so that they remain fit for a FTSE 100 company.

Board and Committee structure and membership

The Board has established Committees to focus on specific governance areas and to help it to meet its obligations and discharge its duties. The following Committees have been established with effect from the IPO: Audit, Board Risk, Remuneration, CSR, Nomination and Investment. You can find a report from each Committee in the Governance section of this Annual Report & Accounts. Other than the CSR Committee, all Committees only have Non-Executive Directors as members.

Following Glyn Jones' resignation after the 2015 AGM, we changed the Committees' membership. Clare Thompson became the Chair of the Investment Committee and Priscilla Vacassin was appointed a member of the Nomination Committee.

I am pleased to report that Dr Richard Ward was appointed a Non-Executive Director ("**NED**") and the Senior Independent Director ("**SID**") on 18 January 2016. He brings a deep knowledge of the insurance industry to the Group. I would also like to thank Andrew Palmer for agreeing to act as SID while we were in the process of completing Richard's appointment.

As we announced on 16 February, Priscilla Vacassin has decided to step down from the Board with effect from 1 March 2016. Clare Thompson has agreed to act as interim Chair of the Remuneration Committee from 1 March. At the same time she will step down as Chair and member of the CSR Committee and the Investment Committee and as a member of the Board Risk Committee. Andrew Palmer will be appointed as Chair of the Investment Committee and Sebastian James as Chair of the CSR Committee with effect from the same date.

Key matters

I highlight the following key governance and shareholder matters from the Corporate Governance report, which the Board considered during the year.

Change and IT migration

The Board oversaw the Group's major change programmes and associated risks and challenges relating to the migration of IT infrastructure from RBS Group and development of the next generation of customer systems, including focusing on risks relating to IT systems' stability, cyber security and the internal control environment.

Solvency II

Preparation for the transition to the Solvency II regulatory regime was a priority for the Board, the Board Risk Committee and the Audit Committee during the year. Additionally, the Remuneration Committee considered how Solvency II might affect senior managers' remuneration.

Sale of the International division

The sale of the International division completed at the end of May. The Board resolved to return substantially all of the net proceeds to shareholders through a special dividend, which was paid on 24 July 2015.

Succession planning

The Nomination Committee focused on succession planning for the Board and Executives, and on recruiting Richard Ward as the SID.

Our Code of Business Conduct

Business practices

We shall engage in honest, professional and ethical conduct and maintain effective procedures to prevent confidential information being misused.

Dealing with customers

We shall treat customers fairly, openly and honestly, and operate an effective complaints process to address any perceived departure from these standards.

Dealing with shareholders and other stakeholders

We shall seek to maximise shareholder value over time, recognising that wealth generated also benefits customers, employees and the communities where we operate.

Dealing with employees

We shall maintain a working environment that attracts, motivates and retains employees, and shall be intolerant of any type of discrimination, harassment or victimisation.

Final dividend 2014

As explained in last year's Annual Report & Accounts, due to the uncertainty around the timing of the completion of the sale of the International division, the Board decided to pay an additional interim dividend for 2014 on 17 April 2015 in place of a final dividend. We will ask shareholders to approve a final dividend for 2015 at the Annual General Meeting in May 2016.

Share consolidation

The Board proposed a share consolidation based on a consolidation ratio of 11 new shares for 12 existing shares due to the size of the special dividend relating to the sale of the International division, and to maintain comparability of share price and earnings per share before and after payment of the special dividend. Shareholders approved this on 29 June 2015.

Vesting of LTIPs

The Remuneration Committee considered and approved the first vesting of the Direct Line Group LTIP on 9 November 2015, at 89.2% of the potential maximum award, which reflected good progress against the objectives set at the time of the IPO.

UK Corporate Governance Code

We, the Board of Direct Line Group, are committed to the principles of the UK Governance Code issued by the Financial Reporting Council. I am pleased to report that we have complied with substantially all of the provisions of the UK Corporate Governance Code (September 2014). You can find further details in the Corporate Governance report.

The way we do business

The way we do business and our underlying values are central to the Group's success. Our Code of Business Conduct governs the way we treat our stakeholders, and our values determine our behaviours. Both determine how we do business throughout the Group and define our corporate identity. They also influence our business relationships and reputation, which are key to our long-term success.

Yours sincerely

Michael N Biggs
Chairman

Our values

Do the right thing

For our people, our customers, our shareholders and our wider stakeholders; make decisions based on what is right, not what is easy; demonstrate personal and professional integrity; do what's right for the long-term sustainability of our business.

Aim higher

Strive to be the best in every area of the business; be ambitious, courageous and innovative; relentlessly challenge and improve; seek and embrace change; learn from our mistakes; persevere, always deliver our promises and don't settle for second best.

Work together

Collaborate across all levels and across all functions; leverage the skills, knowledge and experience, irrespective of hierarchy, to deliver the best possible results; develop relationships based upon trusting each other, partnerships and win-wins; recognise and celebrate success.

Take ownership

Treat it like it's OUR business; take the initiative, if you can see a better way, go and make a difference; take decisions, be accountable for your actions in whatever role you carry out; take responsibility for your own personal development and performance.

Say it like it is

Be real, authentic and true to self; have adult to adult conversations with all audiences; listen, seek to understand and respect diversity of views; be open, call out issues we see; share information and keep things as simple as possible.

Bring all of yourself to work

Be the best you can be, the real and whole you; celebrate our diversity of skills, experiences and personalities; be a role model to others, demonstrate 'can do' spirit, have fun and make this a great place to be; be excited about our Company and our future; believe in yourself, feel confident and empowered.

Dealing with suppliers of goods and services and business partnerships

We shall maintain the highest possible standards of integrity in business relationships with suppliers and partners by treating them honestly and with respect, and avoiding compromising offers of gifts and hospitality.

Dealing with communities and the environment

We shall contribute to the social and economic well-being of those communities where we are an employer, and encourage employees to participate in projects and initiatives to strengthen those communities.

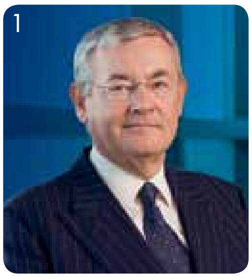
Dealing with competitors

We shall compete with competitors honestly and in accordance with the relevant competition law.

Dealing with regulators

We shall maintain a constructive and open relationship with our regulators to foster mutual trust, respect and understanding, and will not offer anything to officials in return for favourable treatment.

Board of Directors



1 Mike Biggs (63), Chairman of the Board
(appointed April 2012) (N and R)

Biography
Mike is also Chair of the Nomination Committee. He has over 40 years' experience of the UK and international financial services sector. He is a respected figure in the insurance industry and well regarded by City investors.

Mike was previously Chairman of Resolution Limited, then a FTSE 100 UK life assurance business, and has acted as Chief Executive Officer and Group Finance Director of Resolution plc. He was previously Group Finance Director of Aviva plc.

He has a Masters degree in History from the University of Oxford, and is an Associate of the Institute of Chartered Accountants of England and Wales.

External appointments
None

2 Paul Geddes (46), Chief Executive Officer
(appointed August 2009) (C)

Biography
Paul is Chief Executive Officer. He led one of the UK's largest retail banking businesses during a challenging period, improving its customer and financial performance against peers. In 2009, this experience singled him out as a Chief Executive who could turn around Direct Line Group and lead its divestment from RBS Group.

After joining RBS Group in 2004 as Managing Director responsible for products and marketing, he became the Chief Executive Officer of RBS Group's mainland UK retail banking business. Before joining RBS Group, Paul held various senior multi-channel retailing roles in the GUS and Kingfisher groups. Paul started his career in marketing, with UK and European roles at Procter & Gamble. He read Philosophy, Politics and Economics at the University of Oxford, and is a Fellow of the Chartered Institute of Bankers in Scotland.

External appointments
Paul is the Senior Independent Director of the Association of British Insurers Board.

3 John Reizenstein (59), Chief Financial Officer
(appointed December 2010)

Biography
John is an experienced Chief Financial Officer and former banker. He has extensive City and financial services experience.

John was previously an Executive Director at the Co-operative Insurance Society, CIS General Insurance and The Co-operative Bank. He was Chief Financial Officer of these organisations between 2003 and 2007, and subsequently Managing Director, Corporate and Markets. Before this, John spent more than 20 years in investment banking with UBS and Goldman Sachs. He is an Economics graduate of the University of Cambridge.

External appointments
John is a trustee and Director of Farm Africa. He is also an alternate representative of the Association of British Insurers on the Panel on Takeovers and Mergers.

4 Jane Hanson (48), Non-Executive Director
(appointed December 2011) (A, B, C, I and +)

Biography
Jane is Chair of the Board Risk Committee. She has extensive experience of risk management, corporate governance and internal control. She also has wide experience in developing and monitoring customer and conduct risk frameworks.

She spent her early years with KPMG, working in the financial sector, later becoming responsible for delivering corporate governance, internal audit and risk-management services in the north of England. Jane has also held a number of executive roles, including Director of Audit, and Risk and Governance Director at Aviva's UK Life business.

She is a graduate of the University of York with a degree in Music, and a Fellow of the Institute of Chartered Accountants in England and Wales.

External appointments
Jane is Chair of Reclaim Fund Ltd and a Non-Executive Director and Chair of the Board Risk Committee of Old Mutual Wealth Management Limited. She is also an Independent Member of the Fairness Committee at ReAssure Ltd.

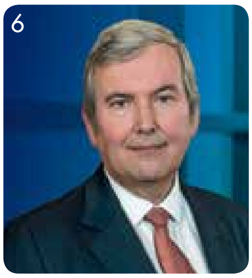
She has her own financial sector consulting business, which provides audit, enterprise risk management and corporate governance advisory and consulting services. Jane is also a magistrate.

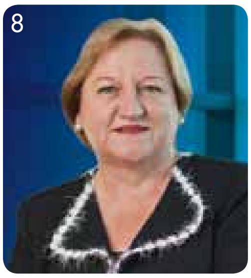
5 Sebastian James (49), Non-Executive Director
(appointed August 2014) (C, R and +)

Biography
Sebastian has been Group Chief Executive of Dixons Carphone plc since 2014. He joined Dixons in April 2008 and held various roles, including Group Operations Director, before becoming Group Chief Executive in February 2012.

Before joining Dixons Retail, Sebastian was Chief Executive Officer of Synergy Insurance Services Limited and subsequently gained wide retail experience as Strategy Director responsible for developing and implementing the turnaround strategy at Mothercare. After completing an MBA at INSEAD and an MA at the University of Oxford, he started his career at The Boston Consulting Group.

External appointments
Sebastian is Group Chief Executive of Dixons Carphone plc and is also a trustee of the charities Save the Children and Dixons Carphone Foundation.





6 Andrew Palmer (62), Non-Executive Director (appointed March 2011) (A, B, I, N, R and +)

Biography

Andrew is Chair of the Audit Committee. He was Senior Independent Director from the AGM in 2015 until the Group appointed Dr Richard Ward on 18 January 2016. He has performed various senior roles in the financial services and insurance industries. Additionally, he has insight into corporate governance developments and best practice in financial reporting. This comes largely through his membership of the Financial Reporting Review Panel of the Financial Reporting Council.

In 2009, Andrew retired from Legal & General Group plc, where he was the Group Finance Director. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

External appointments

Andrew is a Trustee of the Royal School of Needlework, a Trustee and Treasurer of Cancer Research UK, and a Non-Executive Director of Royal London Mutual Insurance Society Limited. He is also a member of the Financial Reporting Review Panel of the Financial Reporting Council.

7 Clare Thompson (61), Non-Executive Director (appointed September 2012) (A, B, C, I and +)

Biography

Clare is Chair of the Corporate Social Responsibility Committee and the Investment Committee. She has extensive experience and knowledge gained from roles across the professional services industry. These include Lead Audit Partner at PwC, where she guided companies through change and advised insurance organisations. In her later role, she gained significant experience of general and life insurance.

Clare was a partner at PwC from 1988 to 2011. During her 23 years as a partner, she held several senior and high-profile roles, particularly in the insurance sector. She is a graduate of the University of York with a degree in Mathematics, and a Fellow of the Institute of Chartered Accountants in England and Wales.

External appointments

Clare is a Non-Executive Director of British United Provident Association (Bupa) and Retail Charity Bonds plc. She is also a Non-Executive member of the partnership board of Miller Insurance Services LLP, and Treasurer of the Disasters Emergency Committee.

8 Priscilla Vacassin (58), Non-Executive Director (appointed September 2012) (B, N, R and +)

Biography

Priscilla is Chair of the Remuneration Committee. She has extensive experience developing organisational values, and creating the leadership, succession, development and remuneration structures required to support corporate strategy. As she has worked as a practitioner and an adviser, Priscilla understands the technical and market complexity of remuneration.

Priscilla was most recently Group Human Resources Director at Prudential plc, and a Non-Executive Director at the Ministry of Defence. Priscilla has previously held senior human resources positions in various financial services and customer-facing industries. These include roles at Abbey National plc, where she was Executive Director, Human Resources; BAA plc, where she was Group Human Resources Director; and Kingfisher plc. She graduated in Law from the University of North East London.

External appointments

Priscilla has her own search and consultancy business.

9 Dr Richard Ward (59), Non-Executive Director and Senior Independent Director (appointed January 2016) (N and +)

Biography

Dr Richard Ward joined Cunningham Lindsey as Executive Chairman in June 2014. Cunningham Lindsey is the leading global provider of claims management and risk service solutions.

Prior to this, Richard was Chief Executive of Lloyd's of London, from 2006 to 2013.

Richard previously worked for over ten years at the London-based International Petroleum Exchange ("**IPE**"), the second largest energy trading exchange, re-branded ICE Futures, as both Chief Executive Officer and Vice-Chairman. Prior to the IPE, Richard held a range of senior positions at British Petroleum and was Head of Marketing & Business Development for energy derivatives worldwide at Tradition Financial Services.

Richard has a 1st Class Honours degree in Chemistry, and a PhD in Physical Chemistry from Exeter University.

External appointments

Richard is Executive Chairman of Cunningham Lindsey and Non-Executive Chairman of Brit plc. He also serves as a Non-Executive Director of Partnership Assurance Group plc and is a member of the PRA Practitioner Panel, Bank of England.

Key:

(A) Audit Committee

(B) Board Risk Committee

(C) Corporate Social Responsibility Committee

(I) Investment Committee

(N) Nomination Committee

(R) Remuneration Committee

(+) Independent

Executive Committee

Paul Geddes chairs the Executive Committee. In addition to Paul Geddes and John Reizenstein, the committee comprises the following:

1 Jonathan Greenwood, Managing Director of Commercial (joined 2000)

Experience and qualifications
Jonathan joined the Group in 2000 as Product and Pricing Director for UK partnerships. After the Group acquired Churchill, Jonathan became Commercial Director and then Managing Director of the Group's household and life businesses. Jonathan was appointed Managing Director of Commercial in 2009.

2 Mike Holliday-Williams, Managing Director of Personal Lines (joined 2014)

Experience and qualifications
Mike was previously Chief Executive Officer of RSA Group's Scandinavian businesses, Codan A/S and Trygg-Hansa. Before joining RSA, Mike worked in the energy, telecoms and retail sectors. He started his career at WHSmith plc, before moving to various Centrica-owned businesses, including British Gas and Onetel. He has also served as Managing Director of MORETH>N and holds an EMBA from Ashridge Business School.

3 Simon Linares, Group Human Resources Director (joined 2014)

Experience and qualifications
Simon joined the Group in September 2014. He was previously Group HR Director for O2, and responsible for all of Telefonica global digital businesses. Before this, he held various senior global HR roles at Diageo, including responsibility for Spain, Africa and several UK-based leadership positions. Before moving into HR, Simon held several commercial business roles in the fast-moving consumer goods and financial services sectors.

4 Steve Maddock, Managing Director of Claims, Business Services and Technology Services (joined 2010)

Experience and qualifications
In addition to leading our Claims and Business Services divisions, Steve is currently leading the management of our IT estate, while Angela Morrison dedicates herself to our next generation of customer systems programme. From 2004, Steve was Director of Strategic and Technical Claims at RSA. He has over 20 years' insurance industry experience, including roles as Director of Claims and Customer Service at Capita, and as Director of Operations at AMP. Steve holds an MBA from the University of Reading, and is Chairman of the Motor Insurers' Bureau and Insurance Database Services Limited.

5 Angela Morrison, Chief Information Officer (joined 2010)

Experience and qualifications
Since completing the migration of systems from RBS Group, Angela has been focusing on our next generation of customer systems. She was previously Chief Information Officer at J Sainsbury and a member of its Operating Board. She previously worked for ASDA/Wal-Mart. Her roles included European Strategy Director; Chief Information Officer through the ASDA/Wal-Mart integration; and e-Commerce Director, which involved establishing ASDA's home grocery business. Angela holds a degree in Electrical and Electronic Engineering from the University of Bristol.

6 Humphrey Tomlinson, General Counsel (joined 2011)

Experience and qualifications
Humphrey was previously Group Legal Director at RSA and is a solicitor with over 25 years' experience. His experience includes advising on corporate and commercial matters, steering corporate transactions in the UK and internationally, managing legal risk, and dealing with corporate governance issues. Before joining RSA, he worked at the City law firm, Ashurst Morris Crisp. He is a graduate of the University of Oxford.

7 José Vazquez, Chief Risk Officer (joined 2012)

Experience and qualifications
José was previously Global Chief Risk Officer at HSBC Insurance. Before joining HSBC, José held senior actuarial roles at Zurich Insurance and was a consultant with KPMG in London. José is a Mathematics graduate from Brunel University and a Fellow of the Institute of Actuaries.

This report explains the Board's role and activities, and how corporate governance operates throughout the Group.

The UK Corporate Governance Code

Direct Line Insurance Group plc (the "**Company**") has complied with the UK Corporate Governance Code 2014's principles and provisions (the "**Code**") throughout the financial year. The exception is the recommendation contained in Provision E.1.1 of the Code that the Senior Independent Director should attend sufficient meetings with major shareholders to listen to their views. During 2015, the Board received regular updates from the Company's corporate brokers on the views of its institutional shareholders and, in addition, the Group's Investor Relations team provided regular updates to the Board. It is open to major shareholders to raise any issues they wish with the Chairman, the SID and the Chair of the Remuneration Committee. On this basis the Board is satisfied that it understands the views of major shareholders and it was not necessary for the SID to meet them. The Board has therefore concluded that it has complied with the main and supporting principles under section E.1 of the Code regarding dialogue with shareholders.

You can find details of how the Company applied the Code's principles and complied with its provisions in this report and the Directors' remuneration report. For more information about the Code, visit the Financial Reporting Council's website at www.frc.org.uk .

Leadership

The Board

The Board's main role is to organise and direct the Group's affairs in a way that is most likely to help it succeed in the long term for the benefit of shareholders as a whole. The Board supervises the Group's operations, ensuring it is effectively managed, that prudent controls are in place, and that risks are assessed and managed appropriately. The Board sets the Group's strategy, and monitors management's performance and progress against the strategic aims and objectives.

The Board's specific duties are set out in the Schedule of Matters Reserved for the Board, which contains items reserved for the Board to consider and approve, including:

- The Group's strategic aims and objectives
- The annual operating and capital expenditure budgets
- Corporate governance matters
- Capital structure, financial reporting and controls, including dividend policy
- The internal controls and risk-management system, including the Group's risk appetite statements
- Major capital projects, major investments and contracts that are either materially strategic or above the Chief Executive Officer's delegated authority
- Board and Committee membership and succession planning
- The remuneration policy for Directors and senior executives

In addition to the schedule of Matters Reserved, each Board Committee has written terms of reference defining its role and the standing authority delegated to it. You can find out more about the Board Committees in the Board Committees' section from pages 58 to 69.

Board composition

As at the date of this report, the Board comprises the Chairman, who was independent when appointed to the Board; the Chief Executive Officer; the Chief Financial Officer; and six independent NEDs. Every current Director served throughout the reporting period, except for Richard Ward, who was appointed to the Board on 18 January 2016.

You can find the names of the Directors as at the date of this report, and their biographical information, on pages 48 and 49.

Glyn Jones, who was a NED and the SID, retired from the Board at the end of the Annual General Meeting on13 May 2015. Following Mr Jones' stepping down, Andrew Palmer was appointed SID while the search for a new NED was undertaken. Richard Ward was appointed SID on his appointment to the Board.

Structure of the Board

The Board and its Committees have been established to ensure that an appropriate balance of skills, experience, independence, sector knowledge and diversity exists to enable the Directors to discharge their duties and responsibilities effectively.

All NEDs must be able to spend enough time in their roles to discharge their duties and responsibilities effectively. The letters of appointment for the Chairman and every NED set out the time the Group anticipates that they will commit to their roles. This is at least three days a week for the Chairman and an average of three days a month for the NEDs. The Nomination Committee reviews this time commitment annually.

On behalf of the Board, the Nomination Committee assessed the NEDs' independence, skills, knowledge and experience as part of its annual review of each Director's performance. The Board concluded that every current NED was independent, continued to contribute effectively, and showed they were committed to the role. The Nomination Committee's work during the year led to the appointment of Richard Ward as an additional NED. It also resulted in changes to the membership of the Committees. The Group announced these changes in May 2015 and February 2016. You can find out more about these activities and the Nomination Committee's work during the year on pages 66 to 67.

Chairman and Chief Executive Officer
The Board has agreed role profiles for the Chairman, Mike Biggs, and the Chief Executive Officer, Paul Geddes. These clearly define their roles and responsibilities. This is to ensure no one person has unlimited powers of decision making.

The Chairman's priority is leading the Board and ensuring its effectiveness. The Chief Executive Officer's priorities are managing the Group, and delivering the Group's strategy and financial results.

Senior Independent Director
Richard Ward is the SID. The role of the SID is: to be a sounding board for the Chairman; to act as an intermediary for the other Directors when necessary; and to be available to shareholders if they have any concerns they cannot resolve through normal channels. His responsibilities also include evaluating the Chairman's performance annually.

NEDs
The NEDs objectively and constructively challenge management. They also use their wider business experience to help develop the Group's strategy.

NEDs are initially appointed for a term of three years. They will normally serve two fixed terms of three years. When appropriate, they may be invited to serve up to a further three years. The Nomination Committee nominates the Directors for appointment. The Board then approves the appointments. NEDs are subject to election or re-election annually at the Company's AGM. You can find the standard terms and conditions of the NED appointments at www.directlinegroup.com .

Information and support
All Directors can access assistance and advice from the Company Secretary. The Board is satisfied that it receives information of appropriate quality and in a timely manner, to enable the Directors to discharge their duties. Directors may seek external independent professional advice at the Company's expense, if they need it to discharge their duties.

Conflicts of interest
The Company's Articles of Association allow the Board to authorise matters where there is, or may be, a conflict between the Group's interests and the direct or indirect interests of a Director, or between the Director's duties to the Group and another person. This is in accordance with the Companies Act 2006.

Each Director has a duty to avoid conflicts of interest. They must declare any conflict of interest that could interfere with their ability to act in the Group's best interests.

The Board has authorised various conflicts in this way. However, the Board still ensures that it will appropriately deal with any actual conflict of interest or duty that might arise. This usually involves making sure a Director does not participate in a relevant Board or Committee discussion or decision.

To do this, the Company Secretary maintains a register of conflicts, and any conflicts that the Board has authorised. The Board reviews this register regularly.

Board activities during 2015
At each scheduled meeting, the Board receives updates from the Chief Executive Officer, Chief Financial Officer and the Chief Risk Officer. The officers update the Board on the operational performance against the agreed plan, financial performance and risk management. The Board also has an annual planner of agenda items. This ensures the Board considers matters in a timely manner during the financial year.

During 2015, the Board's areas of focus, challenge and supervision included:

- Developing and challenging the Group's strategic plan
- Overseeing the prudent management of the Group's capital, ensuring that capital reserves remain robust, while enabling the return of surplus capital to investors through special dividends
- Overseeing the change programmes and associated risks relating to the IT migration from RBS Group. Furthermore, the Board monitored risks relating to IT systems' stability, cyber security and the internal control environment
- Approving and monitoring a comprehensive programme of investment in technology, organisational restructuring and cultural change. This programme aims to improve customer experience, making it easier to do business with the Group, and helping the Group provide outstanding customer service
- Overseeing the management and reduction of the Group's cost base
- Overseeing a review of the Group's governance framework, including reviewing and approving risk-based policies
- Encouraging management initiatives for cultural transformation
- Overseeing the Group's regulatory relationships and preparations for implementing Solvency II
- Overseeing the sale of the International division, the effect on shareholders and the distribution of the proceeds to shareholders, and the share consolidation

Meetings
The Board held nine scheduled meetings in 2015 and five additional meetings. The additional meetings were ad hoc or Board sub-committee meetings, for example, to consider specific matters in relation to the share consolidation. The Board also held its annual strategy day in June 2015.

The Company Secretary attended all Board meetings. At its discretion, the Board invited senior executives and external advisers to attend Board meetings, and present on business developments and governance issues.

This table sets out attendance at the scheduled meetings in 2015:

	Scheduled meetings[1]	Percentage attendance
Chairman		
Mike Biggs	9 of 9	100%
Senior Independent Director		
Andrew Palmer	9 of 9	100%
Glyn Jones	4 of 4	100%
NEDs		
Jane Hanson	9 of 9	100%
Sebastian James	9 of 9	100%
Clare Thompson	9 of 9	100%
Priscilla Vacassin	9 of 9	100%
Executive Directors		
Paul Geddes	9 of 9	100%
John Reizenstein	9 of 9	100%

Board induction, resources and training

The Board is committed to training and developing all Directors and employees. The Company Secretary is responsible for helping the Chairman regularly review and organise appropriate training for the Directors. The Company Secretary also maintains an annual training agenda for the Board and its Committees.

A tailored induction programme, comprising 16 sessions, was prepared for Richard Ward. The programme will focus on the Group's businesses, strategic and transformational priorities, regulatory and governance frameworks, capital and financial management, and risk framework.

The main Board training and development activities in the year under review included:

- Training on topics including customer behaviour, the Group's investment portfolio, and cyber risk
- NED visits to operational business units to meet the management teams and better understand how the business operates. These included visits to the Human Resources, Risk, Legal, Audit and Actuarial teams in Bromley
- Internal training workshops on Solvency II
- The Company Secretary updating the Board regularly on corporate governance
- The Group's brokers and financial advisers presenting quarterly industry and market updates to the Board
- The Investor Relations team reporting regularly to the Board on the Group's relationship with institutional investors and analysts

Note:

1. Attendance is expressed as the number of scheduled meetings attended out of the number of such meetings possible or applicable for the Director to attend.

Direct Line Group's approach to diversity

The Board carefully considered the diversity of its members from various perspectives. It also sought to ensure that Directors had the relevant knowledge, skills, experience and, where necessary, independence to help the Group deliver its strategy.

The Company believes in the benefits of diversity. At the date of this report, of the Board's nine members, three are women. However, while the Board will strive to consider diversity when choosing new members, it is committed to appointing the most appropriate candidates.

The Nomination Committee's terms of reference state that it should duly regard the benefits of diversity, including gender diversity, when choosing Board candidates. You can find more information about the Board's diversity policy in the Nomination Committee report on pages 66 and 67.

The CSR Committee considers diversity as part of its 'Proud to be here' work stream. This is to ensure the Group's talent pipeline remains diverse to meet future requirements. The Group provides mentoring schemes and associated training and development programmes for high-potential candidates. You can find numerical data relating to the gender diversity of the Board, senior managers and employees in the CSR section on page 33.

Board effectiveness review

In 2015, the Board chose to conduct its effectiveness review in-house. The Company Secretary designed and coordinated the process. This involved agreeing a structured questionnaire with the Chairman and Board members, distributing it to stakeholders, collating responses, and preparing reports. The Board and each of its Committees reviewed and discussed these reports.

Relating to the Board, its Committees and individual Directors, the questionnaire focused on:

- The flow of information, including the quality and sufficiency of reports, management information and training
- The behaviour of, and interaction between, the Board or Committee and management, including how much time they spent on strategic matters; how much NEDs challenged the Executive Directors; and the Board's culture and composition
- Administration, including how many and how often meetings occurred; paper volumes; the quality of systems and processes; and Board and Committee support

The questionnaire also asked respondents to comment on aspects they thought worked well in the 2014 review, and areas they thought needed to improve.

The Chairman discussed the outcome of the effectiveness review with the NEDs and Chief Executive Officer. The SID gave feedback on the Chairman's performance, with input from his fellow NEDs.

Based on the questionnaire responses and resulting reports, the Directors are satisfied that the Board and its Committees operated effectively in 2015. The Directors are also satisfied that they made significant progress in areas identified in 2014 as needing to improve. The Board and its Committees agreed an action plan for improving further, which they will pursue in 2016.

The Board has agreed that external facilitators will conduct the 2016 effectiveness review.

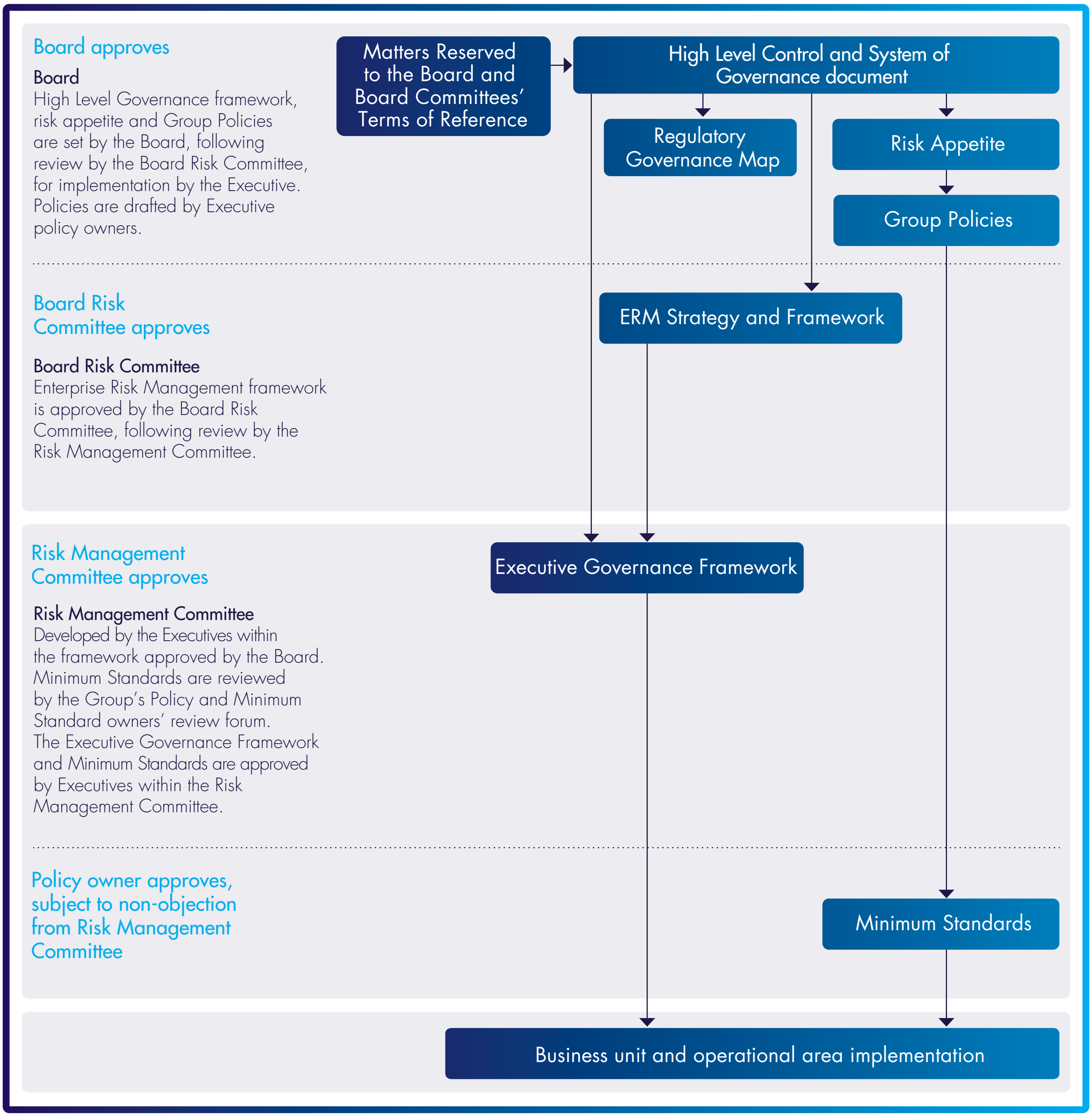
Governance framework and structure

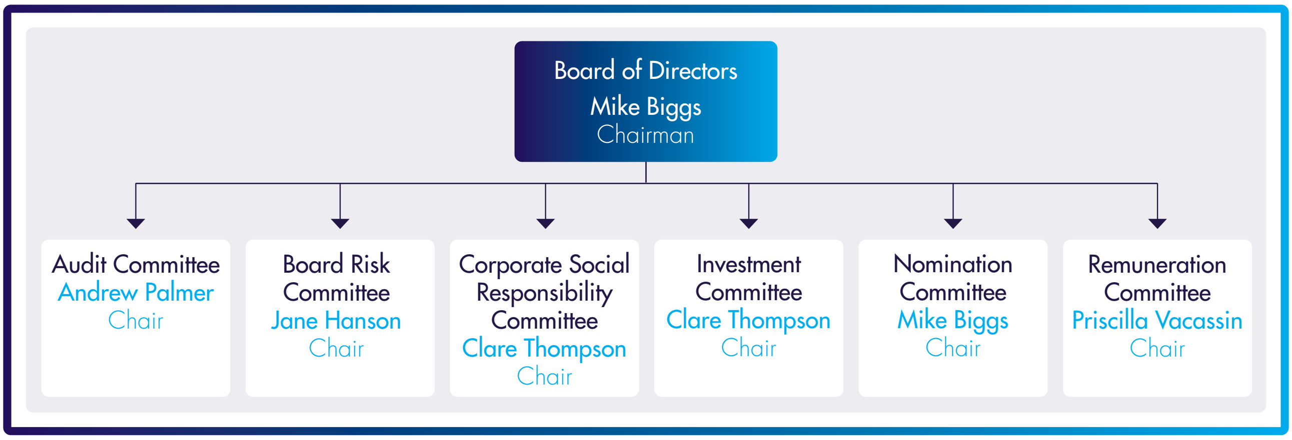
The Board is responsible for ensuring there is an appropriate system of governance throughout the Group. This includes a robust system of internal controls and a sound risk management framework. The Group's governance framework is detailed in the High Level Control and System of Governance document. The Board reviews this document annually.

The core elements are the:

- Matters Reserved to the Board and the Board Committees' Terms of Reference
- Regulatory Governance Map
- Risk Appetite
- Group Policy Framework, which comprises policies that the Board approves. Minimum Standards interpret these policies into a set of operational requirements and these are implemented throughout the Group
- Enterprise Risk Management Strategy and Framework. This sets out the Group's approach to managing risks robustly, and owning and overseeing risks
- Executive Governance Framework, which outlines how each business function is governed and details the authority delegated to Executive Committee members

The diagram summarises the split of responsibilities for the different parts of the Group's governance framework.





Board Committees

The Board has established various Committees to help meet its responsibilities. Each Committee plays a vital role in ensuring the Board operates efficiently and considers matters appropriately. The diagram above details the names of the Board Committees and Chairs, as at the date of this report.

Each Committee has separate terms of reference. The Board reviews these annually. You can find details of each Committee's composition, attendance, role and focus on pages 58 to 69.

The Chief Executive Officer

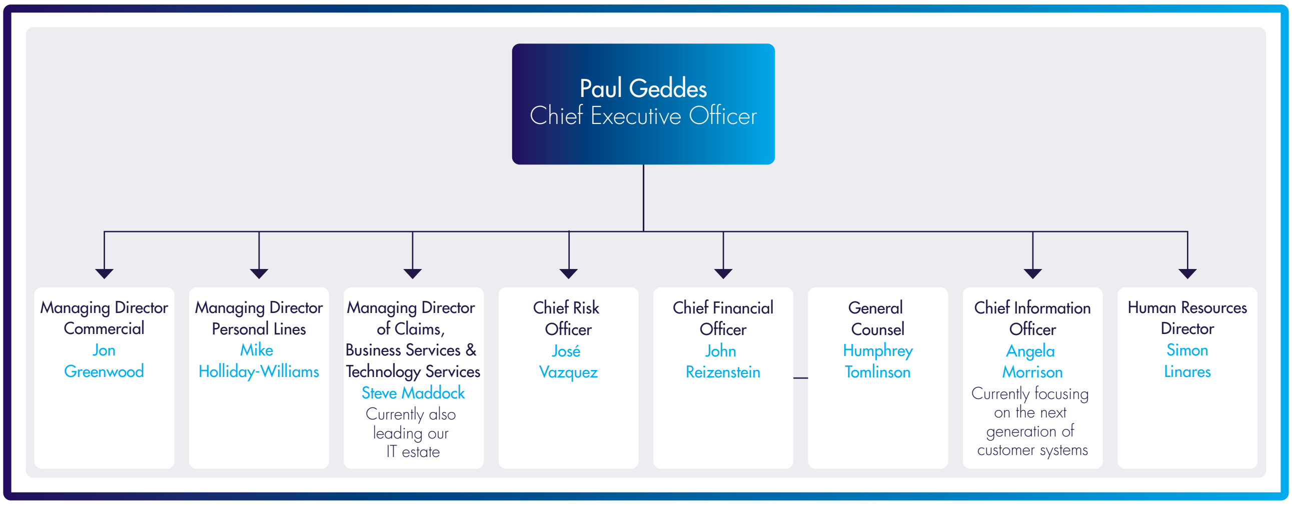
The Board is ultimately responsible for the Company's success. However, the Board has authorised Paul Geddes, the Chief Executive Officer, to manage the Group's day-to-day operations and deliver its strategic objectives.

In turn, Paul Geddes has delegated certain elements of his authority to Executive Committee members. This helps ensure that senior executives are accountable and responsible for managing their businesses and functions. Such delegation also involves ensuring the senior executives have the appropriate financial and other authorities needed to manage those business areas.

Executive Committee

The Executive Committee is the principal management committee that helps the Chief Executive Officer manage the Group day to day. It helps him: set performance targets; implement the Board-determined Group strategy and direction; and monitor key objectives and commercial plans to help achieve the Group's targets. It also helps him evaluate new business initiatives and opportunities, and considers reports on operational matters that are material to the Group or have cross business implications.

The diagram outlines the current executive management structure.



Accountability

Financial and business reporting

Responsibility for preparing the Annual Report & Accounts
The Board is responsible for giving shareholders a fair, balanced and understandable assessment of the Company's position and prospects. The Board is also responsible for maintaining adequate accounting records, and ensuring compliance with statutory and regulatory obligations.

You can find an explanation from the Directors about their responsibility for preparing the financial statements in the statement of Directors' responsibilities on page 99. The Company's external Auditor explains its responsibilities on page 105.

The Directors confirm that they consider that the Annual Report & Accounts, taken as a whole, is fair, balanced and understandable, and provides the information shareholders need to assess the Group's position and performance, business model and strategy. In arriving at this conclusion, the Board was supported by a number of processes, including the following:

- Management drafted the Annual Report & Accounts to ensure consistency across sections, and a steering group comprising a team of cross-functional senior management provided overall governance and co-ordination
- A verification process, to ensure the content was factually accurate
- Members of the Executive Committee reviewed drafts of the Annual Report & Accounts
- The Company's Disclosure Committee reviewed an advanced draft
- The Audit Committee reviewed the substantially final draft before consideration by the Board

The Board meets its responsibilities under the Code as follows:

- How the Company seeks to generate value over the long term is explained in the business model on pages 8 and 9, and the strategy for delivering Company objectives is on pages 14 to 17
- How the Board has assessed the Group's longer-term viability and the adoption of the going concern basis in the financial statements follows below
- The Board's arrangements for applying risk management and internal control principles follow
- The Board has delegated the Audit Committee to oversee managing the relationship with the Company's external Auditor. You can find details of the Committee's role, activities and relationship with the internal and external auditors in the Audit Committee report on pages 58 to 60

Going concern
The Group has sufficient financial resources to meet its financial needs, including managing a mature portfolio of insurance risk. The Directors believe the Group is well positioned to manage its business risks successfully in the current economic environment.

The Finance review on pages 44 and 45 describes the Group's capital management strategy, which covers how it measures its regulatory and economic capital needs, and deploys capital.

The Group's financial position is also covered in that section, including a commentary on cash and investment levels, reserves, currency management, insurance liability management, liquidity and borrowings. Additionally, note 3 to the consolidated financial statements describes capital management needs and policies and also covers insurance, market, liquidity and credit risks which may affect the Group's financial position.

After making due enquiries, the Directors reasonably expect that the Company and the Group have adequate resources to continue in operational existence for at least 12 months from the date of approval of the financial statements. Accordingly, they have adopted the going concern basis in preparing the financial statements.

Risk management and internal control

Assessing principal risks
The Directors confirm that they robustly assessed the principal risks facing the Company, including risks that would threaten its business model, future performance, solvency or liquidity. You can find a description of these risks, and their management or mitigation, on pages 28 and 29.

This confirmation is based on the Directors' twice-yearly review and challenge of the Group's Material Risk Assessment ("**MRA**"), and their review and approval of the Group's risk appetite statements. The MRA identifies risks quantified as having a residual risk impact of £40 million or more based on a 1-in-200-years likelihood period. The quantifications are produced through stress and scenario analysis, and the internal economic capital model. Each directorate's bottom-up risk identification and assessment supplements the MRA. The MRA also plays a key role in developing the Own Risk and Solvency Assessment ("**ORSA**") and assessing the Group's strategic plan.

Viability statement
The Strategic report, on pages 1 to 45, sets out the Group's financial performance, business environment, outlook and financial management strategies. It covers how the Group measures its regulatory and economic capital needs, and deploys capital. You can find discussion about the Group's principal risks and risk management on pages 26 to 29. Note 3 to the consolidated financial statements starts on page 121 and sets out financial disclosures relating to the Group's principal risks. This covers insurance, market and credit; and the Group's approach to monitoring, managing and mitigating exposures to these risks.

Every year and on a rolling basis, the Board considers a strategic plan for the Group. The plan makes certain assumptions in respect of the competitive markets in which the Group operates, and the delivery and implementation of the next generation of customer systems. Appropriate aspects of the strategic plan are stress-tested to understand and help set capital and other requirements.

When reviewing the strategic plan, the Board considered the Group's prospects over the one and four-year periods that the plan covered. This review includes reviews of solvency, liquidity, assessment of principal risks and risk management. The one-year planning period has greater certainty, so it was used to set detailed budgets across the Group. Outcomes for the four-year period are less certain. However, the plan provides a robust planning tool for strategic decisions. The Board recognises that uncertainty increases over time and, therefore, future outcomes cannot be guaranteed or accurately predicted.

Considering the Group's current position, four-year strategic plan and principal risks, the Board has a reasonable expectation that the Company and the Group can continue in operation and provide the appropriate degree of protection to those that are, or may become, policyholders or claimants in the period to 31 December 2019.

Risk management and internal control system

The Board oversees the Group's risk management and internal control system. It has complied with the Code by establishing a continuous process for identifying, evaluating and managing the principal risks the Group faces.

The Board has established a management structure with defined lines of responsibility and clear delegation of authority. This control framework cascades through the divisions and central functions, detailing clear responsibilities to ensure the Group's operations have appropriate controls. This includes controls relating to the financial reporting process.

The Group operates a Three Lines of Defence model. You can find out more about this in the risk management section on pages 26 and 27.

The Board, with the assistance of the Board Risk Committee and the Audit Committee as appropriate, monitored the Company's risk management and internal control systems, and reviewed their effectiveness. The monitoring and review covered all material controls, including financial, operational and compliance controls. The Board and its Committees are overseeing the ongoing work to improve the performance across the board of the Group's IT systems, including focusing on risks relating to IT systems' stability, cyber security and the internal control environment.

The Board was also supported in its review of the annual Control Environment Certification process. As part of this, each directorate self-assessed its risks and whether its key controls were adequate and effective. The Risk and Group Audit functions reviewed and challenged these findings. The Group then combined the overall findings into a Group-level assessment, which the Chief Executive Officer approved. The system reported on the controls' nature and effectiveness, and other management processes that manage these risks.

The Board Risk Committee regularly reviews significant risks and how they might affect the Group's financial position; comparisons to agreed risk appetites; and what the Group does to manage risks outside its appetite.

The Group Audit function supports the Board by providing an independent and objective assurance of the adequacy and effectiveness of the Group's controls. It brings a systematic and disciplined approach to evaluating and improving the effectiveness of its risk management, control and governance frameworks, and processes.

The Directors acknowledge that any internal control system can manage, but not eliminate the risk of not achieving business objectives. It can only provide reasonable, not absolute, assurance against material misstatement or financial loss.

On behalf of the Board, the Audit Committee regularly reviews the effectiveness of the Group's internal control systems. Its monitoring covers all material controls. Principally, it reviews and challenges reports from management, the Group Audit function and the external Auditor. This enables it to consider how to manage or mitigate risk in line with the Group's risk strategy.

Remuneration

The Board has delegated responsibility to the Remuneration Committee for the remuneration arrangements of the Group's Executive Directors and Chairman. It recommends and monitors the remuneration level and structure for senior executives. You can find out more about this in the Directors' remuneration report starting on page 70.

Relations with shareholders

The Board believes that engaging regularly with the Company's shareholders is vital to the Group's business. Communicating and engaging with investors means the Board can stay up to date on opinions. It also gives the Company the opportunity to answer questions and concerns.

The Executive Directors meet frequently with investors and inform the Board about shareholder concerns. This gives Directors the opportunity to discuss governance and strategy with shareholders. The Chairman, SID and NEDs are available to attend meetings with major shareholders at their request.

The Company's Investor Relations team helps Directors continue communicating with institutional investors, fund managers and analysts. The Board receives regular updates on investor relations, including feedback from analysts. The Company's corporate brokers also regularly attend Board meetings to inform the Board of shareholder views.

Annual General Meeting

The Board sees the Company's AGM as a good opportunity for private shareholders to talk directly with the Board. All shareholders can attend the AGM if they wish. All Directors attended the AGM in 2015.

At the AGM, the Chief Executive Officer presents the Group's financial results. Next, the Chairman proposes the AGM's formal business. The AGM's facilitators encourage shareholders to ask questions about the meeting's business. The Chairman, the Committee Chairs and the remaining Directors and members of the Executive team are also available to talk with shareholders at the end of the meeting.

Audit Committee report

Andrew Palmer
Chair of the Audit Committee

The Audit Committee's role

The Committee is responsible for overseeing and challenging the effectiveness of the Group's systems of financial and other controls. It also monitors the work and effectiveness of the Group's internal and external auditors and actuaries.

The Committee has unrestricted access to management and external advisers to help discharge its duties. It is satisfied that in 2015 it received sufficient, reliable and timely information to perform its responsibilities effectively.

Responsibilities

The Committee's main responsibilities are to:

- Monitor the integrity of the Group's financial statements and any other formal announcement relating to its financial performance
- Review and monitor the reserving process and recommend the quarterly reserves to the Board
- Continually review the adequacy and effectiveness of the Group's internal financial controls and internal control systems, and the monitoring procedures
- Monitor and evaluate the Group Audit function's performance
- Monitor and manage the relationship with the External Auditor, including agreeing the external audit fee, assessing effectiveness, and managing any tender process for the audit services contract

You can find the Audit Committee's terms of reference at www.directlinegroup.com .

Committee composition, skills and experience

The Committee comprises three independent NEDs: Andrew Palmer, Jane Hanson and Clare Thompson. You can find their biographies on pages 48 and 49.

On 13 May 2015, Glyn Jones stepped down as a NED and a member of the Committee.

All Committee members are members of the Institute of Chartered Accountants in England and Wales. They also have recent and relevant financial experience, enabling them to contribute diverse expertise to the Committee's proceedings. To keep their skills current and relevant, in addition to Board training, members of the Committee have received training by Deloitte LLP focused on changes to the Code and in particular the new requirements for the longer term viability statement.

Meetings

The Audit Committee held five scheduled meetings in 2015, at appropriate times in the financial and regulatory reporting and audit cycle. This table shows attendance at the scheduled meetings:

	Scheduled meetings	Percentage attendance
Andrew Palmer (Chair)	5 of 5	100%
Jane Hanson	5 of 5	100%
Glyn Jones[1]	2 of 2	100%
Clare Thompson	5 of 5	100%

Sub-committees of the Audit Committee met in May and November 2015 to approve the Group's Interim Management Statements for the first and third quarters of 2015. The quorum of both sub-committee meetings comprised Andrew Palmer, Paul Geddes and John Reizenstein.

There were four additional meetings to consider outputs and approve reports from the Solvency II programme.

The Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Group Financial Controller and Head of External Reporting are invited to attend Audit Committee meetings. The Actuarial Director, external actuarial advisers, External Auditor and Group Head of Audit are also invited to attend meetings and meet privately with the Audit Committee, in the absence of management. The Managing Director of Claims, Business Services and Technology Services is also invited to attend appropriate sections of Audit Committee meetings.

The Chair reports on matters dealt with at each Committee meeting to the subsequent scheduled Board meeting.

Main activities during the year

At every scheduled Committee meeting, the Committee receives reports on financial reporting, reserves, internal controls, Group Audit and Solvency II. You can find out more about this in the following sections.

Financial reporting

During the year, the Committee reviewed the preliminary announcement of the Group's 2014 financial results, the 2014 Annual Report & Accounts, and the 2015 Half Year Report. The Committee then recommended them to the Board for approval.

The review process focused on critical accounting policies and practices, emphasising those requiring a major element of judgement. The review also considered the going concern assumptions, impairment reviews, reserving provisions, unusual transactions, clarity of disclosures and significant audit adjustments.

Note:

1. Attendance is expressed as the number of scheduled meetings attended out of the number of such meetings possible or applicable to attend.

The Committee also advised the Board whether the financial statements, taken as a whole, were fair, balanced and understandable and provided sufficient information to enable the reader to assess the Group's performance, business model and strategy.

When considering the Annual Report & Accounts for 2015, the Committee focused on the significant risks and judgements which could be material to the financial statements. These included:

Reserve valuation – The Committee reviewed the actuarial best estimates of the level of reserves with external consultants. Further information on reserves is given below.

Reinsurance recoverables – The Committee considered the proposed methodology for an impairment provision.

Financial investments – The Committee considered reports on the judgements applied to the carrying value of the Group's financial investments and the need for any impairment provision.

Goodwill and other intangible assets – The Committee considered the carrying value of goodwill and other intangible assets and whether any impairment provision was required.

Transformation projects – The Committee considered major change projects including the IT migration from RBS Group systems.

Internal control environment – The Committee considered reports on the internal control environment and associated mitigating actions/remedial action plans.

The Committee considered reports prepared by management on the significant estimates and judgements that were material to the financial statements and challenged the judgements being made. The Committee also discussed these matters with Deloitte, the External Auditor.

Reserves

Every quarter, the Committee reviews and challenges the key assumptions and judgements, emerging trends, movements, and analysis of uncertainties underlying the actuarial best estimate of technical provisions. At the same time, the Committee considers and challenges the appropriateness of the Chief Financial Officer's proposals for management's best estimate of reserves. These are informed by actuarial analysis, wider commercial and risk management insights, and principles of consistency from period to period.

The Committee approves annual plans for reviews of reserves, informed by emerging internal and external issues.

It also considers an appropriate balance between internal and external actuarial review. Consultants appointed to provide actuarial reviews of reserves are subject to approval by the Committee. The external actuarial review was carried out by PricewaterhouseCoopers LLP for the Directors of Direct Line Insurance Group plc and its relevant affiliates[1].

After reviewing the actuarial best estimate and management's best estimate of reserves, the Committee recommends them to the Board.

Note:

1. The relevant affiliates are U K Insurance Limited and Churchill Insurance Company Limited.

Internal control and Group Audit

During the year, the Audit Committee reviewed the adequacy and effectiveness of the Group's internal control systems.

The Group's Financial Reporting Control Framework ("**FRCF**") is part of its wider internal controls system. It addresses financial reporting risks. The Board delegates supervision of the FRCF to the Audit Committee. The Chief Financial Officer is responsible for the FRCF on a daily basis.

During 2015, the Audit Committee received regular reports on the FRCF and the testing of it. Part of those reports focused on control deficiencies, and mitigating and remedial actions taken.

The Committee considered the Group's internal controls and processes for identifying and responding to risks.

The Audit Committee oversees Group Audit's work and seeks to ensure it adopts industry best practice appropriately. The Group Head of Audit's primary reporting line is to the Chair of the Committee. The secondary reporting line – for day-to-day administration – is to the Chief Financial Officer. Group Audit gives the Committee independent and objective reports on the appropriateness and effectiveness of the Group's internal controls and governance frameworks. The Committee approves Group Audit's annual plan of reviews, and receives quarterly reports detailing internal audit activity, key findings, management responses, and proposed action plans. Group Audit also monitors that these actions are completed. The Committee also approves the Group Audit Charter.

During the year, the Committee assessed whether the Group Audit function was effective and concluded that it was. This included the Committee satisfying itself that the Group Audit function has the appropriate resources. The Committee also continued monitoring ongoing actions from 2014's external quality assessment review.

Solvency II

During the year, the Committee held four additional meetings to consider matters relating to the Solvency II governance and Internal Model Approval Process ("**IMAP**") application. At those meetings, the Committee considered:

- Reports to the PRA for the preparatory reporting stage of Pillar III as at 31 December 2014 and 30 September 2015
- Reviews by the external auditor, mandated by the PRA for the Pillar III reports for 31 December 2014

External audit

The Audit Committee is responsible for overseeing the External Auditor and agreeing the audit fee. This also involves approving the annual audit's scope.

The Committee monitored the performance of the work of and relationship with the External Auditor during the year. Deloitte LLP were appointed as Auditor to the Group at IPO in 2012. Deloitte LLP, as the auditor of the RBS Group, audited the Group as a division of RBS between 2000 and 2012. The Company cannot reappoint Deloitte LLP as its auditor after June 2023. This complies with the transitional rules for audit tendering and auditor rotation, as set out in the Competition & Markets Authority's ("**CMA**") Order and the EU Audit Regulation.

Deloitte LLP must regularly rotate the partner it engages on the audit. The current partner is David Rush. He will be rotated after completing the 2015 year-end audit. This complies with the Group's Minimum Standard on making sure the external audit remains independent.

The Committee has fully considered how the EU Audit Regulation and the CMA's Order on mandatory audit contract tendering affect the Group. Under the CMA Order, the Group will conduct a competitive tender and enter into a new audit services contract before June 2023. The Committee will tender the audit contract for the year ended 31 December 2021 at the latest. The Committee considers that this is in the best interests of the shareholders as it will coincide with the next audit partner's rotation and therefore limit operational disruption during a time of significant regulatory and organisational change over the next few years. However, in conjunction with the results of the annual assessment of the Auditor's effectiveness, this position will be reviewed again in 2016.

There are no contractual obligations restricting the Company's choice of external auditor and no auditor liability agreement has been entered into. Equally, any recommendation to reappoint Deloitte LLP as auditor of the Company depends on continued satisfactory performance.

Auditor independence and non-audit services policy

The Group has an Independence of External Audit minimum standard. This established parameters for preventing or mitigating anything that compromises the External Auditors' independence or objectivity, by virtue of them providing the Group with non-audit services. The Committee reviews and refreshes the standard annually to make sure it remains appropriate.

Before each financial year, the Committee formally approves a list of audit and non-audit services that the External Auditor will provide. This is in accordance with the minimum standard.

The Group has delegated authority to the Audit Committee's Chair to approve any non-audit services costing up to £100,000. Non-audit services costing over £100,000 require the Committee's approval. At least twice a year, the Committee receives and reviews a report on all consultancy spending, including non-audit services.

During the year, the Committee approved fees of £0.9 million to Deloitte LLP for services unrelated to audit work. The following is a breakdown of fees paid to Deloitte LLP for the year ended 31 December 2015.

	Fees £m	Proportion
Audit fees[1]	1.9	67.9%
Non-audit fees	0.9	32.1%
Total fees for audit and other services	**2.8**	

Note:

1. You can find further information in note 11 to the consolidated financial statements.

The non-audit fee of £0.9 million relates to audit-related assurance services, tax services and an IT project.

The Committee reviewed how the Group applied its minimum standard on audit and non-audit services in 2015. It is satisfied that the Group has adequate procedures to make sure the External Auditors are independent and objective.

Effectiveness of the external audit process and reappointing Deloitte as External Auditors

In 2015, the Audit Committee assessed the External Auditors' effectiveness. This was in addition to regularly questioning the Auditor during its meetings. The Audit Committee assessed the Auditor through: a detailed questionnaire which key stakeholders completed; discussing matters with the Chief Financial Officer; formally reviewing Deloitte LLP's independence; and assessing whether it fulfilled the agreed audit plan.

The Financial Reporting Council's Audit Quality Review team selected to review the audit of the 2014 Group financial statements as part of their 2015 annual inspection of audit firms. The focus of the review and their reporting was on identifying areas where improvements were required rather than highlighting areas performed to or above the expected level. The Chairman of the Audit Committee received a full copy of the findings of the Audit Quality Review team and discussed these with Deloitte. The Committee confirms that there were no significant areas for improvement identified within the report. The Committee is also satisfied that there is nothing within the report which might have a bearing on the audit appointment.

The Committee, after taking into account all of the information available, concluded that Deloitte LLP had performed its obligations effectively and appropriately as External Auditor to the Group.

The Audit Committee subsequently recommended to the Board that the Group reappoint Deloitte LLP as External Auditor. The Group will put a resolution regarding this to the shareholders at the 2016 AGM.

The Audit Committee's effectiveness

The Company Secretary facilitated the Committee's review of its effectiveness during the year. The Company Secretary also prepared a report based on responses from Committee members and other stakeholders to a pre-agreed questionnaire. After reviewing and discussing the report, the Committee concluded that it was operating effectively, and has access to sufficient resources to perform its duties.

The Board reviewed and approved this report on 29 February 2016.

Andrew Palmer
Chair of the Audit Committee

Board Risk Committee report

Jane Hanson
Chair of the Board Risk Committee

The Board Risk Committee's role

The Committee is responsible for overseeing and advising the Board on the Group's current and potential future risk exposures, and its strategic approach to managing risk. The Committee recommends risk appetite and tolerance levels to the Board, and supports the Board in promoting a risk-aware culture across the Group.

The Committee has unrestricted access to management and external advisers to help discharge its duties. It is satisfied that during 2015 it received sufficient, reliable and timely information to perform its responsibilities effectively.

Responsibilities

The Committee's main responsibilities are to:

- Consider and recommend the Group's risk appetite, framework and tolerance to the Board for its approval
- Review and approve the design and implementation of the Enterprise Risk Management Framework, and the procedures for monitoring its adequacy and effectiveness
- Consider the Group's risk profile relative to current and future Group strategy, and to risk appetite
- Approve the Risk Management and Compliance Operating Plans
- Review the governance of, and methodology and assumptions used in, the Group's internal economic capital model and approval of changes to the model and associated policies and minimum standards
- Review and recommend the ORSA process and report to the Board
- Review and recommend the High Level Control and System of Governance Framework to the Board
- Review the Group's procedure for detecting internal and external fraud

You can find the Board Risk Committee's terms of reference at www.directlinegroup.com .

Committee composition, skills and experience

The Committee comprised four independent NEDs: Jane Hanson, Andrew Palmer, Clare Thompson and Priscilla Vacassin. You can find their biographies on pages 48 and 49.

Meetings

The Board Risk Committee held six scheduled meetings in 2015. One of these was a joint meeting with the Remuneration Committee. Additionally, six sub-committee meetings were held to consider Solvency II and IMAP matters. This table shows attendance at the scheduled meetings:

	Scheduled meetings	Percentage attendance
Jane Hanson (Chair)	6 of 6	100%
Andrew Palmer	6 of 6	100%
Clare Thompson	6 of 6	100%
Priscilla Vacassin	6 of 6	100%

The Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Group Head of Audit, General Counsel and a representative from the External Auditor are invited to attend meetings. In addition to regular one-to-one meetings with the Chair, the Chief Risk Officer also met privately with the Committee.

The Board Risk Committee also invites the Director of Compliance and Regulatory Risk, Director of Financial Risk and Enterprise Risk Director to appropriate sections of its meetings.

The Chair reports on matters dealt with at each Committee meeting to the subsequent scheduled Board meeting.

Main activities during the year

Risk monitoring

At each of its scheduled quarterly Committee meetings, the Committee receives a report from the Chief Risk Officer. This report highlights the outputs of regular risk monitoring and provides further detail of specific issues to the Committee.

The Committee received regular reports regarding the three strategic risk appetite statements: maintain capital adequacy; stable and efficient access to funding and liquidity; and maintain stakeholder confidence. The Committee also received reports on the risks pertaining to the lower level risk appetite statements that support the three main statements. The Committee monitored the Group's exposure to these appetites, and assessed the drivers that affect its risk appetite status.

The Committee robustly assessed the principal risks facing the Company, which you can find listed on pages 28 and 29. The Committee achieved this by reviewing and challenging the Group's MRA in the context of the Group's risk appetite.

On behalf of the Board, the Committee also monitored the Company's risk management systems, and reviewed their effectiveness. The monitoring and review involved examining an assessment of the control environment and material controls at Group level, based on directorate-level risk and control self-assessments. These assessments were subject to challenge by the Risk and Group Audit functions.

Additionally, the Committee considered more detailed subjects at each scheduled meeting. These related to: compliance and regulatory risk including oversight of the Group's regulatory relationships; operational risk; financial risk, Solvency II and IMAP; and risk governance. The Committee also requested specific reviews of areas of the risk and control environment.

Compliance and regulatory risk

During the year, the Committee considered the Group's compliance with regulatory requirements including conduct and financial crime. In particular, the Committee reviewed how the PRA's Senior Insurance Managers Regime and the FCA's Approved Persons regime would affect the Group. The Committee also reviewed the outputs from conduct and compliance assurance activity, including approving the Annual Assurance Plan.

Additionally, the Committee monitored the Group's actions relating to a financial promotions assurance review; and the management of ongoing regulatory interactions, in particular with the FCA and the PRA.

The Committee received regular reports on the Group's whistle-blowing process; and the Group's actions to prevent financial crime, including review of the Annual Financial Crime Report.

Operational risk

The Committee considered and monitored the risks associated with the migration of the Group's IT infrastructure away from RBS Group. The Committee monitored the Company's risk management and internal control systems, and reviewed their effectiveness. The monitoring and review covered all material risks, including financial, operational and compliance, reviewing the net risk position after the operation of controls, and also considered the effectiveness of any associated mitigating actions. The Committee is overseeing the ongoing work to improve the performance across the board of the Group's IT systems, including focusing on risks relating to IT systems' stability, cyber security and the internal control environment.

The Committee also received regular updates on the Group's major change programmes, including the next generation of customer systems, and considered progress towards the planned significant change to the Group's IT capabilities, including the development of new technology and new digital tools.

The Committee considered the Group's broader operational risk control environment and commissioned reviews by the Risk function on controls relating to major third-party suppliers and the execution of pricing changes. In addition, the Committee considered the Group's cyber risk assessment and associated controls, as well as the governance structures across the Group.

Financial risk

At each meeting, the Committee monitored the Group's performance against the financial risk appetite through the Chief Risk Officer's report. The Committee also considered risks in the strategic plan against risk appetite.

As part of this, the Committee considered the stress and scenario testing plan, and monitored and challenged the test results.

Solvency II and IMAP

One of the Committee's main considerations in 2015 was preparing for the implementation of Solvency II. This is the European Insurance Industry's new framework for ensuring capital adequacy. It involves using a forward-looking risk assessment based on ORSA principles. The Committee also monitored and challenged progress on the Group's IMAP application.

During the year, the Committee reviewed and considered Solvency II matters, including:

- The 2015 IMAP validation framework, scope and process, including an independent assessment and the resolution of validation issues and delivery against regulatory deadlines
- The Group's Solvency Capital Requirement ("**SCR**"), including the key assumptions and dependencies within the calculation methodology such as the materiality limits and the approach to catastrophe modelling
- Governance around the calculation of the Standard Formula, and the justification of this capital requirement including a comparison to the IECM SCR
- Approval of the ORSA including its alignment to the business planning process
- The ongoing application of, and controls over, the IECM including recommendation for Board approval of the defined management actions and the validation approach for 2016

The Committee also received comprehensive training on the requirements of Solvency II.

Risk governance

Every year, the Committee reviews and approves the Enterprise Risk Management Framework, which includes the Group risk policies and minimum standards. The Committee reviewed and challenged each Group policy and recommended the final versions for approval by the Board. The Committee also considered the results from the annual Group assessment of the effectiveness of the internal control environment undertaken by each business directorate, as well as monitoring controls on an ongoing basis.

The Committee considered, challenged and approved the Annual Risk and Compliance Plan. It also reviewed an 'Assessment of Risk Behaviours and Attitudes' across the Group, which is part of an ongoing process to drive continued improvement in these areas by providing feedback on current state, highlighting areas of good practice and areas for focus.

Additionally, the Committee held a Risk Strategy day. During the event, the Committee considered the Group's approach to the management of risk, the risk oversight model and the operation of the Three Lines of Defence model in the Group.

Remuneration

During the year, the Board Risk and Remuneration Committees held a joint meeting. This was to ensure the Group's remuneration arrangements were still appropriate in the light of regulatory developments and did not encourage excessive risk-taking. As part of this review, the joint Committee also considered the Group's preparedness for Solvency II. This followed published requirements, including how the Group would assess the performance of individuals in Control Functions. This Committee also monitored how incentive schemes operated for roles in the insurance sales and service contact centres, and for technicians and support staff in the UK Assistance Accident and Repair Centres.

The Board Risk Committee's effectiveness

The Company Secretary facilitated the Committee's review of its effectiveness during the year. The Company Secretary also prepared a report based on responses from Committee members and other stakeholders to a pre-agreed questionnaire. After reviewing and discussing the report, the Committee concluded that it was operating effectively, and has access to sufficient resources to perform its duties.

The Board reviewed and approved this report on 29 February 2016.

Jane Hanson
Chair of the Board Risk Committee

Corporate Social Responsibility Committee report

Clare Thompson
Chair of the Corporate Social Responsibility Committee

The Corporate Social Responsibility Committee's role

The CSR Committee oversees and advises on how the Group conducts its business responsibly. This includes matters relating to environmental, employee engagement and wellbeing, community involvement, and ethics.

Responsibilities

The Committee's main responsibilities are:

- Approving the Group's CSR strategy
- Reviewing the Group's performance relating to CSR matters
- Assessing the Group's role in society

Committee composition

The Committee comprised three independent NEDs: Clare Thompson, Jane Hanson and Sebastian James. Paul Geddes, Chief Executive Officer, and Angela Morrison, Chief Information Officer, are also Committee members. You can find their biographies on pages 48 to 50.

Meetings

The CSR Committee held three scheduled meetings in 2015. This table shows attendance at the scheduled meetings:

	Scheduled meetings	Percentage attendance
Clare Thompson (Chair)	3 of 3	100%
Paul Geddes	3 of 3	100%
Jane Hanson	3 of 3	100%
Sebastian James	3 of 3	100%
Angela Morrison	3 of 3	100%

The Human Resources Director, Head of Public Affairs and Sustainability, and CSR Manager are invited to attend CSR Committee meetings. The Chair reports on matters dealt with at each Committee meeting to the subsequent scheduled Board meeting.

CSR strategy

The Group's CSR strategy focuses on four areas. A member of the Executive Committee sponsors each area. They are:

- Helping to make our society safer – Mike Holliday-Williams
- Proud to be here – Simon Linares
- Being recognised as part of our communities – Jon Greenwood
- Reduce, Reuse and Recycle – Steve Maddock

You can find out more about the Group's CSR approach and priorities in the CSR section on pages 30 to 33.

Main activities during the year

The Committee monitors the implementation of the CSR strategy through regular updates on the different focus areas. It challenges the robustness of the targets in relation to each strand. It receives regular updates on each element of the CSR strategy and at each of its meetings the Committee receives a report on developments in CSR.

Helping to make our society safer

During the year, the Committee held a strategy session to consider how the Group could best use its expertise and experience to reduce deaths and life-changing injuries on the UK's roads. The overall aim is to cut deaths in the first 1,000 miles of driving to zero, by engaging young drivers and helping them to drive more safely. The Committee received regular progress reports on, and provided valuable insight into, this initiative. You can find further details on this initiative and the manifesto in the CSR section on page 31.

Proud to be here

The primary objective of this strand was to improve employee engagement in order to support a key enabler of the Group's 2015 strategy. The KPIs for this element are linked to the People Strategy and focus on employee engagement and wellbeing. During the year the Committee discussed and challenged the proposed targets and the focus of the work stream. It was agreed that the focus should be on (i) pride in working for the Group; (ii) telling others that the Group is a great place to work; and (iii) employee wellbeing.

Being recognised as part of our communities

The Committee received reports about how the Group was strengthening the level of support provided to the network of Community and Social Committees operating at the main Group locations. The main targets which had been agreed related to volunteering, fund raising and matched payroll giving.

The 'One Day' volunteering initiative and Community Cashback scheme were considered to be the two areas with the greatest potential for impact.

Reduce, Reuse and Recycle

This strand of the strategy considered energy use, waste management and resource use within our operations as well as environmental matters in the Group's supply chain. Key objectives related to a reduction in greenhouse gas emissions and diverting waste from landfill.

The CSR Committee's effectiveness

The Company Secretary facilitated the Committee's review of its effectiveness during the year. The Company Secretary also prepared a report based on responses from Committee members and other stakeholders to a pre-agreed questionnaire. After reviewing and discussing the report, the Committee concluded that it was operating effectively, and has access to sufficient resources to perform its duties.

The Board reviewed and approved this report on 29 February 2016.

Clare Thompson

Clare Thompson
Chair of the CSR Committee

Investment Committee report

Clare Thompson
Chair of the Investment Committee

The Investment Committee's role

The Committee is responsible for overseeing how the Group develops its investment strategy. It also oversees the management and performance of the Group's investment portfolio.

Responsibilities

The Committee's main responsibilities are to:

- Examine the rationale for, and the risks and financial implications of, any proposed changes to the Group's investment strategy and, where agreed, recommend these changes to the Board
- Consider and approve material changes to the risk framework that underpins investment activity, and any proposals to change the operating model. This typically relates to how outsource service providers are used
- Review global financial market developments and changes to the regulatory environment, and consider the ongoing appropriateness of investment activities in light of such developments
- Monitor the results from investment activities, namely adequacy of financial results delivered, compliance with agreed risk tolerances and external service provider performance. The Committee also ensures that any material breaches are reported to the Board Risk Committee

Committee composition, skills and experience

The Committee comprised three independent NEDs: Clare Thompson, Jane Hanson and Andrew Palmer. You can find their biographies on pages 48 and 49.

Clare Thompson was appointed Chair of the Committee on 13 May 2015, after the AGM and when Glyn Jones stepped down as a NED and Committee member.

Meetings

The Investment Committee held four scheduled meetings in 2015. This table shows attendance at the scheduled meetings:

	Scheduled meetings	Percentage attendance
Clare Thompson (Chair)	4 of 4	100 %
Jane Hanson	4 of 4	100 %
Glyn Jones[1]	2 of 2	100 %
Andrew Palmer	4 of 4	100 %

The Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Director of Investment Management and Treasury, and Director of Financial Risk are invited to attend Investment Committee meetings. The Chair reports on matters dealt with at each Committee meeting to the subsequent scheduled Board meeting.

Main activities during the year

Investment strategy

After considering and challenging, the Committee recommended to the Board the following material changes to the Group's investment strategy. The Board approved the changes during 2015.

- A revised minimum requirement for access to liquidity in stressed business or economic conditions
- The introduction of three new asset mandates. Two mandates will invest in global credit and subordinated financial credit respectively, and the third mandate will invest in Sterling commercial real estate loans, a new asset class for the Group's investment portfolio
- Changes to benchmark allocations for various existing asset classes including gilts, investment-grade credit, high-yield credit, securitised credit and investment property
- A revised investment objective for existing investment-grade fixed-income mandates

Risk framework and operating model

In October, the Committee agreed to proposals to move custody and middle-office services to a new provider. During the year, the Committee reviewed the credit exposure limits framework and agreed changes to issuer and concentration limits. It also agreed to limited changes to commercial property guidelines during the year. This gave the Group some flexibility to invest in property that needs development or major refurbishment before letting.

Note:

1. Attendance is expressed as the number of scheduled meetings attended out of the number of such meetings possible or applicable to attend.

Monitoring investment activity and performance

The Committee monitored the performance of investments every quarter. It also received reports from the Director of Investment Management and Treasury on various matters. These included: key market developments; financial results from investment activity; investment performance versus benchmark for internally and externally managed portfolios; operational performance by the custodian and other service providers; and compliance with risk limits and internal delegated authorities. The Committee also received presentations from Investment Managers on their performance against benchmark.

Solvency II

The Committee examined progress on initiatives linked to preparing for Solvency II, notably:

- Preparing a liquidity plan and contingent management actions
- Developing various asset and derivative reports to submit to the PRA and European Insurance and Occupational Pensions Authority
- Restructuring the securitised credit portfolio to meet Solvency II requirements

The Investment Committee's effectiveness

The Company Secretary facilitated the Committee's review of its effectiveness during the year. The Company Secretary also prepared a report based on responses from Committee members and other stakeholders to a pre-agreed questionnaire. After reviewing and discussing the report, the Committee concluded that it was operating effectively, and has access to sufficient resources to perform its duties.

The Board reviewed and approved this report on 29 February 2016.

Clare Thompson
Chair of the Investment Committee

Nomination Committee report

Mike Biggs
Chair of the Nomination Committee

The Nomination Committee's role

The Committee is responsible for keeping the Board's structure, size, composition, and balance of skills, experience, independence and expertise under review. It also provides guidance to management on executive succession planning.

Responsibilities

The Committee's main responsibilities are:

- Considering and recommending to the Board matters regarding appointment of Directors, membership and chairmanship of Board Committees
- Succession planning for Directors and other senior executives, accounting for the skills and expertise the Group needs to deliver its strategy
- Keeping under review the leadership needs of the Group
- Reviewing the NEDs continued independence
- Considering and recommending to the Board Directors' annual re-election and reappointment at the end of their term in office

You can find the Nomination Committee's terms of reference at www.directlinegroup.com .

Committee composition

The Committee comprised the Chairman, Mike Biggs, and two independent NEDs, Andrew Palmer and Priscilla Vacassin. You can find their biographies on pages 48 to 49.

Priscilla Vacassin was appointed as a Committee member on 13 May 2015, when Glyn Jones stepped down as a NED and Committee member.

Richard Ward was appointed a member of the Committee on 25 February 2016.

Meetings

The Nomination Committee held three scheduled meetings in 2015. It also held additional meetings to deal with membership of the Board's Committees and the search for the new SID.

This table shows attendance at the scheduled meetings:

	Scheduled meetings	Percentage attendance
Mike Biggs (Chair)	3 of 3	100%
Glyn Jones[1]	2 of 2	100%
Andrew Palmer	3 of 3	100%
Priscilla Vacassin[1]	1 of 1	100%

The Chief Executive Officer is invited to attend Nomination Committee meetings. The Human Resources Director is also invited to attend appropriate sections of the Nomination Committee meetings. The Chair reports on matters dealt with at each Committee meeting to the subsequent scheduled Board meeting.

Main activities during the year

Board composition

During the year, the Committee: considered the Board's skills and experience; reviewed the structure, size and composition of the Board; reviewed the membership and chairmanship of the Board's Committees; and reviewed NEDs' letters of appointment, terms of appointment and time commitment.

Succession planning

The Committee acknowledges the importance of Board and executive succession planning, monitoring its progress as a standing agenda item at each of its scheduled meetings and providing guidance on executive succession planning to management.

Board changes

Glyn Jones stepped down from the Board following the AGM on 13 May 2015, due to his increasing responsibilities as Chairman of other listed companies. On 18 January 2016, the Group appointed Richard Ward as a NED of the Company and SID.

Board appointment and reappointment process

The Committee oversaw the process to appoint Richard Ward as a NED and SID. The Committee reviewed the Board members' expertise and experience. It then produced a detailed brief and engaged external search consultants, JCA Group, to find suitable candidates.

JCA Group is a signatory to the Voluntary Code of Conduct for executive search firms. It is not connected in any way to the Company.

JCA Group prepared a long list of candidates of appropriate merit from diverse backgrounds. The Committee agreed a shortlist and interviewed candidates. It then approached the PRA and FCA for approval, and recommended appointing Richard Ward as a NED to the Board.

As Richard Ward was appointed since the last AGM, he will submit himself for election at the Company's 2016 AGM. He is considered independent within the Code's meaning.

Note:

1. Attendance is expressed as the number of scheduled meetings attended out of the number of such meetings possible or applicable to attend.

Electing and re-electing Directors

Before the proposed re-election of Directors at the 2015 AGM, the Committee reviewed the independence of NEDs. It concluded that Jane Hanson, Sebastian James, Andrew Palmer, Clare Thompson and Priscilla Vacassin were all independent within the Code's meaning. Mike Biggs was independent when appointed as Chairman. The Committee recommended to the Board and shareholders to re-elect all serving Directors at the Company's 2015 AGM.

Diversity

The Group celebrates the diversity of its workforce. It seeks to recruit the best candidates for all positions throughout the business, whatever their gender. At the date of this report, three of the Group's nine Directors are women, which equates to 33% of the Board. This is the target set in Lord Davies' Women on Boards Review Five Year Summary published in October 2015, to be achieved by 2020. The Board also acknowledges the benefit of diversity. The Nomination Committee has encapsulated in its terms of reference a requirement to consider candidates for appointment to the Board on merit, against objective criteria and with due regard to diversity, including gender diversity.

You can find out more about the Group's approach to diversity in the CSR section on page 33.

The Nomination Committee's effectiveness

The Company Secretary facilitated the Committee's review of its effectiveness during the year. The Company Secretary also prepared a report based on responses from Committee members and other stakeholders to a pre-agreed questionnaire. After reviewing and discussing the report, the Committee concluded that it was operating effectively, and has access to sufficient resources to perform its duties.

The Board reviewed and approved this report on 29 February 2016.

Michael N Biggs
Chair of the Nomination Committee

Remuneration Committee report

Priscilla Vacassin
Chair of the Remuneration Committee

The Remuneration Committee's role

The Committee is responsible for setting and overseeing how the Group implements its remuneration policy. The Committee oversees the level and structure of remuneration arrangements for senior executives, approves share incentive plans, and recommends them to the Board and shareholders. Where applicable, it also oversees share plan changes that need shareholder approval.

Responsibilities

The Committee's main responsibilities are:

- Setting the remuneration policy for the Executive Directors and Board Chairman and monitoring its operation
- Recommending and monitoring the level and structure of remuneration for senior executives
- Considering how the Group's strategy or performance might affect its remuneration policy
- Approving the Group's remuneration governance framework. This includes approving the design and target of any performance-related pay arrangements, and liaising with the Board Risk and Audit Committees where appropriate
- Reviewing the design of all share incentive plans for the Board and shareholders to approve

You can find the Remuneration Committee's terms of reference at www.directlinegroup.com .

Committee composition, skills and experience

The Committee comprised three independent NEDs: Priscilla Vacassin, Sebastian James and Andrew Palmer, and the Chairman of the Board, Mike Biggs. You can find their biographies on pages 48 and 49.

Meetings

The Remuneration Committee held five scheduled meetings in 2015. One was a joint meeting with the Board Risk Committee to discuss matters relating to overlapping remits between the two Committees. This table shows attendance at the scheduled meetings:

	Scheduled meetings	Percentage attendance
Priscilla Vacassin (Chair)	5 of 5	100%
Mike Biggs	5 of 5	100%
Sebastian James	5 of 5	100%
Andrew Palmer	5 of 5	100%

In addition, the Committee actively interacts with the Audit Committee and Board Risk Committee when considering the setting of targets and payouts. As part of this, the Committee receives reports from the Chairs of those Committees at least twice a year. The Chair of the Audit Committee serves on the Committee. The Chair of the Board Risk Committee attended on three occasions.

The Chief Executive Officer, Human Resources Director and senior representatives of the Human Resources function are invited to attend Remuneration Committee meetings. FIT Remuneration Consultants LLP, who act as independent advisers to the Committee, are also invited to attend Remuneration Committee meetings. The Chair reports on matters dealt with at each Committee meeting to the subsequent scheduled Board meeting.

Main activities during the year

Annual Incentive Plan

During the year, the Committee monitored the operation of the Annual Incentive Plan ("**AIP**"). For the 2014 financial year, this involved assessing the Group's performance against the targets that the Committee set at the start of the year. It also received reports from the Chairs of the Audit Committee and Board Risk Committee about whether the Group had achieved the required performance within risk appetite. The Committee concluded that no clawback of awards was required in 2015.

For the 2015 financial year, the Committee approved the performance metrics and monitored performance against them. The Committee also discussed and challenged the AIP's performance metrics for the 2016 financial year and, subsequent to the year end, approved the metrics.

Long-Term Incentives

In 2015, the first awards, made in November 2012 under the Direct Line Insurance Group 2012 Long-Term Incentive Plan ("**LTIP**"), vested. These awards were made shortly after the IPO, and had two performance metrics based on RoTE and TSR. After assessing performance against these metrics, the awards vested at a level of 89.2%. Before vesting, the Committee considered the LTIP's financial and risk underpins. The Committee considered whether to operate the malus provisions. You can find out more about this in the Directors' remuneration report on pages 70 to 95.

The Committee also determined the quantum of awards in 2015 under the LTIP in view of business and individual performance.

The Committee advised and supported RBS Group when it was assessing the Group's performance for the purpose of LTIP awards it had made. The awards were made under an RBS Group LTIP scheme to Direct Line Group employees over Direct Line Group shares prior to the IPO.

Directors and other senior executives

During the year, the Committee reviewed and approved the level and structure of the pay and incentives of the Executive Directors and other senior executives. Additionally, it oversaw remuneration for the strategic leadership team. As part of this review, the Committee considered the Share Ownership Guidelines for the Executive Directors and Executive Committee members.

The Committee also considered how the 11-for-12 share consolidation would affect existing awards under the Company's Share Incentive Plan.

It also considered how selling the Group's International division would affect overseas participants in the Company's share incentive plans.

Remuneration strategy

In addition to the scheduled Committee meetings, the Committee held an additional meeting to review the remuneration framework and ensure that it was aligned to the Group strategy, and to set future priorities.

Joint Remuneration Committee and Board Risk Committee meeting

During the year, the Remuneration and Board Risk Committees held a joint meeting to ensure all remuneration arrangements remained appropriate. You can find out more about this in the Board Risk Committee report.

The Remuneration Committee's effectiveness

The Company Secretary facilitated the Committee's review of its effectiveness during the year. The Company Secretary also prepared a report based on responses from Committee members and other stakeholders to a pre-agreed questionnaire. After reviewing and discussing the report, the Committee concluded that it was operating effectively, and has access to sufficient resources to perform its duties.

The Board reviewed and approved this report on 29 February 2016.

Priscilla Vacassin
Chair of the Remuneration Committee

Priscilla Vacassin
Chair of the Remuneration Committee

Dear shareholder

As Chair of the Remuneration Committee (the "**Committee**") I am pleased to introduce our report on Directors' remuneration for the 2015 financial year. We have set out this report in the following sections:

Linking remuneration to performance – pay outcomes for 2015

As highlighted in the Board Chairman's letter on pages 10 to 11, 2015 has marked another good performance year for the Group with operating profit from ongoing operations ahead of target, despite higher than normal claims costs from major weather events. The incentive outcomes for our Executive Directors as set out in the annual report on remuneration reflect this level of performance.

We base bonuses under the AIP on performance against key financial, strategic and personal measures. We awarded bonuses of 83% of the maximum to the Chief Executive Officer and 86% of the maximum to the Chief Financial Officer for 2015. This reflects achievement of operating profit from ongoing operations ahead of the target set under the AIP, strong progress made on customer experience metrics, as evidenced by improved Net Promoter Scores in Personal Lines and highlighted in the Group highlights section of the Annual Report on page 2, and achievement against personal objectives. We have provided enhanced disclosure this year relating to the AIP outcome for 2015. You can find this on page 78.

November 2015 marked the vesting of the inaugural awards under the Direct Line Group LTIP. These LTIP awards were granted shortly following the IPO. They were subject to total shareholder return ("**TSR**") performance over the three years since IPO and RoTE performance in 2013 and 2014. Since November 2012, grants under the LTIP have been made approximately every six months.

As disclosed last year, the Group achieved an average RoTE of 16.4% over the two-year performance period in 2013 and 2014 which resulted in 82% of the maximum potential vesting of the RoTE element, which comprises 60% of the total award. A strong share price performance in the three years from Admission, together with dividend payments during the period, resulted in a TSR of 135.1% for the three-year TSR performance period and positioned the Group above the upper quintile compared to companies in the FTSE 350 (excluding investment trusts). This resulted in 100% of the maximum potential vesting under the TSR element, which comprises 40% of the total award.

Overall, 89.2% of the total award vested in November 2015, which is a good level of achievement and is reflective of the business performance and returns to shareholders over the same period.

Awards under the LTIP granted in March and August 2013 are due to vest during 2016. The RoTE performance period for these awards ended on 31 December 2015 and, subject to the Committee's satisfaction that the financial and risk underpins have been met at the end of the vesting period, awards under the RoTE element are due to vest at 94% of the maximum potential, again reflecting the returns delivered to shareholders.

We have included these vesting outcomes in the single remuneration figure for both Executive Directors, details of which you can find on page 77.

Consistent with the regulations, the TSR element of the awards due to vest during 2016 will be reported separately next year.

Pay approach for 2016

Our remuneration policy has worked well since its approval by shareholders at the 2014 AGM and is still aligned with our key strategic priorities. As such, we will not change the approved policy this year. However, we intend to review this in 2016 and we will propose a policy for shareholders to approve at the 2017 AGM.

Here are the highlights of our approach to pay for the Executive Directors in 2016:

- The salaries of both Executive Directors will increase by 2.5% in April 2016, a lower increase compared to the average increase to employees across the Group generally
- Our overall approach to measuring performance under the AIP in 2016 will be broadly similar to our approach in 2014 and 2015. We will continue measuring performance using financial, strategic and personal targets and the Committee will also use its broader judgement to carefully assess payouts. From 2016, to better align AIP outcomes with shareholders' experience, we will assess financial performance using profit before tax, as opposed to ongoing operating profit. Consequently, we will remove the specific allocation of other financial measures not included in the definition of ongoing operating profit

- We continue to build on the focus on customer measures and will be increasing the allocated AIP weighting for this element from 20% to 25% to reflect this. At the same time, we will increase the range of the specific customer measures taken into account in order to better reflect the focus of the business in the upcoming year
- We are not proposing to change the performance conditions for 2016 awards under the LTIP. The Committee has considered the current targets, and has determined that the levels of TSR performance (upper quintile) and RoTE performance required for full vesting, as increased in 2015, remain stretching

Separately to the executive share plans, we believe it is important for all our employees to have the opportunity to become shareholders in the Company. We run a Buy-As-You-Earn Share Incentive Plan (the "**SIP**") which allows employees to receive one matching share for every two shares they purchase. In addition, to recognise the continued contribution of our employees to the success of our business, we will be granting a further free share award of around £250 to each eligible employee during March 2016. This award will be the third offer of free shares to employees since the IPO.

Voting on the annual remuneration report

As we are not making any changes to our policy, the policy report will not be put to shareholders until the 2017 AGM. Therefore, the annual report on remuneration will be the only report that we put to an advisory shareholder vote at the AGM on 12 May 2016.

I hope you find this report informative and I welcome any comments you may have.

Finally, on a personal note, this will be my last report as Chair of the Committee as I step down from the Board on 1 March. I hope that you will agree that the work of the Committee, which I have chaired since IPO, has struck an appropriate balance and served well the interests of shareholders. I know that my successor, Clare Thompson, will continue to do so.

Priscilla Vacassin
Chair of the Remuneration Committee

Executive remuneration snapshot

The information in this section relates to the Chief Executive Officer ("**CEO**") and the Chief Financial Officer ("**CFO**").

Implementing the remuneration policy in 2016

Key elements	Key operation features (For more information, see the policy report on pages 86 to 95)	Implementation in 2016
Base salary	• Reviewed annually with any increases taking effect on 1 April • The Committee considers all factors including market data	• 2.5% salary increase for the CEO to £794,600. 2.5% salary increase for the CFO to £480,900
AIP	• Maximum opportunity level is 175% of salary for the CEO and 150% for the CFO • 40% of the award is deferred into shares, typically vesting after three years • At least 50% of bonus is based on financial measures. The Committee considers various non-financial and individual performance measures. It bases its judgement over the payment outcome at the end of the performance period on its assessment of the level of stretch inherent in targets • Any payment is subject to an additional gateway assessment • Malus and clawback conditions apply	• Reported profit before tax replaces ongoing operating profit as primary and sole financial measure accounting for 55% of the total AIP outcome • The weighting allocated to the basket of customer measures has been revised upwards from 20% to 25% in line with the Company's strategic objectives and the number of measures has been broadened
LTIP	• Awards typically granted as nil-cost options • Plan allows for awards with a maximum value of 200% of base salary per financial year • Awards typically granted every six months at half the annual level • Performance is measured over three years and determined by RoTE and relative TSR measures • Awards vest subject to financial underpin and risk gateway • Malus and clawback conditions apply	• Nil-cost options to be granted in March and August 2016 at a total annual grant level of 200% of salary • Performance conditions as per 2015 awards

2015 pay decisions reflect performance achieved during the year

Aligning performance and reward

The Committee has considered the performance over 2015, as demonstrated by the achievement of key performance indicators on pages 24 to 25, which marks the third year of good performance for the Group. As a result of this performance, the Remuneration Committee has approved the following incentive outcomes for the Executive Directors.

Achievement under the AIP

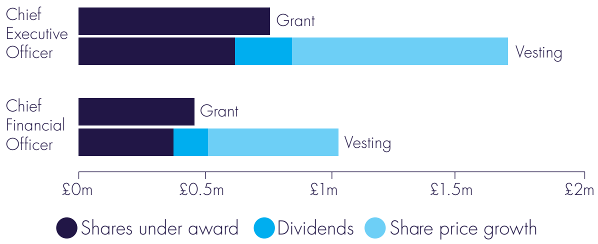
The actual payouts from the AIP this year reflect performance in 2015, with operating profit from ongoing operations ahead of the target set under the AIP, the progress made towards achieving our strategic objectives and the Executives' achievement of personal and shared goals. Further details of the assessment of performance against the targets are provided on page 78.

	Maximum (% of salary)	Target (% of salary)	Actual (% of salary)	Actual (£'000)
Chief Executive Officer	175%	105%	145%	£1,120
Chief Financial Officer	150%	90%	129%	£602

Release of value under the LTIP

The first award under the 2012 LTIP vested in November 2015. The value of the award on vesting, as illustrated below, reflects the significant value generated for shareholders through share price growth and dividends over the three-year period. The value of these awards has been captured across both 2014 and 2015 single figures for the RoTE and TSR elements respectively on page 77 of the implementation report. The total value of the award vesting at the end of the three-year performance period in November 2015, inclusive of shares vesting under both the RoTE and TSR elements, was £1,706,857 to Paul Geddes and £1,033,095 to John Reizenstein. This compares with an increase in the value of the Company of over £2.5 billion plus £1.3 billion returned to shareholders by way of dividends over the same time period.

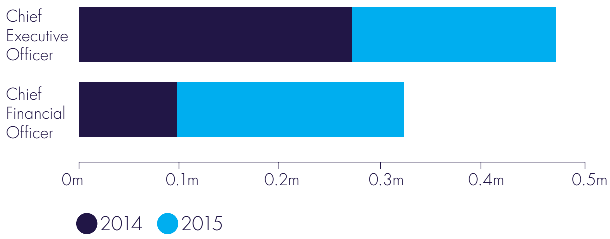
Release of value under the LTIP
(£)



Executive Directors' shareholding at year end

The interests of shareholders and Executive Directors are closely aligned through the Chief Executive Officer and Chief Financial Officer holding Company shares at multiples of salary levels above the share ownership guidelines of 200% of salary. The Executives continue to build on these shareholdings as illustrated below. As at 31 December 2015, the number of shares beneficially held by the Chief Executive Officer and the Chief Financial Officer represented 249% and 280% of their salaries, respectively.

Executive Directors' shareholding at year end
(Number of shares)



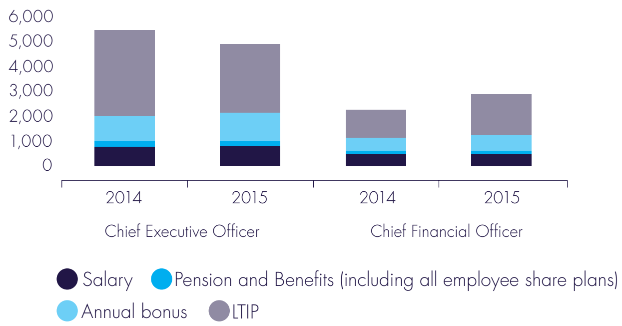
Note:

1. Shares held as at 31 December 2015 reflect the impact of the share consolidation on 30 June 2015 in which every 12 existing Ordinary Shares were replaced by 11 new Ordinary Shares, meaning the aggregate number of Ordinary Shares in issue was reduced. For the purposes of this chart, holdings include all vested but unexercised awards, valued on a basis that is net of applicable personal taxes.

Executive Directors' total pay – explained further in the single figure table on page 77

This chart illustrates the components of total remuneration received in 2014 and 2015, as set out in further detail in the single figure table on page 77. Salaries increased by 2% in 2015, which was the first increase since the Executive Directors' salaries were set in September 2012. The annual bonus payouts in 2015 were 83% and 86% of the maximum potential for Paul Geddes and John Reizenstein, respectively. As disclosed in the 2014 remuneration report, the single figure of remuneration for 2014 included the vesting outcomes of the last legacy awards under the RBS Group LTIP.

Executive Directors' total pay
(£'000)



Introduction

We have prepared this remuneration report in accordance with the requirements of the Companies Act 2006 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended) (the "**Regulations**"). The report also meets the relevant requirements of the Listing Rules of the Financial Conduct Authority, and describes how the Board has complied with the principles and provisions of the UK Corporate Governance Code relating to remuneration matters. Remuneration tables subject to audit in accordance with the relevant statutory requirements are contained in the annual remuneration report.

Annual remuneration report

Remuneration Committee members and governance

The following list details members of the Remuneration Committee during 2015. You can find information about each member's attendance at meetings in the Remuneration Committee report on page 68. You can find their biographies on pages 48 to 49.

Committee Chair
Priscilla Vacassin
Non-Executive Directors
Mike Biggs
Sebastian James
Andrew Palmer

Advisers to the Committee

The Committee consults with the Chief Executive Officer, the Human Resources Director, and senior representatives of the HR, Risk and Finance functions on matters relating to the appropriateness of all remuneration elements for Executive Directors and Executive Committee members. The Chairman, Chief Executive Officer and the Human Resources Director are not present when their remuneration is discussed. The Committee works closely with the Chairs of the Board Risk Committee and the Audit Committee, including receiving reports from those Chairs regarding the setting of targets and payouts under incentive plans and whether it is appropriate to operate malus and clawback. The Chair of the Audit Committee is a member of the Remuneration Committee; and the Chair of the Board Risk Committee attended Remuneration Committee meetings on three occasions.

The Committee retains FIT Remuneration Consultants LLP ("**FIT**") as its independent adviser. FIT is a signatory to the Remuneration Consultants Group's Code of Conduct. The Committee appointed FIT when preparing for the IPO and after considering the firm's experience in this sector.

During the year, FIT advised on market practice, corporate governance, incentive plan design and target setting, regulations, and other matters that the Committee was considering. FIT does not provide the Company with any other services. The Committee is satisfied that the advice FIT provides is objective and independent.

FIT's total fees for remuneration related advice in 2015 were £117,406 exclusive of VAT. FIT charged its fees based on its standard terms of business for providing advice.

Allen & Overy LLP, one of the Group's legal advisers, also provided legal advice relating to the Group's executive remuneration arrangements. It also provided the Group with other legal services.

Statement of policy implementation in 2016

Executive Directors' salaries in 2016

The salary increase awarded to the Executive Directors, effective 1 April 2016, is lower than the average increase awarded to UK employees.

Director	Position	2016 base salary £'000	2015 base salary £'000	Annual change in base salary
Paul Geddes	Chief Executive Officer	795	775	2.5%
John Reizenstein	Chief Financial Officer	481	469	2.5%

Annual Incentive Plan 2016

The maximum annual incentive awards which may be paid to Executive Directors have not changed since the IPO.

Director	Position	Maximum annual incentive award for 2016 (% base salary)	Deferred under the Deferred Annual Incentive Plan (% bonus)
Paul Geddes	Chief Executive Officer	175%	40%
John Reizenstein	Chief Financial Officer	150%	40%

During 2015, the Committee reviewed the AIP performance measures' weightings and composition. It also reviewed the overall framework's operation to make sure it is still fit for purpose. The review concluded that, whilst the framework successfully linked Executive Directors' variable pay with the Group's performance, in order to further align the Executive Directors' interests with those of shareholders and the objectives of the business, the Committee would implement the following changes in 2016:

- To further align Executive Directors with shareholders, profit before tax will replace ongoing operating profit as the primary financial measure and will account for 55% of the total AIP outcome, increased from 50%
- As a result of measuring profit before tax, the Committee decided it was no longer necessary to apply a specific weighting to other profit & loss items not reflected in the definition of ongoing operating profit and the allocation of a specific weighting to this element will, therefore, be removed. The Committee will instead consider this in determining the overall level of payouts in its exercise of judgement
- The weighting allocated to the basket of customer measures will be increased from 20% to 25% in line with the Company's strategic objectives

	Measures	Weighting for 2016	Weighting for 2015
Financial	Profit before tax (2015: ongoing operating profit)	55%	50%
	Other financial measures not reflected in the definition of ongoing operating profit, primarily the performance of the Run-off segment and restructuring costs	0%	10%
Strategic	Based on a basket of customer measures, including Net Promoter Score and complaints	25%	20%
Personal	Objectives for each Executive Director, including shared objectives across the Executive Committee	20%	20%

Like previous years, all AIP outcomes will be determined after the Committee determines a payment gateway. To do this, the Committee must be satisfied that it is appropriate to permit a bonus award at all, or at a given level. The gateway involves some subjectivity about performance. This may result in positive or negative moderation of each AIP performance measure or the overall bonus outcome.

The list below sets out the gateway criteria for the AIP for 2016. There are more criteria than previously. This ensures the Committee considers a broader range of criteria when judging the level of AIP payments.

Gateway criteria for the Annual Incentive Plan for 2016 – outcomes for Executive Directors

- Year-on-year changes in profit before tax
- Quality and sustainability of earnings, referring to reserving, gross written premium, costs and loss ratio, and relevant lead indicators
- Additional customer context, for example, conduct, experience, brand and franchise health
- Capital strength and affordability
- Risk management within risk appetite
- The Group's relative performance to that of its peers
- The wider economic environment
- Exceptional events, such as abnormal weather
- Any regulatory breaches and/or reputational damage to the Group
- Committee satisfaction that paying the bonus does not cause major reputational concerns

The Committee may also use its discretion to account for additional factors. These include the quality of financial results; the 'direction of travel' of all measures; more widely considering reputation, risk, and audit.

In considering such factors, and whether to adjust the overall payouts and/or operate malus and clawback, the Committee receives appropriate input from the Audit Committee and the Board Risk Committee through receiving reports from and discussion with the Chairs of those Committees.

Performance conditions for LTIP awards

LTIP awards granted in 2016 will continue to be subject to performance against these performance conditions:

- 60% based on RoTE over a three-year performance period (2016, 2017 and 2018)
- 40% based on relative TSR performance against the constituents of the FTSE 350 (excluding investment trusts) over a three-year performance period, starting on the date of grant. The starting and closing TSR will be averaged over a three-month period

For these purposes, we use the Group's standard definition for RoTE, subject to such other adjustments as the Committee may consider appropriate. To find out more about how we calculate RoTE, see page 175.

The Committee reviewed the performance targets and, in line with its commitment to ensure that awards to Executive Directors would only be payable if significant value has been created for shareholders, decided that there should be no change to targets for 2016 as they remain appropriately stretching following their increase in 2015.

		Performance required for threshold vesting		Performance required for maximum vesting	
Performance measure	Vesting for threshold performance	Awards in 2015 and 2016	Awards in 2013 and 2014	Awards in 2015 and 2016	Awards in 2013 and 2014
RoTE	20% of this element of the award	Average annual RoTE performance of 14.5%	Average annual RoTE performance of 14.0%	Average annual RoTE performance of 17.5%	Average annual RoTE performance of 17.0%
Relative TSR	20% of this element of the award	Median		Upper quintile	

For the TSR element, there is a straight-line interpolation between threshold and maximum performance, on a ranked basis. For the RoTE element, 40% of the award will vest for RoTE of 15.5% for awards to be made in 2016 (which remains unchanged from 2015). Otherwise, vesting is similar to TSR: a straight-line interpolation occurs from threshold to target, then from target to maximum performance.

The LTIP awards will also vest only to the extent that the Committee is satisfied that the outcome of the TSR and RoTE performance conditions reflects the Group's underlying financial performance from the date of grant until vesting. When considering these matters, the Committee will also deliberate on whether there have been any material risk failings.

Pension and benefits

A pension contribution of 25% of base salary will continue to be paid to both Executive Directors in 2016.

Benefits comprise providing a company car or car allowance, private medical insurance, life assurance, income protection and health screening. Like all employees, the Executive Directors are also eligible for certain discounted Group products.

Non-Executive Directors' fees

The current fees for the Chairman and Non-Executive Directors were set in 2012 and have not changed since.

Position	Fees for 2016 £'000
Board Chairman fee	400
Basic Non-Executive Director fee	70
Additional fees	
Senior Independent Director fee	30
Chair of Audit, Board Risk and Remuneration Committees	30
Chair of CSR Committee	10
Member of Board Committee (Audit, Board Risk or Remuneration)	10
Member of Board Committee (CSR or Nomination)	5

No additional fees are paid for membership or chairmanship of the Investment Committee.

External directorships

The Company encourages Executive Directors to accept, subject to the Chairman's approval, an invitation to join another company's board outside the Group in a non-executive capacity. This recognises that such wider experience is valuable. Executive Directors can retain any remuneration from their non-executive appointment. Executive Directors are generally limited to accepting one external directorship.

John Reizenstein is a trustee and Director of Farm Africa, for which he receives no fees. Otherwise, the Executive Directors do not currently hold any external directorships.

Implementing policy and pay outcomes relating to 2015 performance

Single figure table (audited)

	Salary[1]		Benefits[2]		Annual bonus[3]		Long-term incentives[4,5,6,7]		All employee share plans[8]		Pension		Total	
£'000	2015	2014	2015	2014	2015	2014	2015	2014	2015	2014	2015	2014	2015	2014
Paul Geddes	771	760	18	17	1,120	1,000	2,712	3,389	–	–	193	190	4,815	5,356
John Reizenstein	467	460	15	15	602	518	1,642	1,118	1	1	117	115	2,844	2,227

Notes:

1. The Company operates a flexible benefits policy and salary is reported before any personal elections are made.
2. Benefits include a company car or allowance; private medical and income protection insurance.
3. Includes amounts earned for performance during the year, but deferred for three years under the Deferred Annual Incentive Plan ("DAIP"). For more information, see page 83. These deferred awards are not subject to any conditions, except continuous employment. However, awards remain available for malus and clawback.
4. The expected vesting outcome figures for the RBS Group LTIP awards granted in 2012 and reported in 2014 have been updated. These updates are based on the actual vesting share price of £3.39806 on 9 March 2015, compared to the three-month average share price of £2.828 used in reporting this figure in the 2014 remuneration report. This results in an adjusted reportable increase of approximately £408,958 for Paul Geddes and £92,016 for John Reizenstein, with a corresponding increase to the single figure for 2014 reflected in the table above.
5. The expected vesting outcome figures for the RoTE portion of the awards granted under the Direct Line Group LTIP in 2012 and reported in 2014 have also been updated. These updates are based on the actual vesting of the RoTE portion of the awards and a share price of £3.944 on 9 November 2015, compared to the three-month average share price of £2.828 used in reporting this figure in the 2014 remuneration report. The revised figures reflect the impact of the share consolidation on 30 June 2015 and actual number of dividends accrued on this portion of the award at vesting. This results in an adjusted reportable increase of approximately £323,814 for Paul Geddes and £195,998 for John Reizenstein, with a corresponding increase of the single figure for 2014 reflected in the table above.
6. The long-term incentive figures for 2015 include the estimated vesting outcome for the RoTE portion of the awards made under the Direct Line Group LTIP in March and August 2013 as the performance period under this element is now complete. In line with the criteria set at the time of grant, this has been assessed by referring to RoTE performance during 2013, 2014 and 2015 in respect of 56.4% of the shares under award (being a 94% vesting outcome of shares relating to the RoTE element). For these purposes, an RoTE figure of 17.6% has been used, including the impact of the International division during 2015 until the completion of its sale in May 2015. Had the RoTE figure of 18.5% from ongoing operations been used for the purposes of determining LTIP vesting, then full vesting under the RoTE element would have been achieved. The corresponding values under long-term incentives, including the value of dividends accrued to 31 December 2015, are £1,947,016 for Paul Geddes and £1,178,450 for John Reizenstein based on a three-month average Company share price to 31 December 2015 of £3.97283. Any shares vesting under the Direct Line Group LTIP granted in 2013 will not be delivered until the end of the applicable vesting periods in March and August 2016.
7. The long-term incentive figures for 2015 reflect the actual vesting under the TSR element of awards made under the Direct Line Group LTIP in November 2012. In line with the criteria set at the time of grant, this has been assessed by referring to TSR performance to the end of the performance period of 15 October 2015. A total of 40% of the shares under award (being the maximum number of shares relating to the TSR element) vested. The corresponding values under long-term incentives, including the value of dividends on vesting, are £765,407 for Paul Geddes and £463,271 for John Reizenstein using the share price on 9 November 2015 of £3.944.
8. Includes the value of matching shares under the SIP.

Each Executive Director has confirmed that they have not received any other items in the nature of remuneration, other than those already disclosed in the single figure table.

Annual Incentive Plan outcomes for 2015

The Committee established target performance levels at the start of the year. However, like last year, the Committee did not set a formal threshold to maximum range for performance measures. Instead, the Committee believed it more appropriate to carefully consider performance relative to AIP targets and to assess over or underperformance by judging overall corporate performance at the year-end.

To be transparent with our shareholders, we are disclosing more information this year about bonus payout levels. As such, in the table below, we have included the remuneration targets set at the beginning of the year and performance achieved under the financial measures. We have also explained the performance achieved against the non-financial measures which remain commercially sensitive to disclose.

The chart below illustrates the Committee's assessment of the level of achievement under the AIP. The outcomes reflect strong performance during the year, particularly in terms of the financial measures, as highlighted in the Group highlights and Chairman's statement on pages 2 to 3 and 10 to 11 respectively. Notwithstanding this success, the Committee felt that it was appropriate, within the wider economic context and our continued ambitions for improvement, to moderate the achievement under the AIP by 4.4% for each Executive Director, from 87.4% to 83% for Paul Geddes and from 90.4% to 86% for John Reizenstein, as illustrated in the chart below.

Measures			Weight (as a % of max award)	Target performance (£m)	Actual performance (£m)	Performance Assessment	Achievement against performance measures (0% Vesting; Target 60% Vesting; Maximum 100% Vesting)
Financial	Ongoing operating profit		50%	462.8	520.7	Maximum	100%
	Other financial measures not reflected in the definition of ongoing operating profit[1]		10%	-100.1	-91.5	Above target	94%
Strategic	A basket of key customer measures		20%	See narrative		Above target	75%
Personal	Personal objectives including shared objectives amongst all Executive Committee members	Paul Geddes	20%	See narrative		Above target	65%
		John Reizenstein	20%	See narrative		Above target	80%

Director	Unadjusted achievement under the 2015 AIP	Adjusted achievement under the 2015 AIP
Paul Geddes	87.4% of maximum	83% of maximum
John Reizenstein	90.4% of maximum	86% of maximum

Note:
1. Profit and loss items excluded from ongoing operating profit, primarily the performance of the Run-off segment and restructuring costs and other one-off costs.

Financial element (60% weighting)

While there is no pre-set scale around target, the Committee used a range of 90-110% of target as an initial reference point to consider vesting levels for the financial measures. The Committee will consider the appropriate range each year and as such this scale may not be used in subsequent years. Having considered the actual results against these reference points, the Committee agreed that the level of performance warranted the level of payouts shown in the chart above.

Strategic element (20% weighting)

As described elsewhere in this Annual Report, during 2015 we have continued to invest in improved customer propositions and on improving the customer experience and reducing complaints. This has contributed to an increase in Net Promoter Scores across a number of measures, as well as a reduction in complaints. Overall, a strong performance on the basket of customer measures considered by the Committee has led to an above target payout of 75% of the maximum available under this element.

Personal element (20% weighting)

This element focuses on the individual's personal objectives as well as shared objectives with other Executive Committee members, set by the Remuneration Committee. Both Executives demonstrated strong leadership on various strategic initiatives during the year. As outlined in the Board Chairman's letter on pages 10 to 11, during 2015 the Group progressed on delivering its strategic objectives and building future capability in line with its mission. These objectives also form part of the Executives' personal and shared objectives and, in acknowledgement of progress made during the year, the Committee determined that Paul Geddes and John Reizenstein should each receive awards ahead of an on-target level of performance, of 65% and 80% of the maximum available under this element, respectively. In determining the level of personal achievement for the Chief Financial Officer, the Committee was particularly mindful to recognise the successful completion of the sale of the International business during 2015, in which he played a key role. Whilst the agreement was substantially complete in 2014, the Committee decided to wait until all regulatory approvals had been received during 2015 before recognising this exceptional personal performance.

We anticipate including similar disclosures next year in respect of the 2016 AIP outcome which, consistent with market practice, are not included on a prospective basis on the basis of commercial sensitivity.

Consequently, the annual incentive awards for Executive Directors for the financial year ended 31 December 2015 were as follows:

	Maximum (% of salary)	Target (% of salary)	Actual (% of salary)	Actual £'000 (including cash and deferred elements)
Paul Geddes, CEO	175%	105%	145%	1,120
John Reizenstein, CFO	150%	90%	129%	602

Non-Executive Directors

Fees were the only remuneration paid to Non-Executive Directors in 2014 and 2015. Non-Executive Directors may also claim for reasonable travel and subsistence expenses, in accordance with the Group's travel and expenses policy, and, where these are classified as taxable by HMRC, they have been shown under Benefits below. The Non-Executive Directors receive no other benefits.

Director	2015 Fees[1] £'000	2015 Benefits[2] £'000	Total 2015 £'000	2014 Fees £'000	2014 Benefits £'000	Total 2014 £'000
Michael Biggs	400	4	404	400	4	404
Glyn Jones[3]	42	–	42	115	–	115
Jane Hanson	115	22	137	119	24	143
Sebastian James	85	–	85	28	–	28
Andrew Palmer[4]	144	–	144	125	–	125
Clare Thompson	100	–	100	104	–	104
Priscilla Vacassin[5]	113	–	113	110	–	110

Notes:

1. Non-Executive Directors are not eligible to participate in any of the Group's bonus or share incentive schemes, or to join any Group pension scheme.
2. The values shown under benefits above comprise the value of travel and subsistence expenses reimbursed by the Company (including any potential gross-up for tax and NIC due). Similar amounts of taxable benefits have also been identified in respect of the 2012 and 2013 financial years of £4,031 for Mike Biggs and £35,516 for Jane Hanson which have not previously been included in the respective accounts but are noted here following HMRC's clarification of the Directors' permanent place of employment for tax purposes issued in 2015.
3. Glyn Jones stepped down from the Board on 13 May 2015.
4. Andrew Palmer was appointed as the Senior Independent Director with effect from 13 May 2015.
5. Priscilla Vacassin was appointed to the Nomination Committee with effect from 13 May 2015.

Percentage change in Chief Executive Officer's pay for 2014 to 2015

The table below shows the Chief Executive's year-on-year percentage change in salary, taxable benefits and bonus, compared to the average pay for all other UK employees.

	Salary[1]	Benefits[2]	Bonus (including deferred amount)[3]
Chief Executive Officer	2%	5%	12%
All UK employees	3.6%	11%	8%

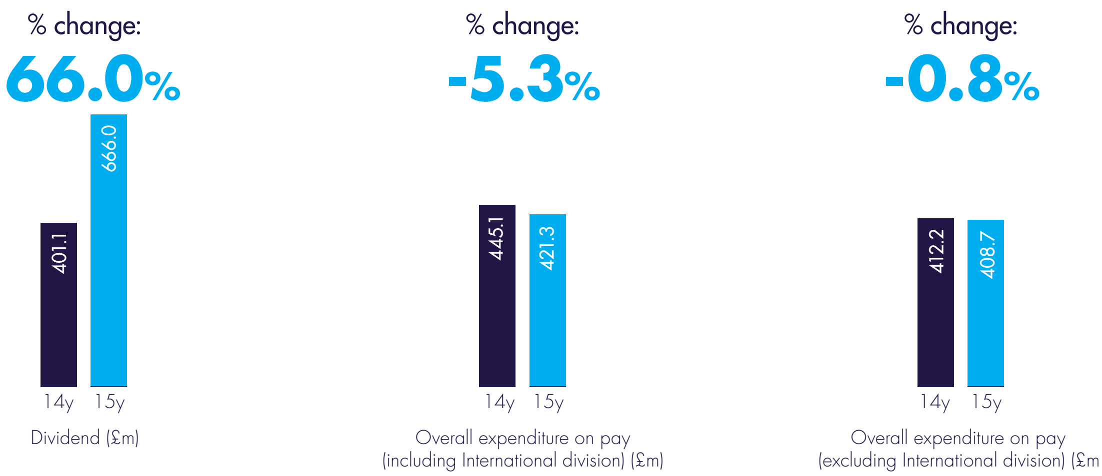
Notes:

1. Based on the change in average pay for UK employees employed in the year ended 31 December 2015 and the year ended 31 December 2014. Salaries are not adjusted for number of working hours and the increase therefore partly reflects the increase in working hours for some employees during the year.
2. There were no changes in benefits provision between 2014 and 2015. The value increase shown above for all employees is mainly due to an increase in the average value of matching shares provided to employees taking part in the BAYE plan over this period.
3. Includes average amounts earned under the AIP and, for employees other than the Chief Executive Officer, other variable incentive schemes, including monthly and quarterly incentive schemes operated in certain parts of the Group.

When determining Directors' remuneration, the Committee considers employment conditions elsewhere in the Group. The Committee particularly reviews overall pay and bonus decisions in aggregate for the wider Group. Through the Chief Executive Officer and the HR Director the Committee may, as required, consider input from employee groups, such as the Employee Representative Body.

Distribution statement

This chart shows the overall pay expenditure across all Group employees compared with the total dividend value paid to shareholders for 2014 and 2015.



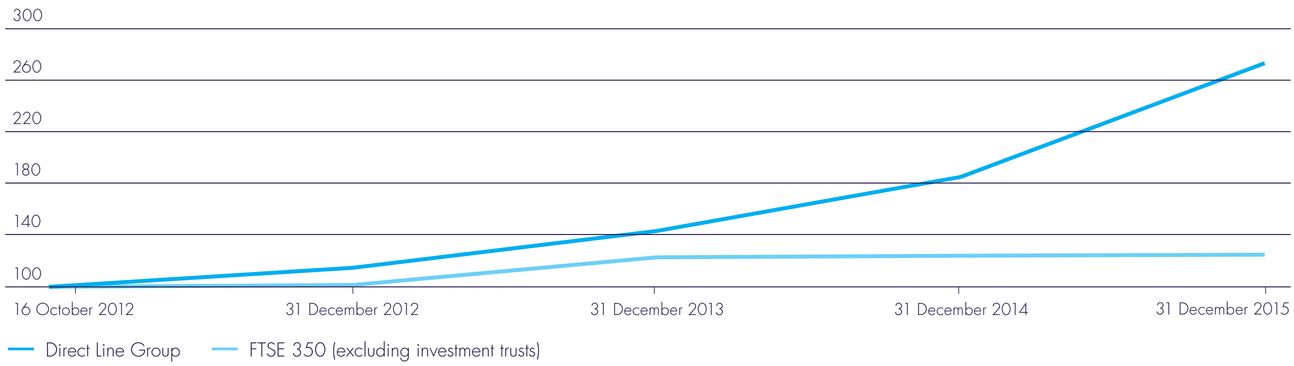
Note:

There have been no share buy-backs since the IPO. The overall expenditure on pay has been taken from note 11 to the consolidated financial statements. Therefore, consistent with market practice, it has not been calculated in a manner consistent with the single figure in this report.

Historical performance of Total Shareholder Return

This graph shows the Company's TSR since the Company's shares began trading on the London Stock Exchange in October 2012 against the FTSE 350 Index (excluding investment trusts) over the same period. This peer group is the same used for measuring relative TSR under the LTIP.

Total Shareholder Return



The table below shows historical levels of the Chief Executive Officer's pay between 2012 and 2015. It also shows vesting of annual and long-term incentive pay awards as a percentage of the maximum available opportunity.

Chief Executive Officer	Single figure of total remuneration £'000	Annual bonus payout (% of maximum)	Long-term incentive vesting (% of maximum)[1]
2015	4,815	83%	96%
2014[2]	5,356	75%	88%
2013	2,536	63%	55%
2012	1,908	65%	30%

Notes:

1. Based on actual vesting under the 2010, 2011 and 2012 RBS Group LTIP. The value included in the single figures in respect of these awards is £205,000 in 2012, £728,000 in 2013 and £2,437,428 in 2014.
2. The 2014 single figure has been revised to reflect the actual vesting of the 2014 awards under the 2012 RBS Group LTIP and actual vesting under the RoTE element of the Direct Line Group LTIP granted in 2012. For 2015, the estimated vesting of the RoTE portion of the Direct Line Group LTIP granted in March and August 2013 has also been included at a value of £1,947,016. The vesting under the RoTE element of these awards has been calculated with reference to an adjusted 2015 RoTE of 17.6% as opposed to 18.5% in order to reflect the impact of the International division during 2015. Any shares vesting under the Direct Line Group LTIP granted in 2013 will not be delivered until the end of the applicable vesting periods in March and August 2016. However, they have been included in the single figure, as the performance period in respect of the RoTE portion has now been completed.

Annual General Meeting voting outcomes

The table shows the percentage of shareholders voting for or against, and the percentage of votes withheld in relation to the resolution to approve the Directors' annual remuneration report, which was put to the 2015 AGM and the resolution to approve the Directors' remuneration policy, which was put to the 2014 AGM.

	For		Against			
	Number	Percentage	Number	Percentage	Number of votes withheld (abstentions)	Percentage of votes withheld (abstentions)
Approval of Directors' remuneration report (2015)	1,108,103,256	96.2%	44,283,445	3.8%	9,502,728	0.8%
Approval of Directors' remuneration policy (2014)	1,064,002,114	97.5%	26,743,783	2.5%	1,945,618	0.2%

Note:

The percentages of votes for and against are expressed as a percentage of votes cast, excluding votes withheld. The percentage of votes withheld is expressed as a percentage of total votes cast, including votes withheld.

The Committee is grateful for the strong vote in favour of the Directors' annual remuneration report in 2015. The Committee continues to communicate with investors on developments in the remuneration aspects of corporate governance generally and changes to the Company's executive pay arrangements in particular.

Shareholdings

This table sets out the share ownership guidelines and share ownership levels:

Position	Share ownership guideline[1] (% of salary)	Value of shares held at 31 December 2015[2,3] (% of salary)
Chief Executive Officer	200%	249%
Chief Financial Officer	200%	280%

Notes:

1. Executive Directors are expected to retain all the Ordinary Shares they obtain from any of the Company's share incentive plans until they achieve a shareholding level that is equal to 200% of base salary. This is calculated after any disposals necessary to pay personal taxes on acquiring such Ordinary Shares.
2. For these purposes, holding Ordinary Shares will be treated as including all vested but unexercised awards, valued on a basis that is net of applicable personal taxes.
3. Shares held as at 31 December 2015 reflect the impact of the share consolidation on 30 June 2015 in which every 12 existing Ordinary Shares were replaced by 11 new Ordinary Shares, meaning the aggregate number of Ordinary Shares in issue was reduced.

This table shows each Executive Director's total share interests.

	Share plan interests at 31 December 2015				Beneficial share interests[1]		
Director	Share plan awards subject to performance conditions[2]	Share plan awards not subject to performance conditions[3]	Share plan interests vested but unexercised	Share plan interests exercised or released[4,5]	Shares held at 31 December 2015[6,7]	Shares held at 31 December 2014 restated for share consolidation	Shares held at 31 December 2014
Paul Geddes	1,626,495	271,453	–	1,201,133	474,255	248,849	271,472
John Reizenstein	984,454	183,541	261,941	161,392	183,496	89,231	97,352

Notes:

1. Shares held as at 31 December 2014 have been restated to reflect the impact of the share consolidation on 30 June 2015 in which every 12 existing Ordinary Shares were replaced by 11 new Ordinary Shares, meaning the aggregate number of Ordinary Shares in issue was reduced. These figures have been provided to facilitate a like-for-like comparison with shares held as at 31 December 2015.
2. This includes awards under the Direct Line Group LTIP. As described in the notes to the single figure table, 94% of awards made under the Direct Line Group LTIP in March and August 2013 that are subject to the RoTE performance condition measured to 31 December 2015 are expected to vest. This has been calculated with reference to an adjusted 2015 RoTE of 17.6% as opposed to 18.5% in order to reflect the impact of the International division during 2015. The corresponding values under long-term incentives, including the value of dividends accrued to 31 December 2015, are £1,947,016 for Paul Geddes and £1,178,450 for John Reizenstein based on a three-month average Company share price to 31 December 2015. These shares will be delivered to Executive Directors in March and August 2016.
3. Includes matching shares held under the SIP which are subject to forfeiture and deferred shares under the Direct Line Group DAIP. For more information, see page 85.
4. 20% of the shares awarded to Paul Geddes under the Direct Line Group DAIP in March 2013 vested during the financial year. This is consistent with the policy at RBS Group. These vesting shares and related dividend accrual shares were exercised by Paul Geddes on 30 March 2015 (51,060 shares at £3.233949). Additionally, under the RBS Group LTIP 2012, 717,300 shares vested to Paul Geddes and 161,392 shares vested to John Reizenstein on 9 March 2015 (share price £3.39806).
5. Paul Geddes exercised an award granted on 7 November 2012 under the Direct Line Group LTIP on 9 November 2015 as shown on page 84 (432,773 shares). The Direct Line Group DAIP and LTIP plan rules provide that all dividends accruing in the vesting period (or until exercise for awards made in 2012 and 2013) will be added on vesting. The figure of exercised shares accordingly includes all dividends that were accrued in respect of the 2012 LTIP awards.
6. Includes holdings of connected persons, as defined in section 96B(2) of the Financial Services and Markets Act 2000, and free and partnership shares held under the SIP which are not subject to forfeiture and considered beneficially owned.
7. Beneficial share interests include partnership shares John Reizenstein purchased under the SIP and free shares held by both Executive Directors under the SIP. At 9 March 2016, the number of shares beneficially held by John Reizenstein has increased to 183,575. There was no change to the number of shares held by Paul Geddes.

The table shows the Non-Executive Directors' beneficial interests in the Company's shares.

Director	Shares held at 31 December 2015[1,2,3]	Shares held at 31 December 2014 restated for share consolidation[4]	Shares held at 31 December 2014
Mike Biggs	–	–	–
Jane Hanson	26,190	26,190	28,571
Glyn Jones[3]	70,159	61,921	67,551
Andrew Palmer	10,475	10,475	11,428
Clare Thompson	35,220	30,960	33,775
Priscilla Vacassin	35,220	30,960	33,775
Sebastian James	–	–	–

Notes:

1. There were no changes to the number of shares held by Directors between the year end and the date of this report.
2. Includes holdings of connected persons, as defined in section 96B(2) of the Financial Services and Markets Act 2000.
3. Glyn Jones stepped down from the Board on 13 May 2015 and this represents his holding at that date.
4. Shares held as at 31 December 2015 reflect the impact of the share consolidation on 30 June 2015 in which every 12 existing Ordinary Shares were replaced by 11 new Ordinary Shares, meaning the aggregate number of Ordinary Shares in issue was reduced.

Direct Line Group share awards

Direct Line Group Deferred Annual Incentive Plan awards made in 2015

This table details the awards made to Paul Geddes and John Reizenstein under the Direct Line Group DAIP relating to the bonus in respect of 2014.

Grant date	Three-day average share price for grant of awards £	Face value of award £	No. of share options as at 1 January 2015	No. of share options granted during the year[1]	No. of share options vested during the year[2]	No. of share options adjusted for share consolidation[3]	No. of dividend shares acquired at vesting	No. of share options exercised[4]	No. of share options held at 31 December 2015	Vesting date
Paul Geddes										
28-Mar-13	2.0157	380,004	81,406	–	37,704	3,143	7,359	51,060	34,562	1-Jun-13 to 28-Mar-16
26-Mar-14	2.433667	333,999	137,241	–	–	11,437	–	–	125,804	26-Mar-17
25-Mar-15	3.3007	400,000		121,186	–	10,099	–	–	111,087	25-Mar-18
			218,647	**121,186**	**37,704**	**24,679**	**7,359**	**51,060**	**271,453**	
John Reizenstein										
28-Mar-13	2.0157	137,999	68,462	–	–	5,706	–	–	62,756	28-Mar-16
26-Mar-14	2.433667	166,000	68,210	–	–	5,685	–	–	62,525	26-Mar-17
25-Mar-15	3.3007	207,200		62,774	–	5,232	–	–	57,542	25-Mar-18
			136,672	**62,774**	**–**	**16,623**	**–**	**–**	**182,823**	

Notes:

1. Awards are granted as nil-cost options.
2. The terms on which Paul Geddes' 2012 bonus outcome was deferred meant that 60% of the outcome was deferred, with deferral split broadly evenly between deferral into deferred cash and deferred shares, with phased vestings of the deferred amounts over the three-year deferral period.
3. Awards adjusted on 30 June 2015 as a result of the share consolidation in which every 12 existing Ordinary Shares were replaced by 11 new Ordinary Shares.
4. Exercised on 30 March 2015 at £3.233949, resulting in an aggregate gain of £165,125.

Direct Line Group Long-Term Incentive Plan awards made in 2015

This table details the Directors' interests in the Company's LTIP. For all LTIP awards, 20% of the awards granted would vest if the minimum performance was achieved

Grant date	Three-day average share price for grant of awards £	Face value of award £	No. of options at 1 January 2015[1]	No. of options granted during the year[2]	No. of options vested during the year[3]	No. of options lapsed for performance[4]	No. of options adjusted for share consolidation[5]	No. of dividend shares acquired at vesting	No. of options exercised	No. of options held at 31 December 2015	Vesting date
Paul Geddes											
07-Nov-12	1.96	760,000	388,250	–	317,458	38,437	32,355	115,315	432,773	–	09-Nov-15
28-Mar-13	2.0157	760,000	377,040	–	–	–	31,420	–	-	345,620	28-Mar-16
28-Aug-13	2.1564	759,999	352,439	–	–	–	29,370	–	-	323,069	28-Aug-16
26-Mar-14	2.433667	759,998	312,285	–	–	–	26,024	–	-	286,261	26-Mar-17
29-Aug-14	2.9020	759,999	261,888	–	–	–	21,824	–	-	240,064	29-Aug-17
25-Mar-15	3.3007	760,000	–	230,254	–	–	19,188	–	-	211,066	25-Mar-18
26-Aug-15	3.517	775,200	–	220,415	–	–	–	–	-	220,415	26-Aug-18
			1,691,902	**450,669**	**317,458**	**38,437**	**160,181**	**115,315**	**432,773**	**1,626,495**	
John Reizenstein											
07-Nov-12	1.96	460,000	234,993	–	192,145	23,265	19,583	69,796	–	261,941	09-Nov-15
28-Mar-13	2.0157	459,999	228,208	–	–	–	19,018	–	–	209,190	28-Mar-16
28-Aug-13	2.1564	459,999	213,318	–	–	–	17,777	–	–	195,541	28-Aug-16
26-Mar-14	2.433667	460,000	189,015	–	–-	–	15,752	–	–	173,263	26-Mar-17
29-Aug-14	2.9020	459,999	158,511	–	–-	–	13,210	–	–	145,301	29-Aug-17
25-Mar-15	3.3007	460,000	–	139,364	–	–	11,614	–	–	127,750	25-Mar-18
26-Aug-15	3.5170	469,200	–	133,409	–	–	–	–	–	133,409	26-Aug-18
			1,024,045	**272,773**	**192,145**	**23,265**	**96,954**	**69,796**	**–**	**1,246,395**	

Notes:

The Company's share price on 31 December 2015 was £4.075 and the range of prices in the year was £2.903 to £4.143.

1. These awards take the form of nil-cost options over the Company's shares and are subject to performance conditions to be assessed by the Committee. Awards granted before 2014 accrue dividend entitlements until the date of transfer of shares. Awards granted from 2014 accrue dividend entitlement from the grant date to the date on which an award vests.
2. The RoTE targets for awards granted in 2015, applying to 60% of the award, were 14.5% for 20% vesting, 15.5% for 40% vesting and 17.5% for full vesting. A straight-line interpolation occurs from threshold to target, and then from target to maximum performance. The remaining 40% of each award is based on TSR performance conditions, which are the same as noted on page 76.
3. The closing market price on the date of the vesting of the award was £3.944.
4. Awards under the LTIP vested at 89.2% of the maximum potential on 9 November 2015.
5. Awards lapsed on 30 June 2015 as a result of the share consolidation in which every 12 existing Ordinary Shares were replaced by 11 new Ordinary Shares.

The Company's policy is to issue awards twice a year, after the Group announces its full and half-year results. The value of each grant of awards is set at 50% of the normal annual policy level. This means the total combined face value of awards to each Executive Director during the year equates to 200% of their base salary paid in the year.

Direct Line Group 2012 Share Incentive Plan

During 2015, all employees, including Executive Directors, were eligible to invest from £10 to £150 a month from their pre-tax pay into the SIP, and receive one matching share for every two shares they purchased. This table details the number of shares held by John Reizenstein under the SIP. Paul Geddes does not participate in the plan.

Director	Matching shares granted during the year	Matching shares cancelled during the year	Value of matching shares granted[1] £	Balance of matching shares at 31 December 2015[2]
John Reizenstein	240	–	887	718

Notes:

1. The accumulated market value of matching shares at the time of each award. Purchase of the matching shares takes place within 30 days of the contributions being deducted from salary.
2. This balance reflects the impact of the share consolidation on 30 June 2015, in which every 12 existing Ordinary Shares were replaced by 11 new Ordinary Shares.

At the time of the IPO, and under the same terms as other employees, Executive Directors received the opportunity to subscribe for 143 free Company shares, which vested in November 2015, three years from grant. Both Executive Directors subscribed for this offer. They were also eligible to participate in the award of approximately £400 worth of free shares in March 2015. However, both waived their eligibility to this award.

Dilution

The Company complies with the dilution levels that the Investment Association guidelines recommend. These levels are 10% in 10 years for all share plans and 5% in 10 years for discretionary plans. This is consistent with the rules of the Company's share plans.

The Board reviewed and approved this report on 29 February 2016.

Priscilla Vacassin
Chair of the Remuneration Committee

Policy report

A resolution in respect of the Directors' remuneration policy was approved at the Company's AGM on 15 May 2014 by a significant majority (97.5% in favour). No changes to the policy are proposed. For ease of reference, a copy of the policy approved by shareholders is repeated below (subject only to minor referencing updates to assist with the reading of the policy).

Policy table

Element	Purpose and link to strategy	Operation
Base salary	• This is the core element of pay that reflects the individual's role and position within the Group and is payable for doing the expected day-to-day job • Ensuring we are competitive in the market allows us to attract, retain and motivate high calibre executives with the skill sets to achieve our key aims while managing costs	• Base salaries are reviewed annually and set in April of each year, although the Committee may undertake an out-of-cycle review if it determines that this is appropriate • Salaries are typically reviewed against: – level of skill, experience and scope of responsibilities, individual and business performance, economic climate and market conditions; – the median market pay in the context of insurance peers and companies of a similar size, particularly FTSE 31-100 companies being companies which are considered to be reflective of the size and complexity of the Group; and – general base salary movement across the Group. • The Committee does not strictly follow data but uses it as a reference point in considering, in its judgement, the appropriate level having regard to other relevant factors including corporate and individual performance and any changes in an individual's role and responsibilities • The principles for setting base salary are similar to those applied to other employees in the Group, although the specific benchmarking groups used to review external market relativities may differ across employee groups • Base salary is paid monthly
Annual Incentive Plan (the "**AIP**")	• To motivate Executives and incentivise delivery of performance over a one-year operating cycle, focusing on the short to medium-term elements of our strategic aims	• For Executive Directors, at least 40% of the award is deferred into shares under the Deferred Annual Incentive Plan (the "**DAIP**"), typically vesting three years after grant (with deferred awards also capable of being settled in cash). The remainder of the award is paid in cash following year-end • The percentage deferred and the terms of deferral will be kept under review by the Committee to ensure that levels are in line with regulatory requirements and best practice and may be changed in future years but will not, in the view of the Committee, be changed to be less onerous overall • Malus and clawback provisions apply to both the cash and deferred elements and are explained in more detail in the notes to the policy table
2012 Long-Term Incentive Plan (the "**LTIP**")	• To motivate and incentivise delivery of sustained business performance over the long term, aligning Executives' interests with those of shareholders • To aid long-term retention of key executive talent	• Awards will typically be made in the form of nil-cost options or conditional share awards which vest to the extent performance conditions are satisfied over a period of at least three years. Under the Plan rules, awards may also be settled in cash • Vested options will remain exercisable for a period of seven years • Malus and clawback provisions apply to the LTIP and are explained in more detail in the notes to the policy table • Awards under the LTIP may be made at various times during the financial year. While the Committee reserves the right to do otherwise, practice has been to make awards twice in each financial year following the announcement of the Group's annual and half-year results

Maximum opportunity	Performance measures
• The Committee has determined that its policy will be to only set base salaries by reference to the factors set out in the previous column for the duration of this policy. In any event, no increase will be made if it would take an Executive Director's salary above the median level of salaries for relevant roles in the FTSE 100 as determined using data available to the Committee at or shortly prior to when any increase is considered • Where salary increases are awarded, the Committee will have regard to the increase being awarded to employees within the Group more generally, as well as the other factors outlined in this table under 'Operation'	• Not applicable
• Maximum and target bonus levels for Executive Directors are set by reference to practice at other insurance and general market comparators • The maximum bonus level potential under the AIP is 175% of base salary per annum. The current maximum bonus level applying for each individual Executive Director is shown in the 'Statement of policy implementation in 2016' section of the annual remuneration report	• Performance over the financial year is assessed against performance measures which the Committee considers to be appropriate • These may be financial, non-financial (Group, divisional or business line) and individual. Each year, at least 50% of the bonus is based on financial measures. The remainder of the bonus will be based on a combination of non-financial and individual performance measures • Targets are set at the beginning of each financial year by the Committee • No more than 10% of the bonus is paid for threshold performance (30% for the individual performance element). No more than 60% of the maximum opportunity pays out for target performance. However, the Committee retains flexibility to amend the level of payout at different levels of performance for future bonus cycles based on its assessment of the level of stretch inherent in the targets that have been set and will disclose any such determinations appropriately • Before any payment can be made, the Committee will perform an additional gateway assessment to determine whether the amount of any bonus is appropriate in view of such facts or circumstances as the Committee considers relevant. This assessment may result in moderation (either positive or negative) of each AIP performance measure but subject to the individual maximum bonus levels • The AIP remains a discretionary arrangement and the Committee reserves discretion to adjust the out-turn (from zero to the cap) should it consider that to be appropriate. In particular, the Committee will operate this discretion as a gateway in respect of any risk concerns
• The Plan allows for awards over shares with an absolute maximum value of 200% of base salary per financial year (although awards of up to 300% of base salary are permitted in exceptional circumstances in relation to the recruitment or retention of an employee, as determined by the Committee)	• The Committee will determine the performance conditions for each award made under the LTIP, with performance measured over a single period of at least three years with no provision to retest • Performance is measured against targets set at the beginning of the performance period which may be set by reference to the time of grant or financial year • Awards vest based on performance against financial and/or share return measures, as set by the Committee, to be aligned with the long-term strategic objectives of the Group • For awards to be granted in 2016, vesting will continue to be determined based on two measures: RoTE and relative Total Shareholder Return ("**TSR**") performance against the FTSE 350 (excluding investment trusts). The Committee may apply different performance measures and targets in future years • Awards will be subject to a payment gateway such that the Committee must be satisfied that there are no material risk failings, reputational concerns or regulatory issues • In addition, there is an underpin relating to the Committee's view of the underlying financial performance of the Group • Fuller details of the performance conditions and targets for 2016 and prior-year awards are set out in the annual remuneration report • For both the TSR and RoTE elements, 20% of the award vests for threshold performance with 100% vesting for maximum performance. The Committee reserves the discretion to make changes to these levels which it considers non-material • The Committee reserves the right to lengthen (but not reduce) any performance period and/ or to introduce a separate holding period

Element	Purpose and link to strategy	Operation
Pension	• To remain competitive within the market place • To encourage retirement planning and retain flexibility for individuals	• Pension contributions are paid only in respect of base salary • Executive Directors are eligible to participate in the defined contribution pension arrangement or alternatively they may choose to receive a cash allowance in lieu of pension • This is in line with the approach taken for all Group employees
Benefits	• A comprehensive and flexible benefits package is offered, with the emphasis on individuals being able to choose the combination of cash and benefits that suits them	• Executive Directors receive a benefits package generally set by reference to market practice in companies of a similar size and complexity, particularly FTSE 31-100 companies. Benefits currently provided include a company car or car allowance, private medical insurance, life insurance, health screening and income protection • The Committee may periodically amend the benefits available to employees. The Executive Directors are eligible to receive such additional benefits on similar terms to other senior executives • In line with our approach to all employees, certain Group products are offered to Executive Directors at a discount • Executive Directors are also eligible to participate in any of the employee share plans operated by the Company, in line with HMRC guidelines (where relevant), on the same basis as for other eligible employees. Currently this includes the Share Incentive Plan, which was also used to provide an award of free shares to all employees (including Executive Directors) at the time of the IPO
Share ownership guidelines	• To further align the interests of Executive Directors with those of shareholders	• Executive Directors are expected to retain all of the ordinary shares vesting under any of the Company's share incentive plans, after any disposals for the payment of applicable taxes, until they have achieved the required level of shareholding

Notes to the policy table

Stating maximum amounts for each element of remuneration

Where the table refers to the maximum amounts that may be paid in respect of any element of the policy (as required under the Regulations) these will operate simply as caps and not be indicative of any aspiration.

Malus and clawback

Malus (being the forfeiture of unvested awards) and clawback (being the ability of the Company to claim repayment of paid amounts) provisions apply to the AIP (cash and deferred element) and LTIP if, in the opinion of the Committee, any of the following has occurred:

- There has been a material misstatement of the Company's financial results which has led to an overpayment
- The assessment of performance targets is based on an error or inaccurate or misleading information or assumptions
- Circumstances warranting summary dismissal in the relevant period
- A material failure of risk management or any other act or omission that has had a sufficiently significant impact on the reputation of the Company to justify such action

Amounts in respect of awards under both plans may be subject to clawback for up to three years post payment or vesting as appropriate.

Maximum opportunity	Performance measures
• Pension contributions for both Executive Directors are set at 25% of base salary per annum	• Not performance related
• The costs of benefits provided may fluctuate from year to year even if the level of provision has remained unchanged • An annual limit of 10% of base salary per Executive Director has been set for the duration of this policy. The Committee will monitor the costs in practice and ensure that the overall costs do not increase by more than the Committee considers to be appropriate in all the circumstances • In addition, the limit for any employee share plans in which the Executive Directors participate will be in line with the caps permitted by HMRC from time to time • The Executive Directors may be entitled to retain fees received for any directorships held outside the Group	• Not performance related
• 200% of salary for both Executive Directors • The Committee reserves the discretion to amend these levels in future years	• Not applicable

Exercise of discretion

In line with market practice, the Committee retains discretion in relation to the operation and administration of the AIP, DAIP and LTIP. This discretion includes, but is not limited to:

- The timing of awards and payments
- The size of awards, within the overall limits disclosed in the policy table
- The determination of vesting
- The treatment of awards in the case of change of control or restructuring
- The treatment of leavers within the rules of the plan and the termination policy summary shown on pages 92 to 93
- Adjustments needed in certain circumstances (for example, rights issue, corporate restructuring or special interim dividend)

The Committee also retains the discretion to amend the performance measures, weightings and targets after they have been set if events make it appropriate to do so. Any changes will be explained in future annual remuneration reports and, if appropriate, be the subject of consultation with the Company's major shareholders.

Adjustment to number of shares under deferred bonus and LTIP

The number of shares subject to deferred bonus and LTIP awards may be increased to reflect the value of dividends that would have been paid in respect of any dates falling between the grant of awards and the date of vesting of awards (the date of transfer of shares for awards made prior to 2014).

The terms of incentive plan awards may be adjusted in the event of a variation of the Company's share capital, demerger or a similar event that materially affects the price of the shares or otherwise in accordance with the plan rules.

Remuneration payments agreed prior to appointment to the Board

The Committee reserves the right to make any remuneration payments and payments for loss of office (including, where relevant, exercising any discretions available to it in connection with such payments) notwithstanding that they are not in line with the policy set out above where the terms of the payment were agreed (i) before the policy came into effect or (ii) at a time when the relevant individual was not a Director of Direct Line Insurance Group plc and, in the opinion of the Committee, the payment was not in consideration for the individual becoming a Director of the Company. For these purposes 'payments' include pension arrangements, the Committee satisfying awards of variable remuneration and, in relation to an award over shares, the terms of the payment are 'agreed' at the time the award is granted.

Selection of performance measures

Annual Incentive Plan

The AIP performance measures have been selected by the Committee to incentivise Executive Directors to achieve financial targets for the year as well as specific strategic and personal objectives. These measures are aligned with the key performance indicators that we use as a business to monitor performance against our strategic priorities, as shown on pages 24 and 25 of the Annual Report & Accounts.

The relevant targets are set at or following the start of each year to ensure that Executive Directors are appropriately focused on the key objectives for the next 12 months.

Long-Term Incentive Plan

The ultimate goal of our strategy is to provide long-term sustainable returns for our shareholders.

For 2016, awards under the LTIP will therefore continue to be subject to performance against both RoTE and relative TSR targets, which are important KPIs for the business. The Committee believes that this combination provides a balanced approach to the measurement of Group performance over the longer term by using both a stated financial KPI that incentivises individuals to keep growing the business in an efficient way and a measure based on relative shareholder return. This combination of measures achieves an appropriate balance of absolute and relative returns.

Differences in remuneration policy from broader employee population

When determining Executive Directors' remuneration, the Committee takes into account pay throughout the Group to ensure that the arrangements in place remain appropriate.

The Group has one consistent reward policy for all levels of employees. Therefore, the same reward principles guide reward decisions for all Group employees, including Executive Directors, although remuneration packages differ to take into account appropriate factors in different areas of the business:

- **AIP** – approximately 3,200 employees participate in the AIP and the corporate performance measures for all employees are consistent with those used for Executive Directors, although the weighting attributable to those factors may differ. The Group's strategic leaders also receive part of their bonus in Company shares deferred for a period of three years
- **LTIP** – our strategic leaders participate in the LTIP currently based on the same performance conditions as those for Executive Directors, although the Committee reserves the discretion to vary the performance conditions for awards made to employees below the Board for future awards
- **All employee share plans** – the Committee considers it is important for all employees to have the opportunity to become shareholders in the Company. The HMRC-approved Buy-As-You-Earn Share Incentive Plan in the UK and an International plan mirroring the UK plan for Italy were both launched during 2013. At year-end, approximately 2,700 employees throughout the Group had signed up to the UK plan.

Remuneration policy for Non-Executive Directors

Element	Purpose and link to strategy	Approach to setting fees and cap	Other items
Chairman and Non-Executive Directors' fees	To enable the Company to recruit and retain Non-Executive Directors of the highest calibre, at the appropriate cost	• Non-Executive Directors are paid a basic annual fee plus reasonable travel expenses. Additional fees may be paid to Non-Executive Directors who chair a Board Committee, sit on a Board Committee and for the Senior Independent Director. The level of fees for 2016 is shown in the annual remuneration section • Fee levels for Non-Executive Directors are reviewed and may be increased at appropriate intervals by the Board, with affected individual Directors absenting themselves from deliberations • In setting the level of fees, the Company takes into account the expected time commitment of the role and fees at other companies of a similar size, sector and/or complexity to the Group • The fees paid to the Chairman are inclusive of all Board and Committee membership fees and are determined by the Remuneration Committee • Subject to a Non-Executive Director aggregate fee cap in the Articles of Association (currently £2,000,000 per annum), the Company reserves the right to change how the elements and weightings within the overall fees are paid and to pay a proportion of the fees in shares within this limit	• The Non-Executive Directors are not entitled to receive any compensation for loss of office, other than fees for their notice period. They do not participate in the Group's bonus, employee share plans or pension arrangements and do not receive any benefits

Recruitment remuneration policy

The recruitment remuneration policy aims to give the Committee sufficient flexibility to secure the appointment and promotion of high-calibre executives to strengthen the management team and secure the skill sets to deliver the Group's strategic aims.

Principles for recruitment remuneration

- In terms of the principles for setting a package for a new Executive Director, the starting point for the Committee will be to look to the policy for Executive Directors as set out in the policy table and structure a package in accordance with that policy. Consistent with the Regulations, the caps contained within the policy table for fixed pay do not apply to new recruits, although the Committee would not envisage exceeding these caps in practice
- For an internal appointment, any variable pay element awarded in respect of the prior role may either continue on its original terms or be adjusted to reflect the new appointment, as appropriate
- For external and internal appointments (including a major change in role), the Committee may agree that the Company will meet certain relocation expenses, legal and other fees involved in negotiating any recruitment or pay expatriate benefits in line with the Group's international assignment policy, as appropriate

Buy-out awards

- Where it is necessary to make a recruitment-related pay award to an external candidate, the Company will not pay more than is necessary, in the view of the Committee, and will in all cases seek, in the first instance, to deliver any such awards under the terms of the existing incentive pay structure
- All such awards for external appointments, whether under the AIP, LTIP or otherwise, to compensate for awards forfeited on leaving their previous employer will be capped at the commercial value of the amount forfeited and will take account of the nature, time horizons and performance requirements of those awards. In particular, the Committee's starting point will be to ensure that any awards being forfeited which remain subject to outstanding performance requirements (other than where substantially complete) are bought out with replacement requirements and any awards with service requirements are bought out with similar terms. However, exceptionally the Committee may relax those obligations where it considers it to be in the interests of shareholders and those factors are, in the view of the Committee, equally reflected in some other way, for example through a significant discount to the face value of the awards forfeited. It will only include guaranteed or non-prorated amounts under the AIP where the Committee considers that it is necessary to secure the recruitment

The elements of any package for a new recruit, including the maximum level of variable pay, but excluding buy-outs, and the approach taken by the Committee in relation to setting each element of the package will be consistent with the Executive Directors' remuneration policy described in this report, as modified by the above statement of principles where appropriate. The Committee reserves the right to avail itself of the current Listing Rule 9.4.2 if needed in order to facilitate, in exceptional circumstances, the recruitment of an Executive Director. Awards granted under this provision will only be used for buy-out awards.

Any commitments made before promotion to the Board (except when made in connection with the appointment to the Board) can continue to be honoured under the policy even if they are not consistent with the policy prevailing when the commitment is fulfilled.

In exceptional circumstances, the initial notice period may be longer than the Company's 12 month policy up to a maximum of 24 months. However, this will reduce by one month for every month served, until it has reduced to 12 months in line with the Company's policy position.

The remuneration policy for the Chairman and Non-Executive Directors as set out earlier in this report will apply in relation to any recruitments to those positions.

Service contracts

Subject to the discretion noted above for new recruits, it is the Company's policy to set notice periods for Executive Directors of no more than 12 months (both by the Director or Company). The Executive Directors' service agreements summary is as follows:

Director	Effective date of contract	Notice period (by Director or Company)	Exit payment policy
Paul Geddes	1 September 2012	12 months	Base salary only for unexpired portion of notice period and to be paid in a lump sum or monthly instalments, in which case instalments are subject to mitigation if an alternative role is found.
John Reizenstein	1 September 2012	12 months	Base salary only for unexpired portion of notice period and to be paid in a lump sum or monthly instalments, in which case instalments are subject to mitigation if an alternative role is found.

There are no further obligations which could give rise to a remuneration or loss of office payment other than those set out in the remuneration policy table and termination policy summary.

Termination policy summary

It is appropriate for the Committee to retain discretion to consider the termination terms of any Executive Director, having regard to all the relevant facts and circumstances available to them at the time. A Director is deemed a 'good leaver' if the following circumstances are met:

- Annual Incentive Plan and Long-Term Incentive Plan – death, injury, ill-health, redundancy, retirement, the sale of the individual's employing company or business out of the Group, or in such other circumstances as the Committee determines
- Deferred Annual Incentive Plan – for any reason other than summary dismissal or resignation unless, in the case of resignation only, the Committee determines otherwise

The table overleaf sets out the general position although it should be noted that the Committee, consistent with most other companies, has reserved a broad discretion to determine whether an Executive Director should be categorised as a 'good leaver' and that discretion forms part of the approved policy. Similarly, while the policy is generally to reduce AIP and LTIP awards on a pro-rata basis, the Committee has reserved discretion to disapply such reduction if, in the circumstances, it considers that to be appropriate taking into account the performance of the departing Executive and the circumstances of leaving.

Incentives	If a leaver is a 'bad leaver', for example leaving through resignation or summary dismissal	If a leaver is deemed to be a 'good leaver'	Other events, for example change in control or winding up of Company
Annual Incentive Plan	No awards made	Bonus paid at the normal time and on a time pro-rata basis, unless the Committee determines otherwise.	Bonus determined on such basis as the Committee considers appropriate and paid on a time pro-rata basis, unless the Committee determines otherwise.
Deferred Annual Incentive Plan	All awards will lapse	Deferred shares typically vest on the normal vesting date, although the Committee reserves discretion to accelerate vesting. In the case of the participant's death or other exceptional circumstances, awards may vest immediately.	Awards will vest in full. In the event of a demerger or similar event, the Committee may determine that awards vest on the same basis.
Long-Term Incentive Plan	All awards will lapse	Awards will vest on the normal vesting date subject to performance and, unless the Committee determines otherwise, time pro rating. In exceptional circumstances, as determined by the Committee, for example in the case of the participant's death, awards may vest on cessation.	Awards will vest subject to the application of the performance conditions and, unless the Committee determines otherwise, time pro rating. In the event of a demerger or similar event, the Committee may determine that awards vest on the same basis.

Service agreements for Executive Directors provide that Paul Geddes and John Reizenstein are not eligible to receive any enhanced redundancy terms which may be offered by the Group from time to time. Their rights to a statutory redundancy payment are not affected.

Depending on the circumstances of departure, an Executive Director may have additional claims under relevant employment protection laws and the Company may contribute to any legal fees involved in agreeing a termination. It may also agree to incur certain other expenses such as the provision of outplacement services. Any such fees would be disclosed as part of the detail of any termination arrangements.

Non-Executive Director letters of appointment

Non-Executive Directors are appointed for a three-year term which may be renewed by mutual agreement. In common with the Executive Directors, all Non-Executives are subject to annual re-election by shareholders.

The Directors may appoint additional members to join the Board during the year. Directors appointed in this way will be subject to election by shareholders at the first AGM after their appointment. In subsequent years, the Directors are required to submit themselves for re-election at each AGM.

Terms and conditions of appointment of all of the Directors are available for inspection by any person at the Company's registered office and at the AGM.

The Chairman and Non-Executive Directors have notice periods of three months from either party, which do not apply in the case of a Director not being re-elected by shareholders or retiring from office under the Articles of Association. Other than fees for this notice period, the Chairman and Non-Executive Directors are not entitled to any compensation on exit.

External directorships

The Company encourages Executive Directors to accept, subject to the approval of the Chairman, an invitation to join the board of another company outside the Group in a non-executive capacity, recognising the value of such wider experience. In these circumstances, they are permitted to retain any remuneration from the non-executive appointment. Executive Directors are generally limited to accepting one external directorship.

Consideration of employment conditions elsewhere in the Group
As explained elsewhere in the Directors' remuneration report, the Committee reviews the overall pay and bonus decisions in aggregate for the wider Group and therefore takes account of pay and conditions in the wider Group in determining the Directors' remuneration policy and the remuneration payable to Directors. Through the Chief Executive Officer, Paul Geddes, and other senior management the Committee may receive input provided by employee groups within the Group, such as the Employee Representative Body, as required.

In accordance with prevailing commercial practice, the Committee did not consult with employees in preparing the Directors' remuneration policy.

Consideration of shareholders' views
The Committee takes into account the approval levels of remuneration related matters at the AGM in determining whether the current Directors' remuneration policy remains appropriate.

The Committee, consistent with its approach of operating within the highest standards of corporate governance, takes significant account of guidelines issued by the Investment Association and other shareholder bodies (such as the National Association of Pension Funds) when setting the remuneration policy.

The Committee will also seek to build an active and productive dialogue with investors on developments in the remuneration aspects of corporate governance generally and any changes to the Company's executive pay arrangements in particular.

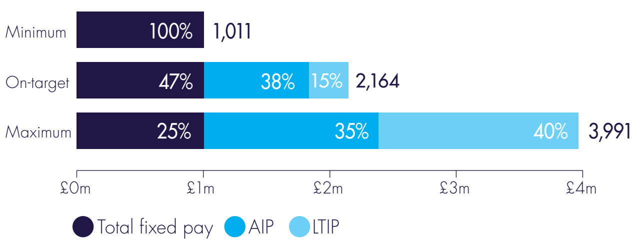
The Committee is satisfied that no element of the Directors' remuneration policy conflicts with the Group's approach to environmental, social or corporate governance matters.

Performance scenarios
The Directors' remuneration policy has been designed to ensure that a significant proportion of total remuneration is delivered in the form of variable pay and is therefore dependent on performance against our strategic objectives.

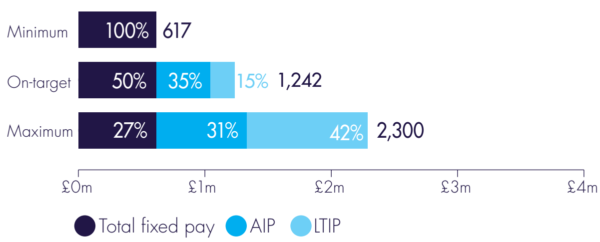
The Committee has considered the level of remuneration that may be paid under different performance scenarios to ensure that it would be appropriate in each situation in the context of the performance delivered and the value created for shareholders.

The following charts show the potential remuneration that may be earned by Executive Directors under three assumed performance scenarios as follows:

CEO – Paul Geddes
(£'000)



CFO – John Reizenstein
(£'000)



The elements of remuneration included in each scenario are as follows.

Minimum	Consists of fixed remuneration only (that is, base salary, benefits and pension): • Base salary is the salary to be paid from 1 April 2016 • Benefits measured as benefits paid in 2015 as set out in the single figure table on page 77, including the value of matching shares under the SIP where relevant • Pension measured as the defined contribution or cash allowance in lieu of Company contributions, as a percentage of salary (25% of base salary for both Executive Directors)
On-target	Based on what the Director would receive if performance was on-target (excluding share price appreciation and dividends): • Fixed remuneration as above • AIP – consists of the on-target bonus of 60% of maximum bonus opportunity • LTIP – consists of the threshold level of vesting (20% vesting)
Maximum	Based on the maximum remuneration receivable (excluding share price appreciation and dividends): • Fixed remuneration as above • AIP – consists of the maximum bonus (175% of base salary for Paul Geddes, 150% for John Reizenstein) • LTIP – consists of the face value of awards (200% of base salary)

The Directors present their report for the financial year ended 31 December 2015.

You can find the forward-looking statements disclaimer on page 176.

Strategic report

The Company's Strategic report is on pages 1 to 45. It includes the following information that would otherwise need to be disclosed in this Directors' report:

Subject	Pages
Use of financial instruments	43 and 44
Important events since the financial year end	10 to 13
Likely future developments in the business	13 and 34 to 37
Employee involvement	32 and 33

Corporate governance statement

The FCA's Disclosure and Transparency Rules require a corporate governance statement in the Directors' report to include certain information. You can find information that fulfils the corporate governance statement's requirements in this Directors' report; the Corporate Governance report; the Committee reports; and the Directors' remuneration report, on pages 46 to 95. This information is incorporated in the Directors' report by reference.

Disclosure of information under Listing Rule 9.8.4R

Subject	Page
Contracts of significance	98
Details of shareholder dividend waivers	97
Significant shareholder agreements	97

Post-balance sheet events

There were no post-balance sheet events to report.

Dividends

The Group aims to generate long-term sustainable value for shareholders, while balancing operational, regulatory, rating agency and policyholder requirements. The Board has a progressive dividend policy for the Company. This aims to increase the dividend annually in real terms to reflect the Company's cash flow generation and long-term earnings potential.

The Group expects that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend, and two-thirds will be paid as a final dividend in the second quarter of the following year. The Board may revise the dividend policy from time to time.

Additionally, if the Board believes the Group has capital surplus to its view of its requirements, it is intended that such excess capital will be returned to shareholders. The Company may consider a special dividend and/or a repurchase of its own shares to distribute surplus capital to shareholders.

The Board recommends a final dividend of 9.2 pence per share to shareholders. Subject to shareholder approval at the Company's 2016 AGM, this will become payable on 19 May 2016 to all holders of Ordinary Shares on the Register of members at close of business on 11 March 2016. A second special interim dividend has also been declared of 8.8 pence per share and will have the same record and payment dates as the final dividend for 2015.

The final dividend resolution provides that the Board may cancel the dividend and therefore payment of the dividend at any time prior to payment if it considers it necessary to do so for regulatory capital purposes. Detailed explanatory notes can be found in the Notice of AGM.

The Company paid a special interim dividend of 27.5 pence per share in July 2015. This represented substantially all of the net proceeds from the sale of the International division.

The Company paid an interim dividend of 4.6 pence per share in September 2015.

Due to uncertainty about the timing of completion of the International division sale (and related distribution), the Board declared a second interim dividend (in lieu of a final dividend) for 2014 of 8.8 pence per share. It also declared a second special interim dividend of 4.0 pence per share for the 2014 financial year, which was paid in April 2015, at the same time as the second interim dividend.

The special interim dividends are consistent with the Group's policy to distribute excess capital.

Including the special, interim and final dividends, the total dividend for the 2015 financial year is 50.1 pence per share (2014: 27.2 pence). Of this, 36.3 pence relates to special interim dividends (2014: 14.0 pence).

Further information about dividends and capital management can be found in the Finance review on pages 44 and 45, and note 15 to the financial statements on page 143.

Directors

You can find the current Directors' biographies on pages 48 to 49. All Directors will retire and be submitted for election or re-election at the 2016 AGM except for Priscilla Vacassin, who steps down from the Board on 1 March 2016. This is in accordance with the UK Corporate Governance Code and the Articles of Association of the Company, which govern the appointing and replacing of Directors.

The Directors listed on pages 48 and 49 were the Directors of the Company throughout the year apart from Richard Ward, who was appointed on 18 January 2016, and Glyn Jones, who resigned as a Director on 13 May 2015 due to increasing commitments elsewhere.

The Company's Articles of Association set out the Directors' powers. You can obtain a copy of these on the Company's website at www.directlinegroup.com . The Directors' powers are also subject to relevant legislation and, in certain circumstances, authority from the Company's shareholders.

Secretary

Roger Clifton is the Company Secretary of Direct Line Insurance Group plc. He can be contacted at the Company's Registered Office, details of which are on the inside back cover.

Directors' interests

You can find details of the Directors' remuneration, service contracts, employment contracts and interests in the shares of the Company in the Directors' remuneration report on pages 70 to 95.

Directors' indemnities

The Articles of Association of the Company permit it to indemnify the Company's officers – and officers of any associated company – against liabilities arising from conducting Company business, to the extent permitted by law. As such, the Company has executed deeds of indemnity for each Director's benefit, regarding liabilities that may attach to them in their capacity as Directors of the Company or associated companies. These indemnities are qualifying third-party indemnities as defined by section 234 of the Companies Act 2006. No amount was paid under any of these indemnities during the year.

The Company maintains directors' and officers' liability insurance. This provides appropriate cover for legal actions brought against its Directors.

The Company has also provided the directors of DLG Pension Trustee Limited with qualifying pension scheme indemnities. This is in accordance with section 235 of the Companies Act 2006. DLG Pension Trustee Limited acts as trustee for two of the Company's occupational pension schemes.

Share capital

The Company has a premium listing on the London Stock Exchange. As at 31 December 2015, its share capital comprised 1,375,000,000 fully paid Ordinary Shares of 10 10/11 pence each.

On 29 June 2015, shareholders approved a share consolidation. This resulted in issuing 11 new Ordinary Shares of 10 10/11 pence each for every 12 Ordinary Shares of 10 pence each in issue at close of business on 29 June 2015.

Shareholders approved certain authorities at the Company's 2015 AGM related to the Company's share capital. As part of the share consolidation approved at the General Meeting on 29 June 2015, these authorities were refreshed and adjusted to account for the share consolidation. Therefore, the Directors now have authority to:

- allot shares in the Company or grant rights to subscribe for, or convert, any security into shares up to an aggregate nominal amount of £50,000,000;
- allot shares up to an aggregate nominal amount of £100,000,000, for the purpose of a rights issue; and
- make market purchases of up to 137,500,000 shares in the Company, representing approximately 10% of the Company's issued share capital at the time.

To date, the Directors have not used these authorities. Shareholders will be asked to renew them at the 2016 AGM in line with the most recent institutional investors' guidelines.

The Company has not held any shares in treasury during the period under review.

You can find out more about the Company's share capital and shares under option at 31 December 2015 in notes 28 and 34 to the consolidated financial statements.

Under the Company's Share Incentive Plan, shares are held by a Trustee on behalf of employee participants. The Trustees will only vote on those shares and receive dividends that are beneficially owned by a participant, in accordance with the participant's wishes. An Employee Benefit Trust is also in operation, the Trustee of which has discretion to vote on any shares it holds as it sees fit, save for any shares owned beneficially by participants, in which case the Trustee will only vote on such shares as per instructions from the participant. The Trustee of this Trust has waived its right to dividends on all shares within the Trust. You can find out more about the number of shares held by the employee share plan trusts in note 28 on page 150. The Company is only aware of the dividend waivers and voting restrictions mentioned above.

Rights attaching to shares

All of the Company's issued Ordinary Shares rank equally in all respects. The Company's Articles of Association set out the rights and obligations attaching to the Company's Ordinary Shares. You can obtain a copy of this on the Company's website at www.directlinegroup.com .

All issued shares are fully paid and free from any restrictions on their transfer, except where law requires, such as insider trading rules. All employees must conform to the Company's share dealing rules. These rules restrict particular employees' ability to deal in the Company's shares at certain times, and mean they need to obtain permission to deal before doing so. Some of the Company's employee share plans also include restrictions on transfer of shares while the shares are held within the plans.

Each general meeting notice will specify the time for determining a shareholder's entitlement to attend and vote at the meeting. This will not be more than 48 hours, excluding any part of a day that is not a working day, before the time fixed for the meeting. To be valid, all proxy appointments must be filed at least 48 hours before the meeting's time.

Where the Company has issued a notice under section 793 of the Companies Act 2006 which is in default for at least 14 days, the person(s) interested in those shares shall not be entitled to attend or vote at any general meeting until the default has been corrected or the shares sold.

There is no arrangement or understanding with any shareholder, customer or supplier, or any other external party that provides the right to appoint a Director or a member of the Executive Committee, or any other special rights regarding control of the Company.

Articles of Association

Unless expressly specified to the contrary in the Articles of Association, they may only be amended by a special resolution of the Company's shareholders at a general meeting.

Significant agreements affected by a change of control

A number of agreements may take effect, alter or terminate upon a change of control of the Company. None of these agreements are considered to be significant in terms of its impact on the business of the Group as a whole.

All of the Company's employee share incentive plans contain provisions relating to a change of control. Outstanding awards would typically vest and become exercisable. This is subject to satisfying any performance conditions, and normally with an additional time-based pro-rata reduction where performance conditions apply, and approval from the Remuneration Committee.

Substantial shareholdings

In accordance with the provisions of chapter 5 of the FCA's Disclosure and Transparency Rules, the Company has been notified of the following indirect interest in the Company's voting rights. The Company has not been notified of any direct interests.

	31 December 2015	9 March 2016
BlackRock, Inc.	5.08%	5.08%

Political donations

The Group made no political donations during the year (2014: nil).

Employees with disabilities

The Group is committed to promoting diversity across every area of the business. At recruitment, we adjust and enhance our application and selection process and also guide and provide additional training for interviewers, where necessary.

An element of our Diversity Network Alliance focuses on matters important to employees with disabilities. It also identifies areas where we can improve. To help people continue working for us, we make reasonable adjustments to their working environments and equipment, and roles and role requirements. We also ensure that everyone can access the same opportunities.

Greenhouse gas emissions

The Group has followed the 2013 UK Government environmental reporting guidance for greenhouse gas ("**GHG**") emissions, used the UK Government's greenhouse gas conversion factors, and adopted the financial control approach to setting the organisational boundaries of responsibilities for GHG emissions. GHG emissions are classified as direct or indirect, and divided into scope 1 and scope 2 emissions. Direct GHG emissions are those from sources that the Group owns or controls. Indirect GHG emissions are those that are a consequence of the Group's activities, but occur at sources owned or controlled by another organisation. The Group has considered the six main GHGs, reported in tonnes of carbon dioxide equivalent ("**CO_2e**"), and set 2013 as the base year. The Group has included emissions from the International division, until its sale in May 2015, under discontinued operations in the table opposite. It has not included emissions associated with its investment portfolio.

Scope 1 – direct emissions including fuels used in office buildings, accident repair centres and owned vehicles

Scope 2 – indirect emissions resulting from generating electricity purchased for office buildings and accident repair centres

Total GHG emissions for continuing operations for 2015 were 22,611 tonnes (2014: 27,308 tonnes), as set out in the table below. This primarily comprised emissions from purchased electricity and natural gas, diesel fuel and refrigerant gas used.

In addition to total emissions, the Group also monitors emissions per £ million of net earned premium. In 2015, this was 7.7 tonnes per £ million of net earned premium for continuing operations (2014: 9.1 tonnes). This is a measure of how efficiently insurance products are provided and allows comparison between our year-on-year performance and performance against insurance companies.

Ecometrica has externally verified the GHG emissions data. Verification statements can be found on the Group's website at www.directlinegroup.com .

You can find further information on the Group's approach to energy and the environment in the CSR section on page 32.

Greenhouse gas emissions

CO_2e tonnes	Continuing operations		Total Group including discontinued operations	
	2015	2014	**2015**	2014
Scope 1 direct	**7,643**	7,784	**7,645**	7,787
Scope 2 indirect	**14,968**	19,524	**15,498**	20,972
Total gross emissions	**22,611**	27,308	**23,143**	28,759
Emissions per £ million of net earned premium	**7.7**	9.1	**8.8**	8.7

Longer term viability and going concern basis

The statements required to be included in the Annual Report following the UK Corporate Governance Code provisions C.1.3 and C.2.2 can be found on pages 56 and 57, and are incorporated here by reference.

Disclosing information to the Auditor

Each Director at the date of approving this Annual Report & Accounts confirms that:

- as far as they are aware, there is no relevant audit information of which Deloitte LLP, the Company's external auditor, is unaware; and
- they have taken all the steps they ought to have taken as a Director to make themselves aware of any relevant audit information and establish that Deloitte LLP is aware of that information.

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

Auditor

Deloitte LLP has expressed its willingness to continue in office as the external auditor. A resolution to reappoint Deloitte LLP will be proposed at the forthcoming AGM. You can find an assessment of the effectiveness and recommendation for Deloitte LLP's reappointment in the Audit Committee report on pages 59 and 60.

Directors' responsibility statement

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

Company law requires the Directors to prepare such financial statements for each financial year. Under that law, the Directors must prepare the Group financial statements in accordance with International Financial Reporting Standards ("**IFRS**"), as adopted by the EU and Article 4 of the International Accounting Standard ("**IAS**") regulation. They have also chosen to prepare the Parent Company financial statements under IFRS, as adopted by the EU. Under company law, the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the Company's state of affairs and profit or loss for that period.

In preparing these financial statements, IAS 1 requires that Directors:

- Properly select and apply accounting policies
- 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 IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance
- Assess 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, the Company's financial position at any time, and enable them to ensure the financial statements comply with the Companies Act 2006. Additionally, they are responsible for safeguarding the Company's assets and hence taking reasonable steps to prevent and detect fraud and other irregularities. The Directors are responsible for maintaining and ensuring the integrity of the corporate and financial information included on the Company's website at www.directlinegroup.com . Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, whose names and functions are listed on pages 48 and 49, confirms that, to the best of their knowledge:

- the financial statements, prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position, and profit or loss of the Company, and the undertakings included in the consolidation taken as a whole; and
- the Strategic report (on pages 1 to 45) and Directors' report (on pages 96 to 99) include a fair review of the development and performance of the business, and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties they face.

The Board reviewed and approved this report on 29 February 2016.

By order of the Board

Roger C. Clifton
Company Secretary

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Opinion on the financial statements of Direct Line Insurance Group plc

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2015 and of the Group's profit for the year then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards ("**IFRSs**") as adopted by the European Union; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the International Accounting Standard ("**IAS**") Regulation.

The financial statements comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and Parent Company balance sheets, the consolidated and Parent Company cash flow statements, the consolidated and Parent Company statements of changes in equity and the related notes 1 to 40 on the consolidated financial statements, and the related notes 1 to 17 on the Parent Company financial statements. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the consolidated financial statements, in addition to complying with its legal obligation to apply IFRSs as adopted by the European Union, the Group has also applied IFRSs as issued by the International Accounting Standards Board ("**IASB**").

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

Independence

We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and we confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

Going concern and the Directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group

As required by the Listing Rules we have reviewed the Directors' statement on page 56 regarding the appropriateness of the going concern basis of accounting to the financial statements and the Directors' statement on the longer-term viability of the Group. We have nothing material to add or draw attention to in relation to:

- the Directors' confirmation on page 56 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- the disclosures on pages 28 to 29 that describe those risks and explain how they are being managed or mitigated.
- the Directors' statement on page 56 about whether they considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and their identification of any material uncertainties to the Group's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements;
- the Director's explanation on pages 56 to 57 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We agreed with the Directors' adoption of the going concern basis of accounting and we did not identify any material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team. The procedures described in our response to each risk are not exhaustive and we have focused on those procedures that we consider address areas of judgement or subjectivity; see overleaf.

Risk	How the scope of our audit responded to the risk
The methodology and assumptions used in setting insurance reserves Insurance reserves include the Group's insurance liabilities from continuing business totalling £4.5 billion, as detailed in note 31.The determination of the value of the insurance reserves requires significant judgement in the selection of key assumptions and methodologies. The Group has indicated to the market that assuming current claims trends continue, the contribution from prior-year reserve releases is expected to remain significant, albeit lower than in 2014. Management exercises significant judgement in respect of the trends in bodily injury claims frequency and severity, the speed of recognition of emerging data and trends, the propensity for large claims to settle as periodic payment orders ("**PPOs**"), the likely outcome of the Government's consultation on the Ogden discount rate used by the courts to calculate claims for long-term damages and other regulatory developments. There were a number of weather events at the end of 2015 which caused severe flooding across the UK. Management has exercised judgement in the determination of the full extent of the claims. Therefore the scope of this risk was extended to include the valuation of the additional provision for these events.	We have tested the design and implementation and operating effectiveness of the key controls over the end-to-end reserving process, including the controls over the inputs and outputs for the actuarial best estimate ("**ABE**") and the controls for setting of the margin above ABE. We also tested the completeness and accuracy of the underlying data used in the actuarial calculations through performing reconciliations on the data back to the financial ledger and the actuarial data used by our Deloitte actuarial specialists in performing their audit. Having done this, we worked with those specialists to: • consider the suitability of the methodology used in setting insurance reserves against industry benchmarks; • challenge management's key assumptions and judgements particularly in relation to the cost per claim for the floods against industry benchmarks; • assess whether the reserving methodology has been applied consistently across periods; • evaluate prior-year reserve releases and emerging trends for consistency with management's methodology; and • challenge management's identification of items to be included in the margin above ABE, to perform sensitivity analysis on the range of potential scenarios and assess the consistency of the point within the range that the margin is set. In addition to this, we have performed work to understand the sensitivity of insurance reserves to changes in key assumptions and methodology, as well as reviewed the actuarial disclosure in the Annual Report.
The valuation of investments held at fair value, derivatives and loan loss provisioning The Group's financial investments shown in note 26 represent the largest number on the balance sheet, £5.6 billion. As the Group's investments portfolio has diversified, the risk associated with valuation has increased over instruments where market prices are not always readily available, such as securitised credit assets or infrequently traded assets. These investments are typically more illiquid, resulting in reduced availability of observable inputs and therefore increased judgement in their valuation. The valuation of the Group's derivatives, held in order to hedge interest rate risk and foreign exchange risk, is also deemed to be complex, with small differences in interest rate curves resulting in material valuation changes. Management are required to assess financial assets for indications of impairment. Where limited observable market inputs are available, this requires management to exercise increased judgement. The infrastructure debt portfolio has increased by 330% to £330 million in the year and is held at amortised cost. There are no readily observable market inputs for this portfolio and so this has resulted in an increased risk of material misstatement.	We have tested the design and implementation and operating effectiveness of controls over the investment valuation process. We attended the year-end impairment review meeting in order to assess the operation of a key management review control. We have tested the valuation of securitised credit instruments where an observable market price could not be obtained by engaging our pricing and valuation specialists to calculate independent valuations using a discounted cash flow approach. We have used our financial instrument specialists to test the macro hedge arrangements, valuation of the related financial instruments and the accounting treatment applied. We have engaged our credit specialists to challenge the methodology used in the assessment of credit risk within the growing infrastructure debt portfolio. In addition, we have checked that the Group's disclosures satisfy the requirements of IFRS 7 and IFRS 13. We have reviewed the classification and accounting treatment of the Group's investment portfolio in line with the accounting policies set out in note 1.12 to the financial statements.

Risk	How the scope of our audit responded to the risk
IT control environment In May 2015, the Group essentially finished their planned programme of transitioning IT infrastructure from RBS Group to an independently hosted data centre. In addition, management have a number of ongoing projects to assess and improve the IT control environment. Due to the significant change in the IT environment, there is an increased risk that the underlying IT infrastructure controls supporting key financial reporting processes might not adequately mitigate the risk of material financial misstatement.	We have tested the design, implementation and operating effectiveness of general IT controls around key IT processes on the applications and the migrated infrastructure, with a focus on access security, change management and operational controls, and have understood the governance process over the infrastructure migration itself. Our audit procedures also included testing additional business controls and site visits to the hosted UK data centre to test the physical access controls and the operational offices in India. We have also reviewed the scope of management's ongoing project to improve the IT environment and tailored our audit approach to take into account the findings and changes implemented as at the time of our audit.
Transformation projects There is a risk that the transformation programme, which includes outsourcing and offshoring, could impact the financial reporting control environment, in particular where processes and controls have changed operation and location. There is also a risk that the change will cause management stretch which could impact on the effectiveness of existing internal controls. There is a risk that there may no longer be an appropriate level of review or adequate segregation of duties.	We have tested the design and implementation and operating effectiveness of key business processes that have been subject to change. For example, we have tested the operating effectiveness of controls at a number of outsourced locations, involving site visits by the audit team. When testing the controls that had been impacted by the transformation programme, our testing focused on identifying that there remained an appropriate level of review and segregation of duties in the process.
Reinsurance asset valuation The valuation of the reinsurance asset, £1 billion in respect of the ceded part of the insurance reserves, as detailed in note 22, requires significant judgement to reflect the credit risk exposure to long-term assets arising from periodic payment orders. In addition, management refined their methodology for calculating the reinsurance bad debt. There is also a risk that reinsurance treaty terms and actuarial assumptions are not correctly applied when performing reinsurance valuations.	We have tested the design and implementation and operating effectiveness of the key controls over the reinsurance asset measurement and valuation process. We reviewed a sample of reinsurance contracts and assessed whether their terms are correctly applied. We have assessed the relevance and reliability of the data used in the calculation by reviewing the data against observable market inputs and other supporting documentation. To test the credit risk exposure, we engaged our credit and actuarial specialists in order to assess the reasonableness and appropriateness of the reinsurance bad debt valuation methodology and assumptions used. This included the distribution of withdrawals within the transitional matrix which estimates the probability of default at a point in time, the basis for allocating cash flows across future periods, and the selection of scenarios applied to calculate the renewed recovery rates.
Revenue recognition Due to the large number of policies underwritten by the Group there is a risk that the revenue recorded in the financial statements and the flow of premium information from the underwriting systems to the financial reporting ledger is not complete and accurate.	We have tested the design, implementation and operating effectiveness of the key controls over revenue recognition, focusing on the flow of information from the underwriting systems to the financial reporting ledger. We have performed substantive testing of the flow of data from system downloads through to posting in the general ledger. In addition, we performed substantive analytical testing procedures on the gross and unearned premium balances.

Last year our report included a risk around IT migration, which has been captured within the IT control environment risk description. This is due to the migration programme finishing early in the year but there still being a significant level of change in the IT control environment during the year.

The description of risks above should be read in conjunction with the significant issues considered by the Audit Committee discussed on page 59. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Our application of materiality

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

We have determined that the critical benchmark for the Group was average profit before tax from ongoing operations. This measure uses a three-year average of profit before tax, excluding the impact of discontinued activities and transformation costs to exclude the effect of year-on-year volatility. We calculated materiality for the Group to be £28 million (2014: £28 million), which is below 5.2% (2014: 6.5%) of average profit before tax from ongoing operations. We also considered this measure to be suitable having compared to other benchmarks: our materiality is 5.7% of statutory profit before tax, 0.8% of gross earned premium and below 1.4% of equity. Group materiality is used for setting audit scope and the assessment of uncorrected misstatements. Materialities are set for each significant component in line with the components proportion of the chosen benchmark. This is capped at the lower of 90% of Group materiality and the component materiality calculated for a standalone audit. The main UK insurance trading entity, which makes up 94% of Group revenue and 66% of Group statutory profit before tax, is scoped to a component materiality of £24.8 million (2014: £25.1million). We determine performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed materiality for the financial statements as a whole. The audit testing for U K Insurance Limited is carried out to a performance materiality of £17.4 million (2014: £17.6 million).

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £560,000 (2014: £560,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

The scope of our Group audit was determined by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level.

Due to the completion of the International disposal in 2015, our Group audit scope has focused on the UK as this is now the Group's single trading location. In addition, we perform site visits at the Group's key outsourcers. Two entities in the UK were subject to a full audit, and a further two were subject to an audit of specified account balances where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group's operations.

These four entities represent the principal business units and account for 99% (2014: 98%) of the Group's net assets, 92% (2014: 99%) of the Group's gross earned premium and 93% (2014: 95%) of the Group's profit before tax. They were also selected to provide an appropriate basis for undertaking audit work to address the risks of material misstatement identified above.

Our audit work was executed at levels of materiality applicable to each individual entity which were lower than Group materiality.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances. The Group audit team also performs the audit of the UK entities, which account for 100% of the Group's net assets and 95% of the Group's profit before tax.

The Group audit team was responsible for both the UK location and Group audit.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- 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.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

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

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

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if, in our opinion, certain disclosures of Directors' remuneration have not been made or the part of the Directors' remuneration report to be audited is not in agreement with the accounting records and returns. We have nothing to report arising from these matters.

Corporate governance statement

Under the Listing Rules we are also required to review the part of the corporate governance statement relating to the Company's compliance with certain provisions of the UK Corporate Governance Code. We have nothing to report arising from our review.

Our duty to read other information in the Annual Report

Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee which we consider should have been disclosed. We confirm that we have not identified any such inconsistencies or misleading statements.

Respective responsibilities of the Directors and the 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). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

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.

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 Group's and the Parent 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.

David Rush FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
29 February 2016

Consolidated income statement

For the year ended 31 December 2015

	Notes	2015 £m	2014 £m
Continuing operations			
Gross earned premium	6	3,110.1	3,144.2
Reinsurance premium	6	(189.2)	(157.5)
Net earned premium	6	2,920.9	2,986.7
Investment return	7	198.1	215.1
Instalment income		100.1	100.4
Other operating income	8	50.7	46.9
Total income		3,269.8	3,349.1
Insurance claims	9	(1,829.3)	(1,778.6)
Insurance claims recoverable from reinsurers	9	162.4	51.2
Net insurance claims	9	(1,666.9)	(1,727.4)
Commission expenses	10	(319.3)	(354.0)
Operating expenses	11	(738.5)	(776.0)
Total expenses		(1,057.8)	(1,130.0)
Operating profit		545.1	491.7
Finance costs	12	(37.6)	(37.2)
Gain on disposal of subsidiary	21	–	2.3
Profit before tax		507.5	456.8
Tax charge	13	(108.3)	(97.5)
Profit from continuing operations, net of tax		399.2	359.3
Profit from discontinued operations, net of tax	5A	181.2	13.3
Profit for the year attributable to owners of the Company		580.4	372.6
Earnings per share:			
Continuing operations:			
Basic (pence)	16	27.9	24.0
Diluted (pence)	16	27.6	23.8
Continuing and discontinued operations:			
Basic (pence)	16	40.6	24.9
Diluted (pence)	16	40.1	24.7

The attached notes on pages 111 to 163 form an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

For the year ended 31 December 2015

	Notes	2015 £m	2014 £m
Profit for the year		580.4	372.6
Other comprehensive (loss) / income			
Items that will not be reclassified subsequently to the income statement:			
Actuarial gain on defined benefit pension scheme	33	6.7	2.8
Tax relating to items that will not be reclassified	14	(1.6)	(0.6)
		5.1	2.2
Items that may be reclassified subsequently to the income statement:			
Exchange differences on translation of foreign operations		14.4	(14.5)
Cash flow hedges		(1.4)	1.3
Fair value (loss) / gain on AFS investments	29	(100.5)	97.2
Less: realised net gains on AFS investments included in income statement	29	(44.3)	(22.8)
Tax relating to items that may be reclassified	29	34.6	(17.6)
		(97.2)	43.6
Other comprehensive (loss) / income for the year net of tax		(92.1)	45.8
Total comprehensive income for the year attributable to owners of the Company		488.3	418.4

The attached notes on pages 111 to 163 form an integral part of these consolidated financial statements.

Consolidated balance sheet

As at 31 December 2015

	Notes	2015 £m	2014 £m
Assets			
Goodwill and other intangible assets	18	524.8	517.5
Property, plant and equipment	19	186.3	181.3
Investment property	20	347.4	307.2
Reinsurance assets	22	1,011.4	862.5
Current tax assets	14	0.1	0.1
Deferred acquisition costs	23	203.8	208.4
Insurance and other receivables	24	955.8	959.9
Prepayments, accrued income and other assets		110.9	107.9
Derivative financial instruments	25	19.6	27.3
Retirement benefit asset	33	13.1	3.5
Financial investments	26	5,614.6	5,961.2
Cash and cash equivalents	27	963.7	880.4
Assets held for sale	5C	5.1	1,208.4
Total assets		9,956.6	11,225.6
Equity		2,630.0	2,810.5
Liabilities			
Subordinated liabilities	30	521.1	526.3
Insurance liabilities	31	4,524.5	4,674.1
Unearned premium reserve	32	1,476.6	1,434.2
Borrowings	27	61.3	69.8
Derivative financial instruments	25	46.4	29.4
Trade and other payables including insurance payables	35	656.5	660.6
Deferred tax liabilities	14	29.9	20.6
Current tax liabilities	14	10.3	35.7
Liabilities held for sale	5C	–	964.4
Total liabilities		7,326.6	8,415.1
Total equity and liabilities		9,956.6	11,225.6

The attached notes on pages 111 to 163 form an integral part of these consolidated financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 29 February 2016. They were signed on its behalf by:

John Reizenstein
Chief Financial Officer

Consolidated statement of changes in equity

For the year ended 31 December 2015

	Notes	Share capital £m	Employee trust shares £m	Capital reserves £m	Revaluation reserve £m	Non-distributable reserve £m	Foreign exchange translation reserve £m	Retained earnings £m	Total shareholders equity £m
Balance at 1 January 2014		150.0	(10.2)	1,450.0	58.8	92.8	0.1	1,048.5	2,790.0
Profit for the year		–	–	–	–	–	–	372.6	372.6
Other comprehensive income		–	–	–	56.8	–	(13.2)	2.2	45.8
Dividends	15	–	–	–	–	–	–	(401.1)	(401.1)
Transfer to non-distributable reserve	29	–	–	–	–	32.1	–	(32.1)	–
Shares acquired by employee trusts		–	(4.4)	–	–	–	–	–	(4.4)
Credit to equity for equity-settled share-based payments	34	–	–	–	–	–	–	6.6	6.6
Shares distributed by employee trusts		–	1.0	–	–	–	–	(1.0)	–
Tax on share-based payments	14	–	–	–	–	–	–	1.0	1.0
Balance at 31 December 2014		150.0	(13.6)	1,450.0	115.6	124.9	(13.1)	996.7	2,810.5
Profit for the year		–	–	–	–	–	–	580.4	580.4
Other comprehensive loss		–	–	–	(110.2)	–	13.0	5.1	(92.1)
Dividends	15	–	–	–	–	–	–	(666.0)	(666.0)
Transfer to non-distributable reserve	29	–	–	–	–	28.0	–	(28.0)	–
Shares acquired by employee trusts		–	(17.8)	–	–	–	–	–	(17.8)
Credit to equity for equity-settled share-based payments	34	–	–	–	–	–	–	12.1	12.1
Shares distributed by employee trusts		–	11.0	–	–	–	–	(11.0)	–
Tax on share-based payments		–	–	–	–	–	–	2.9	2.9
Balance at 31 December 2015		150.0	(20.4)	1,450.0	5.4	152.9	(0.1)	892.2	2,630.0

The attached notes on pages 111 to 163 form an integral part of these consolidated financial statements.

Consolidated cash flow statement

For the year ended 31 December 2015

	Notes	2015 £m	2014 £m
Net cash generated from / (used by) operating activities before investment of insurance assets	36	42.1	(410.6)
Cash generated from investment of insurance assets	36	503.1	1,121.1
Net cash generated from operating activities		545.2	710.5
Cash flows from investing activities			
Purchases of property, plant and equipment		(67.9)	(86.7)
Purchases of intangible assets		(75.5)	(92.8)
Purchases of assets held for sale		–	(12.6)
Proceeds on disposals of assets held for sale		7.1	0.8
Net cash flows from disposal / (acquisition) of subsidiaries		327.1	(24.7)
Net cash generated from / (used by) investing activities		190.8	(216.0)
Cash flows from financing activities			
Dividends paid	15	(666.0)	(401.1)
Finance costs		(38.2)	(37.9)
Purchase of employee trust shares		(17.8)	(4.4)
Net cash used by financing activities		(722.0)	(443.4)
Net increase in cash and cash equivalents		14.0	51.1
Cash and cash equivalents at the beginning of the year		898.2	853.2
Effect of foreign exchange rate changes		(9.8)	(6.1)
Cash and cash equivalents at the end of the year	27	902.4	898.2

The attached notes on pages 111 to 163 form an integral part of these consolidated financial statements.

Corporate information

Direct Line Insurance Group plc is a public limited company registered in England and Wales (company number 02280426). The address of the registered office is Churchill Court, Westmoreland Road, Bromley, BR1 1DP, England.

1. Accounting policies

Basis of preparation

As required by the Companies Act 2006 and Article 4 of the EU IAS Regulation, the consolidated financial statements are prepared in accordance with IFRSs issued by the IASB as adopted by the EU. The financial statements have been prepared in accordance with and full compliance with IFRSs as issued by the IASB.

The consolidated 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's financial statements and the Group's consolidated financial statements are presented in Sterling, which is the functional currency of the Company.

The International segment was classified as a discontinued operation and International assets and liabilities have been presented as a disposal group.

Adoption of new and revised standards

The following amendments have been adopted in the year and have not had a material impact on the Group's financial statements:

IFRS 2 (amended), 'Share-Based Payment' – The amendment defines "performance condition" and "service condition".

IFRS 3 (amended), 'Business Combinations' – The first amendment deals with the accounting for contingent consideration in a business combination and the second amendment clarifies that joint arrangements, not just joint ventures, are outside the scope of IFRS 3.

IFRS 8 (amended), 'Operating Segments' – The first amendment clarifies that an entity must disclose the judgements made by management in applying the aggregation criteria and the second amendment clarifies when a reconciliation of segment assets to total assets is required to be disclosed.

IFRS 13 (amended), 'Fair Value Measurement' – The amendment clarifies that the portfolio exception in IFRS 13 can also be applied to other contracts within the scope of IFRS 9 or IAS 39.

IAS 16 (amended), 'Property, Plant and Equipment' and IAS 38 (amended), 'Intangible Assets' – These amendments clarify that an asset may be revalued by reference to observable data either by adjusting the gross carrying amount of the asset to market value or by determining the market value of the carrying value and adjusting the gross carrying amount proportionately so that the resulting carrying amount equals the market value. In addition, they also clarify that accumulated depreciation and amortisation is the difference between gross and carrying amounts of the asset.

IAS 19 (amended), 'Employee Benefits' – The amendment simplifies the accounting for employee contributions in respect of defined benefit plans that are independent of the number of years of service.

IAS 24 (amended), 'Related Party Disclosures' – The amendment provides additional clarification as to when an entity which provides managerial services is a related party.

IAS 40 (amended), 'Investment Property' – The amendment clarifies that IFRS 3 should be used to assess whether a transaction is the purchase of an asset or a business combination.

1.1 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and the entities that are controlled by the Group at 31 December 2015 and 31 December 2014. Control exists when the Group is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. In assessing if the Group controls another entity, the existence and effect of the potential voting rights that are currently exercisable or convertible are considered.

Where necessary, adjustments have been made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. The policies set out below have been applied consistently throughout the years ended 31 December 2015 and 31 December 2014 to items considered material to the consolidated financial statements.

A subsidiary acquired is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated financial statements at fair value.

All intercompany transactions, balances, income and expenses between Group entities are eliminated on consolidation.

1.2 Foreign currencies

The Group's consolidated financial statements are presented in Sterling which is the presentational currency of the Group. Group entities record transactions in the currency of the primary economic environment in which they operate (their functional currency), translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates 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 the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in the income statement except for differences arising on AFS non-monetary financial assets, which are recognised in other comprehensive income.

1. Accounting policies continued

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into Sterling at the foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into Sterling at average exchange rates unless these do not approximate the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in the consolidated statement of comprehensive income. The amount accumulated in equity is reclassified from equity to the consolidated income statement on disposal or partial disposal of a foreign operation.

1.3 Contract classification

Insurance contracts are those contracts where the Group (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.

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

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

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

Investment 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.

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

Vehicle replacement referral income

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

Income is recognised immediately when the customer or claimant is provided with the hire vehicle.

Revenue from vehicle recovery and repair services

Fees in respect of services for vehicle recovery are recognised as the right to consideration, and accrue through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable.

The Group's income also comprises vehicle repair services provided to other third-party customers. Income in respect of repairs to vehicles is recognised upon completion of the service. The price is determined using market rates for the services and materials used after discounts have been deducted where applicable.

Other income

Commission fee income in respect of services is recognised when a policy has been placed and incepted. Income is stated excluding applicable sales taxes.

Legal services revenue represents the amount charged to clients for professional services provided during the year including recovery of expenses but excluding value added tax. Revenue is only recognised once services have been provided and certainty exists as to the outcome of the respective cases.

1.5 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 PPOs established under the Courts Act 2003. A court can award damages for future pecuniary loss in respect of personal injury or for other damages in respect of personal injury and may order that the damages are wholly or partly to take the form of PPOs. These are covered in more detail in note 2.1. Costs for both direct and indirect claims handling expenses are also included.

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the incidence, timing and amount of claims 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 claims experience. The approach adopted takes into account the nature, type and significance of the business and the type of data available, with large claims generally being assessed separately. The data used for statistical modelling purposes is generated internally and reconciled to the accounting data.

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

A liability adequacy provision is made for unexpired risks arising where the expected value of 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.

1.6 Reinsurance

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

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

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 debtors, to allow for the risk that the reinsurance asset may not be collected or where the reinsurer's credit rating has been downgraded significantly. This also includes an assessment in respect of the ceded part of claims provisions to reflect the counterparty risk exposure to long-term reinsurance assets particularly in relation to periodical payments. Increases in this provision affect the Group by reducing the carrying value of the asset and the impairment loss is recognised in the income statement.

1.7 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.

1.8 Goodwill and other intangible assets

Acquired goodwill, being the excess of the cost of an acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary, associate or joint venture acquired, is initially recognised at cost and subsequently at cost less any accumulated impairment losses. Goodwill arising on the acquisition of subsidiaries, associates and joint ventures is included in the balance sheet category 'goodwill and other intangible assets'. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

Intangible assets that are acquired by the Group 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 operating expenses. The estimated useful economic lives are as follows:

Software development costs	Up to 10 years

Expenditure on internally generated goodwill and brands is written off as incurred. Direct costs relating to the development of internal-use computer software and associated business processes are capitalised once technical feasibility and economic viability have been established. These costs include payroll costs, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the projected benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred, as are all training costs and general overheads.

1.9 Property, plant and equipment

Items of property, plant and equipment (except investment property – note 1.11) 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.

1. Accounting policies continued

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. Land is not depreciated. Estimated useful lives are as follows:

Freehold and leasehold buildings	50 years or the period of the lease if shorter
Vehicles	3 years
Computer equipment	Up to 5 years
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.

1.10 Impairment of intangible assets, goodwill and property, plant and equipment

At each reporting date, the Group assesses whether there is any indication that its intangible assets, goodwill or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss, if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. If an asset does not generate cash flows that are independent of those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit ("**CGU**") to which the asset belongs. 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 or CGU, discounted at a rate that reflects market interest rates, adjusted for risks specific to the asset or CGU that have not been reflected in the estimation of future cash flows.

If the recoverable amount of an intangible or a tangible asset 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. Impairment losses on goodwill are not reversed.

1.11 Investment property

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

1.12 Financial assets

Financial assets are classified as AFS, held-to-maturity ("**HTM**"), designated at fair value through profit or loss, or loans and receivables. The Group only holds AFS financial assets, HTM financial assets and loans and receivables.

AFS

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

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

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

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 or HTM. Loans and receivables are initially recognised at fair value plus directly related transaction costs and are subsequently measured at amortised cost using the effective interest rate method less any impairment losses.

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

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

Impairment of financial assets
At each balance sheet date the Group assesses whether there is any objective evidence that a financial asset or group of financial assets classified as AFS, HTM 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 have 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.

HTM and loans and receivables
If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as HTM or loans and receivables has been incurred, the Group 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 charged to the income statement and the bad debt provision is released 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 Group 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 cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised directly in equity. Any ineffective portion is recognised in the income statement.

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.

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 Group 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.

1.13 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, are measured at amortised cost using the effective interest rate method.

1. Accounting policies continued

1.14 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.

1.15 Subordinated liabilities
Subordinated liabilities comprise subordinated guaranteed dated 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.

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

When the Group has an onerous contract, it recognises the present obligation under the contract as a provision. A contract is onerous when the unavoidable costs of meeting the contractual obligations exceed the expected future economic benefit. In respect of leasehold properties, a provision is recognised when the Group has a detailed formal plan to vacate the leasehold property, or significantly reduce its level of occupancy, the plan has been communicated to those affected and the future property costs under the lease exceed future economic benefits.

Restructuring provisions are made, including redundancy costs, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan and has communicated the plan to those affected.

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

1.18 Pensions and other post-retirement benefits
The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

Contributions to the Group's defined contribution pension scheme are recognised in the income statement when payable.

The Group's defined benefit pension scheme, as described in note 33, was closed in 2003. Scheme liabilities are measured on an actuarial basis, using the projected unit credit method, and discounted at a rate that reflects the current rate of return on a high-quality corporate bond of equivalent term and currency to the scheme liabilities.

Scheme assets are measured at their fair value. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). The current service cost and any past service costs, together with the net interest on net pension liability or asset, is charged or credited to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside the income statement and presented in other comprehensive income under 'Items that will not be reclassified subsequently to the income statement'.

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

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

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

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

1.20 Share-based payments
The Group operates a number of share-based compensation plans under which it awards Ordinary Shares and share options to its employees. Such awards are generally subject to vesting conditions that vary the amount of cash or shares to which an employee is entitled.

Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the Group to meet specified performance targets).

The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility.

The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of the Company's Ordinary Shares).

The cost is expensed on a straight-line basis over the vesting period (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest.

The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

1.21 Capital instruments
The Group classifies a financial instrument that it issues as a financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms, or as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities.

The consideration for any Ordinary Share of the Company purchased by the Group for the benefit of the employee trusts is deducted from equity.

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 the AGM.

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 first originate or are acquired. In subsequent periods, if there is a significant increase in credit risk of a financial instrument since it was originated or acquired, the full lifetime expected credit loss 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'.

IFRS 9 'Financial Instruments' has been adopted for use from 1 January 2018 by the EU, with an option for insurance industry participants to either apply the standard from that date or defer adoption until the IASB issues IFRS 4 (Phase 2) 'Insurance Contracts' and it is adopted by the EU. This option has been provided in order to avoid potential asset and liability mismatches which could arise within the remit of current IFRS until both standards are applied simultaneously.

The Group will make a decision as to the classification of financial assets and liabilities once further certainty exists as to the adoption of IFRS 4 (Phase 2). Accordingly, at this point in time, the Group is not able to fully quantify the impact of adopting IFRS 9 on its financial statements.

In May 2014 the IASB issued IFRS 15 'Revenue from Contracts with Customers' to establish a single comprehensive model to use in accounting for revenue recognition and measurement (insurance contracts are excluded from the scope of IFRS 15). The standard provides 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 Group 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 Group's financial statements.

The effective date of this new standard has been revised to annual periods beginning on or after 1 January 2018, although early adoption is permitted.

In January 2016 the IASB issued IFRS 16 'Leases'. There are some changes to the guidance with the definition of a lease, in particular, more detail is provided on determining whether a contract conveys the right to use a particular asset; however, in most areas companies will find that their arrangements under the new guidance will not change. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors will continue to classify leases as operating or finance, with the approach to lessor accounting substantially unchanged. The standard will require the Group to consider how some of the lease arrangements are currently treated to determine if changes are required to existing accounting practices.

IFRS 16 applies to annual reporting periods beginning on or after 1 January 2019, although early adoption is permitted.

2. Critical accounting estimates and judgements

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial information. The Group's principal accounting policies are set out on pages 111 to 117. Company law and IFRSs require the Directors, in preparing the Group'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 and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of Financial Statements. The judgements and assumptions involved in the Group'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 Group would affect its reported results.

2.1 General insurance: outstanding claims provisions and related reinsurance recoveries

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling. Outstanding claims provisions net of related reinsurance recoveries at 31 December 2015 amounted to £3,602.6 million (2014: £3,898.6 million with an additional £393.6 million included in liabilities held for sale).

Claims reserves are assessed separately for large and attritional claims, typically using standard actuarial methods of projection. Key judgements in this assessment include the selection of specific methods as well as assumptions for claims frequency and severity through the review of historical claims and emerging trends.

The corresponding reinsurance recoveries and impairment provision are calculated on an equivalent basis, using significant judgement, as discussed in note 1.6. The reinsurance bad debt provision is mainly for expected recoveries against future PPO payments. The methodology to calculate the impairment provision was refined in the year to more closely align to Solvency II and to more accurately reflect potential future exposure to credit risk and the expected timeframe of cash flows associated with recoveries against these claims.

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. Other estimates are also required for case management expenses, loss of pension, court protection fees, alterations to accommodation and transportation fees.

In August 2012, the Ministry of Justice announced a review of the approach to setting the Ogden discount rate within the existing legal framework. Following further consultation, in 2015 the Justice Secretary appointed a panel of three financial investment experts who will provide testimony on potential changes to the discount rate on personal injury damages. We are awaiting the outcome of their review.

The Group holds provisions for a reduction in the Ogden discount rate at 31 December 2015 to 1.5% (2014: 1.5%). Details of sensitivity analysis to the assumed Ogden discount rate are shown in note 3.3.1.

The Group settles some large bodily injury claims as PPOs rather than lump sum payments.

The table below analyses the outstanding PPO claims provisions on a discounted and an undiscounted basis at 31 December 2015 and 31 December 2014. These represent the total cost of PPOs rather than any costs in excess of purely Ogden-based settlement.

At 31 December	Discounted 2015 £m	Undiscounted 2015 £m	Discounted 2014 £m	Undiscounted 2014 £m
Gross claims				
Approved PPO claims provisions	452.3	1,315.7	422.6	1,245.7
Anticipated PPOs	538.3	1,660.8	651.0	1,963.2
Total	990.6	2,976.5	1,073.6	3,208.9
Reinsurance				
Approved PPO claims provisions	(231.1)	(721.5)	(216.6)	(688.6)
Anticipated PPOs	(227.8)	(818.4)	(216.5)	(839.6)
Total	(458.9)	(1,539.9)	(433.1)	(1,528.2)
Net of reinsurance				
Approved PPO claims provisions	221.2	594.2	206.0	557.1
Anticipated PPOs	310.5	842.4	434.5	1,123.6
Total	531.7	1,436.6	640.5	1,680.7

The provisions for PPOs have been categorised as either claims which have already settled as PPOs (approved PPO claims provisions) or those expected to settle as PPOs in the future (anticipated PPOs). Anticipated PPOs consist of both existing large loss case reserves including allowances for development and claims yet to be reported to the Group. Reinsurance is applied at claim level and the net cash flows are discounted for the time value of money. The discount rate is consistent with the long duration of the claims payments and the assumed future indexation of the claims payments.

In the majority of cases, the inflation agreed in the settlement is the Annual Survey of Hours and Earnings SOC 6115 inflation published by the Office for National Statistics, for which the long-term rate is assumed to be 4.0% (2014: 4.0%). The rate of interest used for the calculation of present values is 4.0% (2014: 4.0%), which results in a real discount rate of 0.0% (2014: 0.0%). Since lump sum payments are calculated using a real discount rate of 2.5% (2014: 2.5%) the PPOs reserved cost is greater than that of lump sum settlements.

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

2.2 Impairment provisions – financial assets

The Group 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 Group 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 whether 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.

AFS

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

- price performance of a particular AFS debt security, or group of AFS debt securities, demonstrating an adverse trend compared to the market as a whole;
- 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.

There was no impairment provision on AFS debt securities in the year ended 31 December 2015 (2014: £1.3 million release).

Had all the declines in AFS asset values met the criteria above at 31 December 2015, the Group would suffer a loss of £48.7 million (2014: £15.8 million loss of which £0.3 million related to the disposal group), 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.

HTM and loans and receivables

On a quarterly basis, the Group reviews whether there is any objective evidence that the financial instruments classified as HTM or loans and receivables are impaired based on the following criteria:

- adverse movements in the credit rating of the borrower;
- actual, or imminent, default on interest or nominal; or
- offer on buyback or loan below par value.

There was no impairment provision in respect of financial instruments classified as HTM or loans and receivables in the year ended 31 December 2015 (2014: £nil).

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 AFS debt securities at 31 December 2015 amounted to £5,226.6 million (2014: £5,830.3 million with an additional £706.9 million included in assets held for sale). The fair value of derivative financial assets and liabilities amounted to £19.6 million (2014: £27.3 million) and £46.4 million (2014: £29.4 million) respectively.

Freehold and long leasehold properties that are classified as investment properties are recognised in the financial statements at fair value. The fair value at 31 December 2015 amounted to £347.4 million (2014: £307.2 million) and was determined using a valuation model that includes inputs that are unobservable.

2. Critical accounting estimates and judgements continued

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 Group 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 values obtained from quoted market prices of comparable securities.

Investment property

Investment property is recorded at fair value, measured by independent valuers who hold recognised and relevant professional qualifications. 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 and liabilities 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 includes inputs for the asset that are unobservable.

2.4 Deferred acquisition costs

The Group defers a proportion of acquisition costs incurred during the year to subsequent accounting periods. Management uses 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 1.7. Total deferred acquisition costs at 31 December 2015 amounted to £203.8 million (2014: £208.4 million with an additional £111.1 million included in assets held for sale). During 2015, the Group reviewed these costs included in the calculation of deferred acquisition costs and considers them to be appropriate, and has determined that they are recoverable.

2.5 Goodwill

The Group capitalises goodwill arising on the acquisition of businesses as discussed in note 1.8. The carrying value of goodwill at 31 December 2015 was £211.0 million (2014: £211.0 million).

Goodwill is the excess of the cost of an acquired business over the fair value of its net assets. The determination of the fair value of assets and liabilities of businesses acquired requires the exercise of management judgement; for example, those financial assets and liabilities for which there are no quoted prices and those non-financial assets where valuations reflect estimates of market conditions, such as property. Different fair values would result in changes to the goodwill arising and to the post-acquisition performance. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's CGUs or groups of CGUs expected to benefit from the combination. Goodwill impairment testing involves the comparison of the carrying value of a CGU or group of CGUs with its recoverable amount. The recoverable amount is the higher of the CGU's fair value and its value in use. Value in use is the present value of expected future cash flows from the CGU or group of CGUs. Fair value is the amount obtainable from the sale of the CGU in an arm's length transaction between knowledgeable, willing parties.

Impairment testing inherently involves a number of judgemental areas: the preparation of the five-year strategic plan and the extrapolation of cash flow forecasts beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of CGUs; and the valuation of the separable assets of each business whose goodwill is being reviewed. Details of a sensitivity analysis on the recoverable amount in excess of carrying value are shown in note 18.

2.6 Property, plant and equipment

The Group 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 Group is satisfied that the aggregate value of property, plant and equipment is not less than its carrying value.

3. Risk management

3.1 Enterprise Risk Management Strategy and Framework

The ERMF sets out, at a high level, our approach and processes for managing risks. Further information can be found in the Risk management section of the Strategic report on page 26.

3.2 Risk and capital management modelling

The Board has ultimate responsibility for ensuring that the Group has sufficient funds to meet its liabilities as they fall due. The Group carries out detailed modelling of its assets, liabilities and the key risks to which these are exposed. This modelling includes the Group's own assessment of its SCR. The assessment has been submitted to the PRA as part of the Group's application for IMAP. The SCR quantifies the insurance, market, credit, operational and liquidity risk that the regulated entities are undertaking.

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

3.3 Principal risks from insurance activities and use of financial instruments

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

3.3.1 Insurance risk

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

The insurance risks that the Group faces include those referred to below:

Reserve risk

Reserve risk relates to both premiums and claims. This is the risk that reserves are understated arising from:

- the random nature of claims;
- data issues; and
- operational failures.

Understatement of reserves may result in not being able to pay claims when they fall due. Alternatively, overstatement of reserves can lead to a surplus of funds being retained resulting in opportunity cost.

Reserve risk is controlled through a range of processes:

- regular reviews of the claims, premiums and an assessment of the requirement for a liability adequacy provision for the main classes of business by the internal actuarial team;
- the use of external actuaries to review periodically the actuarial best estimate reserves produced internally, either through peer review or through provision of independent reserve estimates;
- accompanying all reserve reviews with actuarial assessment of the uncertainties through a variety of techniques including 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
- regular assessment of the volatility in the reserves to help the Board set management best estimate reserves.

The Group'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 Ministry of Justice. The Group has calculated its estimated reserves based on an assumed Ogden discount rate of 1.5%, in recognition of the uncertainty regarding the future rate.

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

3. Risk management continued

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 could have an additional financial impact on the Group.

	Increase / (decrease) in income statement		Increase / (decrease) in total equity at 31 December	
	2015 £m	2014 £m	2015 £m	2014 £m
PPOs[1]				
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	76.0	87.3	76.0	87.3
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(109.4)	(121.8)	(109.4)	(121.8)
Ogden[2]				
Impact of an increase in the Ogden discount rate by 100 basis points	131.9	159.6	131.9	159.6
Impact of a decrease in the Ogden discount rate by 100 basis points	(190.0)	(224.0)	(190.0)	(224.0)

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 4.0%. 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 total equity and would be reflected in the income statement.
2. The sensitivities relating to an increase or decrease in the Ogden discount rate illustrate a movement in the value from the current prescribed level of 2.5%.
3. These sensitivities reflect one-off impacts at 31 December excluding the impact of taxation and should not be interpreted as a prediction.

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

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

Underwriting risk
This is the risk that future claims experience on policies written is materially different from the results expected, resulting in losses. The Group predominantly underwrites personal lines insurance including motor, residential property, roadside assistance, creditor, travel and pet business. The Group 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 Group's liability usually extends for a 12 month period, after which the Group 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.

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

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

- Geographic concentration risk – the Group purchases a catastrophe reinsurance programme to protect against a modelled 1 in 200-year loss. The retained deductible is £150 million at 31 December 2015 (2014: £150 million);
- Product concentration risk – the Group's business is heavily concentrated in the UK general insurance market. However, the Group offers a diversified portfolio of products and a variety of brands sold through a range of distribution channels to its customers; and
- Sector concentration risk – the concentration of the Group to any given industry sector is monitored and analysed in respect of commercial customers.

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

Distribution risk
This is the risk of material change in the volume of policies, written through a distribution channel, which may result in losses or reduced profitability.

Pricing risk
This is the risk of economic loss arising from policies being incorrectly priced or accepted to achieve desired volume and profitability.

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

- Reinsurance concentration risk – 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;
- 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, in terms of both policy management and claims not being handled within the reinsurance contract terms and conditions or paid on an ex-gratia basis resulting in reinsurance recoveries not being made in full;
- Inappropriate or inaccurate management information and / or modelling being used to determine the value for money and purchasing of reinsurance (including aggregate modelling); and
- Changes in the external legal, regulatory, social or economic environment altering the definition and application of reinsurance policy wordings or the effectiveness or value for money of reinsurance.

The Group 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 Group's capital requirements; and / or
- transfer risk that is not within the Group's current risk retention strategy.

3. Risk management continued

Using reinsurance, the Group cedes 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 Group's panel of reinsurers is therefore important and both the quality and amount of the assumed counterparty risk are subject to an approval process whereby reinsurance is only purchased from reinsurers that hold a credit rating of at least A- at the time cover is purchased. The Group's leading counterparty exposures represent the accumulated counterparty risk for all Group underwriting entities and are reviewed on a monthly basis. The Group aims to contract with a diverse range of reinsurers on its contracts to mitigate the credit and / or non-payment risks associated with its reinsurance exposures.

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

3.3.2 Market risk

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

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

- Spread risk;
- Interest rate risk;
- Property risk; and
- Foreign currency risk.

The Group has policies and limits approved by the 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 Group is willing to accept having considered strategy, risk appetite and capital resources.

The Group 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 Group's investments across asset classes has been approved at the Investment Committee.

The strategic asset allocation within the investment portfolio is reviewed by the Investment Committee, which makes recommendations to the Board for its investment strategy approval. The Investment Committee determines policy and controls, covering such areas as risk, liquidity and performance. The Investment Committee meets at least three times a year to evaluate risk exposure, the current strategy, associated policies and investment guidelines and to consider investment recommendations submitted to it. Oversight of the implementation of decisions taken by the Investment Committee is via the 1st and 2nd Lines of Defence.

The investment management objectives are to:

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

The Group has a property portfolio and an infrastructure debt portfolio in order to improve matching to the longer duration PPOs.

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

Spread risk

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

Interest rate risk

This is the risk of loss from all assets and liabilities for which the net asset value is sensitive to changes in the term structure of interest rates or interest rate volatility. The Group's interest rate risk arises mainly from its debt, floating interest rate investments and assets and liabilities exposed to fixed interest rates.

The fixed interest rate up to 27 April 2022 on the Group's 30-year maturity £500 million of subordinated guaranteed dated notes has been exchanged for a floating rate of interest (note 30).

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

The market value of the Group's financial investments with fixed coupons is affected by the movement of interest rates. For the majority of investments in US Dollar corporate bonds, excluding £336.9 million of short duration high yield bonds (2014: £297.4 million), the Group hedges the exposure of this portfolio to the US Dollar interest rate risk using swaps. These derivatives reduce the duration of the portfolio to close to zero.

Property risk
This risk results from adverse price fluctuations on commercial property investments. At 31 December 2015, the value of these property investments was £347.4 million (2014: £307.2 million). The property investments are located in the UK.

Foreign currency risk
The exposure to currency risk is generated by the Group's investments in US Dollar corporate bonds and US Dollar securitised credit.

The Group maintains exposure to US Dollar securities through £1,876.3 million (2014: £1,892.3 million) of investments in US Dollar corporate bonds and US Dollar securitised credit. The foreign currency exposure of these investments is hedged by foreign currency forward contracts, maintaining a minimal unhedged currency exposure on these portfolios, as well as a low basis currency risk on the hedging.

The Group was also exposed to currency risk through its investments in subsidiaries in Italy and Germany (that is, investments in equity) until the disposal of the International business on 29 May 2015.

Sensitivity analysis
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 Group.

	Increase / (decrease) in income statement		Increase / (decrease) in total equity at 31 December	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Spread				
Impact of a 100 basis points increase in spreads on financial investments and derivatives[1,2,4,5]	**–**	–	**(160.1)**	(163.5)
Interest rate				
Impact of a 100 basis points increase in interest rates on financial investments and derivatives[1,3,4,5]	**22.1**	19.1	**(120.0)**	(122.8)
Investment property[5]				
Impact of a 15% decrease in property markets	**(52.1)**	(46.1)	**(52.1)**	(46.1)

Notes:

1. The income statement impact on financial investments is limited to floating rate instruments and interest rate derivatives used to hedge a portion of the portfolio. The income statement is not impacted in relation to fixed rate instruments, in particular AFS debt securities, where the coupon return is not impacted by a change in prevailing market rates, as the accounting treatment for AFS debt securities means that only the coupon received is processed through the income statement with fair value movements being recognised through total equity.
2. The increase or decrease in total equity reflects a fair value movement in infrastructure debt and HTM debt securities that would not be recorded in the financial statements under IFRSs as they are classified as loans and receivables and HTM respectively, which are carried at amortised cost. This result has been included in the table above to provide a comprehensive analysis of the fair value impact of this sensitivity.
3. The sensitivities set out above reflect one-off impacts at 31 December with the exception of the income statement interest rate sensitivity on financial investments and derivatives, which projects a movement in a full year's interest charge as a result of the increase in the interest rate applied to these assets or liabilities on those positions held at 31 December.
4. The subordinated liabilities and associated interest rate swap are excluded from the sensitivity analysis.
5. The sensitivities calculated above exclude the impact of assets in the disposal group at 31 December 2014.
6. The sensitivities set out above have not considered the impact of the general market changes on the value of the Group's insurance liabilities or retirement benefit obligations.
7. These sensitivities reflect one-off impacts at 31 December excluding the impact of taxation and should not be interpreted as a prediction.

3. Risk management continued

The Group 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 2015, the Group has pledged £12.3 million in cash (2014: £17.3 million) to cover out of the money derivative positions. At 31 December 2015, counterparties have pledged £19.7 million in UK Gilts (2014: £21.5 million in UK Gilts) to the Group to cover in the money derivative positions.
The terms and conditions of collateral pledged for both assets and liabilities are market standard. When securities are pledged they are required to be readily convertible to cash, and as such no policy has been established for the disposal of assets not readily convertible into cash.

3.3.3 Credit risk

This is the risk of loss resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which the Group is exposed. The Group is mainly exposed to the following credit risk factors:

- Counterparty default risk; and
- Concentration risk.

Counterparty default risk
This is the risk of loss from unexpected default, deterioration in the credit standing of the counterparties and debtors of the Group. It is primarily managed by the 1st Line of Defence and monitored by the Credit Risk Forum. The main responsibility of this forum is to ensure that all material aspects of counterparty risk within the Group are identified, monitored and measured.

The main sources of counterparty risk for the Group are:

- Investments – this arises from the investment of funds in a 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. 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 amount and longevity.

The following tables 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 2015	Neither past due nor impaired £m	Past due 1 – 90 days £m	Past due more than 90 days £m	Assets that have been impaired £m	Carrying value in the balance sheet £m
Reinsurance assets	1,011.4	–	–	–	1,011.4
Insurance and other receivables	917.3	32.4	6.1	–	955.8
Derivative assets	19.6	–	–	–	19.6
Debt securities	5,240.1	–	–	–	5,240.1
Deposits with credit institutions with maturities > three months	44.9	–	–	–	44.9
Infrastructure debt	329.6	–	–	–	329.6
Cash and cash equivalents	963.7	–	–	–	963.7
Total	8,526.6	32.4	6.1	–	8,565.1

At 31 December 2014	Neither past due nor impaired £m	Past due 1 – 90 days £m	Past due more than 90 days £m	Assets that have been impaired £m	Carrying value in the balance sheet £m
Reinsurance assets	862.5	–	–	–	862.5
Insurance and other receivables	907.3	52.0	0.6	–	959.9
Derivative assets	27.3	–	–	–	27.3
Debt securities	5,830.3	–	–	–	5,830.3
Deposits with credit institutions with maturities > three months	54.7	–	–	–	54.7
Infrastructure debt	76.2	–	–	–	76.2
Cash and cash equivalents	880.4	–	–	–	880.4
Total	8,638.7	52.0	0.6	–	8,691.3

Within the analysis of debt securities above are bank debt securities at 31 December 2015 of £1,305.1 million (2014: £1,328.3 million), that can be further analysed as: secured £86.4 million (2014: £104.1 million); unsecured £1,059.6 million (2014: £1,058.3 million); and subordinated £159.1 million (2014: £165.9 million).

Concentration risk
This is the risk of exposure to increased losses associated with inadequately diversified portfolios of assets and / or obligations, in particular:

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

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

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

At 31 December 2015	Corporate £m	Local government £m	Sovereign £m	Securitised credit £m	Debt securities total £m	Infrastructure debt £m
Australia	107.6	–	–	–	107.6	–
Austria	6.3	–	–	–	6.3	–
Belgium	42.9	–	10.9	–	53.8	–
Canada	47.5	11.4	–	–	58.9	–
Cayman Islands	22.1	–	–	95.3	117.4	–
China	4.5	–	–	–	4.5	–
Denmark	7.9	8.5	–	–	16.4	–
Finland	–	13.7	–	–	13.7	–
France	235.5	25.4	–	–	260.9	–
Germany	325.4	16.4	–	–	341.8	–
Hong Kong	8.2	–	–	–	8.2	–
Ireland	0.8	–	–	–	0.8	–
Italy	10.1	–	4.2	–	14.3	–
Japan	47.8	–	–	–	47.8	–
Luxembourg	5.3	–	–	–	5.3	–
Mexico	9.1	–	–	–	9.1	–
Netherlands	170.7	–	–	–	170.7	–
New Zealand	5.3	–	–	–	5.3	–
Norway	18.3	10.0	–	–	28.3	–
Portugal	1.1	–	–	–	1.1	–
Singapore	24.7	–	–	–	24.7	–
South Korea	8.0	8.7	–	–	16.7	–
Spain	32.5	–	–	–	32.5	–
Sweden	80.7	11.2	–	–	91.9	–
Switzerland	83.9	–	–	–	83.9	–
UK	1,250.7	–	427.6	177.3	1,855.6	329.6
USA	1,639.0	–	–	83.5	1,722.5	–
	4,195.9	105.3	442.7	356.1	5,100.0	329.6
Supranational	–	–	–	–	140.1	–
Total	**4,195.9**	**105.3**	**442.7**	**356.1**	**5,240.1**	**329.6**

3. Risk management continued

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

At 31 December 2014	Corporate £m	Local government £m	Sovereign £m	Securitised credit £m	Debt securities 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	–	–	218.8	238.1	–
China	6.1	–	–	–	6.1	–
Denmark	25.1	–	–	–	25.1	–
Finland	–	14.3	–	–	14.3	–
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	–	5.7	–	18.3	–
Netherlands	154.4	–	–	–	154.4	–
New Zealand	3.6	–	–	–	3.6	–
Norway	24.4	10.1	–	–	34.5	–
Singapore	25.5	–	–	–	25.5	–
South Korea	7.5	7.6	–	–	15.1	–
Spain	30.6	–	–	–	30.6	–
Sweden	73.1	13.0	–	–	86.1	–
Switzerland	82.6	–	–	–	82.6	–
UAE	–	7.0	–	–	7.0	–
UK	1,334.8	–	984.5	69.4	2,388.7	76.2
USA	1,439.6	6.0	–	134.2	1,579.8	–
	4,117.1	120.7	993.8	422.4	5,654.0	76.2
Supranational	–	–	–	–	176.3	–
Total	4,117.1	120.7	993.8	422.4	5,830.3	76.2

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

At 31 December	2015 £m	2015 %	2014 £m	2014 %
Basic materials	102.9	2%	151.9	3%
Communications	237.2	4%	298.5	5%
Consumer, cyclical	298.3	6%	230.7	4%
Consumer, non-cyclical	432.5	8%	363.4	6%
Diversified	52.8	1%	65.9	1%
Energy	243.6	5%	225.7	4%
Financial	1,896.6	36%	1,842.4	32%
Industrial	250.4	5%	250.7	4%
Mortgage and other asset backed securities	356.1	7%	422.4	7%
Sovereign, supranational and local government	688.1	13%	1,290.7	22%
Technology	115.8	2%	67.8	1%
Transport	–	–	15.2	0%
Utilities	565.8	11%	605.0	11%
Total	5,240.1	100%	5,830.3	100%

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

At 31 December	2015 £m	2015 %	2014 £m	2014 %
Social, of which:				
Education	132.3	40%	34.0	44%
Healthcare	98.1	30%	–	–
Other	58.8	18%	22.6	30%
Transport	40.4	12%	19.6	26%
Total	329.6	100%	76.2	100%

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

At 31 December 2015	AAA £m	AA+ to AA- £m	A+ to A- £m	BBB+ to BBB- £m	BB+ and below £m	**Total £m**
Corporate	266.3	604.5	1,976.2	1,019.2	329.7	**4,195.9**
Supranational	123.9	16.2	–	–	–	**140.1**
Local government	36.9	59.0	9.4	–	–	**105.3**
Sovereign	–	438.5	–	4.2	–	**442.7**
Securitised credit[1]	331.2	24.9	–	–	–	**356.1**
Total	**758.3**	**1,143.1**	**1,985.6**	**1,023.4**	**329.7**	**5,240.1**

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	15.3	–	–	120.7
Sovereign	–	988.1	–	5.7	–	993.8
Securitised credit[1]	339.4	83.0	–	–	–	422.4
Total	784.1	1,699.9	2,111.8	940.9	293.6	5,830.3

Note:

1. Securitised credit consists of prime mortgage backed securities, collateralised loan obligations, securitised student loans and commercial mortgage backed securities.

3. Risk management continued

The tables below analyse the credit quality of financial and insurance assets that are neither past due nor impaired (excluding debt securities analysed above). The tables include reinsurance exposure, after provision. Note 3.3.1 details the Group's approach to reinsurance counterparty risk management.

At 31 December 2015	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB- £m	BB+ and below £m	Not rated £m	**Total £m**
Reinsurance assets	–	778.2	225.7	3.2	–	4.3	**1,011.4**
Insurance and other receivables[1]	–	12.4	23.2	25.8	0.4	855.5	**917.3**
Derivative assets	–	0.1	0.4	19.1	–	–	**19.6**
Deposits with credit institutions with maturities > three months	–	5.0	34.9	5.0	–	–	**44.9**
Infrastructure debt	–	–	86.1	227.8	15.7	–	**329.6**
Cash and cash equivalents	831.9	–	60.8	71.0	–	–	**963.7**
Total	**831.9**	**795.7**	**431.1**	**351.9**	**16.1**	**859.8**	**3,286.5**

At 31 December 2014	AAA £m	AA+ to AA– £m	A+ to A– £m	BBB+ to BBB- £m	BB+ and below £m	Not rated £m	Total £m
Reinsurance assets	–	654.1	196.3	4.3	–	7.8	862.5
Insurance and other receivables[1]	–	17.3	17.4	15.5	0.4	856.7	907.3
Derivative assets	–	2.5	0.8	24.0	–	–	27.3
Deposits with credit institutions with maturities > three months	–	54.7	–	–	–	–	54.7
Infrastructure debt	–	–	–	76.2	–	–	76.2
Cash and cash equivalents	729.1	–	81.4	69.9	–	–	880.4
Total	729.1	728.6	295.9	189.9	0.4	864.5	2,808.4

Note:

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

3.3.4 Operational risk

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

Change risk

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

IT continuity risk

This is the risk of loss of technology services due to data, systems or data centre failure and / or failure of a third party to restore services.

Outsourcing risk

This is the risk of failing to implement a robust framework for the sourcing, appointment and ongoing contract management of external suppliers, outsourced service providers and intragroup relationships.

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

3.3.5 Liquidity risk

This is the risk of being unable to realise investments in order to settle financial obligations when they fall due.

The measurement and management of liquidity risk within the Group is undertaken within the limits and other policy parameters of the Group's liquidity risk appetite and is detailed within the liquidity risk minimum standard. Compliance is monitored in respect of both the minimum standard 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 Group 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 tables below analyse the maturity of the Group's derivative assets and liabilities.

	Notional amounts	Maturity and fair value			
At 31 December 2015	**£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)	**27.1**	0.4	–	–	**0.4**
Interest rate swaps	**678.4**	1.1	0.2	17.6	**18.9**
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	**5.0**	0.3	–	–	**0.3**
Total	**710.5**	**1.8**	**0.2**	**17.6**	**19.6**

	Notional amounts	Maturity and fair value			
At 31 December 2015	**£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)	**1,876.3**	42.2	–	–	**42.2**
Interest rate swaps	**1,241.9**	3.0	(0.5)	1.6	**4.1**
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	**0.7**	0.1	–	–	**0.1**
Total	**3,118.9**	**45.3**	**(0.5)**	**1.6**	**46.4**

	Notional amounts	Maturity and fair value			
At 31 December 2014	£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
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	435.6	1.9	0.5	–	2.4
Total	1,186.6	3.1	1.7	22.5	27.3

	Notional amounts	Maturity and fair value			
At 31 December 2014	£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	–	–	–	–
Designated as hedging instruments:					
Foreign exchange contracts (forwards)	5.0	0.1	–	–	0.1
Total	2,862.7	24.3	0.5	4.6	29.4

Note:

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

3. Risk management continued

The tables below analyse financial investments, cash and cash equivalents, 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 2015	Total £m	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m
Debt securities	5,240.1	269.2	1,628.4	1,203.9	1,657.4	481.2
Deposits with credit institutions with maturities in excess of three months	44.9	44.9	–	–	–	–
Infrastructure debt	329.6	11.6	22.0	23.9	78.4	193.7
Cash and cash equivalents	963.7	963.7	–	–	–	–
Total	6,578.3	1,289.4	1,650.4	1,227.8	1,735.8	674.9

At 31 December 2015	Total £m	Within 1 year £m	1 – 3 years £m	3 – 5 years £m	5 – 10 years £m	Over 10 years £m
Subordinated liabilities	521.1	8.3	–	–	512.8	–
Insurance liabilities[1]	4,524.5	1,349.8	1,043.3	564.2	575.1	992.1
Borrowings	61.3	60.8	0.5	–	–	–
Trade and other payables including insurance payables	656.5	652.9	3.0	0.2	0.3	0.1
Total	5,763.4	2,071.8	1,046.8	564.4	1,088.2	992.2

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
Debt securities	5,830.3	938.3	1,663.4	1,175.3	1,669.8	383.5
Deposits with credit institutions with maturities in excess of three months	54.7	54.7	–	–	–	–
Infrastructure debt	76.2	2.8	9.4	7.5	23.3	33.2
Cash and cash equivalents	880.4	880.4	–	–	–	–
Total	6,841.6	1,876.2	1,672.8	1,182.8	1,693.1	416.7

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	526.3	8.3	–	–	518.0	–
Insurance liabilities[1]	4,674.1	1,396.8	1,181.6	651.2	530.5	914.0
Borrowings	69.8	69.8	–	–	–	–
Trade and other payables including insurance payables	660.6	659.4	1.2	–	–	–
Total	5,930.8	2,134.3	1,182.8	651.2	1,048.5	914.0

Note:

1. Insurance liabilities exclude unearned premium reserves as there are no liquidity risks inherent in them.

3.4 Capital adequacy

Capital is managed in accordance with the Group's capital management minimum standard, the objectives of which are to manage capital efficiently and maintain an appropriate level of capitalisation and solvency. The Group determines the appropriate level of capital on the basis of a number of criteria, including economic, regulatory and rating agency capital requirements. The Group seeks to hold capital resources consistent with an 'A' range credit rating.

Prior to 1 January 2016, the regulated insurance entities of the Group carried out an assessment of the adequacy of their overall financial resources in accordance with the PRA's ICA methodology. The insurance capital requirement is calculated on an internal model which is calibrated to a 99.5% confidence interval and considers business written to date and one year of future business. Additionally, the model allows for the uncertainty around the run-off of this business.

From 1 January 2016, the Group's regulatory capital position will be assessed against the Solvency II framework. Initially, the Group (including its regulated insurance entities) will assess its SCR using the standard formula. Its principal underwriter UKI has applied for its internal economic capital model to be approved as its internal model and approval is expected during 2016. From that point, UKI will calculate its capital requirement using the internal model which, will form part of a Group-wide partial internal model.

In 2015, the Group monitored its financial resources with reference to the requirements of the Insurance Group Directive and on this basis at 31 December 2015 had a surplus of approximately £1.7 billion (2014: £1.9 billion). The Group's capital requirements and solvency position are produced and presented to the Board on a regular basis.

4. Segmental analysis

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

Motor

This segment consists of personal motor insurance together with the associated legal protection cover. The Group sells motor insurance through its own brands, Direct Line, Churchill and Privilege, and through partnership brands.

Home

This segment consists of home insurance together with associated legal protection cover. The Group sells home insurance through its own brands, Direct Line, Churchill and Privilege, and through partnership brands.

Rescue and other personal lines

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

Commercial

This segment consists of commercial insurance for small and medium-size entities sold through NIG, Direct Line for Business, Churchill for Business and through partnership brands.

Certain income and charges are not allocated to the specific operating segments above as they are considered by management to be outside underlying business activities by virtue of their one-off incidence, size or nature. Such income and charges are categorised as either run-off or restructuring and other one-off costs, described below.

Run-off

The segment consists of two principal lines, policies previously written through the personal lines broker channel and Tesco business. These residual businesses are now in run-off.

Restructuring and other one-off costs

Restructuring costs are costs incurred in respect of the business activities which have a material effect on the nature and focus of the Group's operations. One-off costs are costs that are non-recurring in nature.

No inter-segment transactions occurred in the year ended 31 December 2015 (2014: £nil). If any transaction were to occur, transfer prices between operating segments would be set on an arm's length basis in a manner similar to transactions with third parties. Segment income, expenses and results will include those transfers between business segments which will then be eliminated on consolidation.

For each operating segment, there is no individual policyholder or customer that represents 10% or more of the Group's total revenue.

4. Segmental analysis continued

The table below analyses the Group's revenue and results for continuing operations by reportable segment for the year ended 31 December 2015.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	**Total ongoing £m**	Run-off £m	**Continuing operations £m**
Gross written premium	1,406.7	866.3	394.1	485.3	**3,152.4**	0.1	**3,152.5**
Gross earned premium	1,358.7	880.3	388.0	483.0	**3,110.0**	0.1	**3,110.1**
Reinsurance premium ceded	(109.4)	(35.3)	(1.6)	(42.9)	**(189.2)**	–	**(189.2)**
Net earned premium	1,249.3	845.0	386.4	440.1	**2,920.8**	0.1	**2,920.9**
Investment return	138.9	20.5	3.8	31.5	**194.7**	3.4	**198.1**
Instalment income	69.7	23.3	1.7	5.4	**100.1**	–	**100.1**
Other operating income	33.9	0.5	12.6	3.7	**50.7**	–	**50.7**
Total income	1,491.8	889.3	404.5	480.7	**3,266.3**	3.5	**3,269.8**
Insurance claims	(956.7)	(434.8)	(231.6)	(304.5)	**(1,927.6)**	98.3	**(1,829.3)**
Insurance claims recoverable from reinsurers	161.9	(0.3)	–	28.7	**190.3**	(27.9)	**162.4**
Net insurance claims	(794.8)	(435.1)	(231.6)	(275.8)	**(1,737.3)**	70.4	**(1,666.9)**
Commission expenses	(31.9)	(176.7)	(24.5)	(86.1)	**(319.2)**	(0.1)	**(319.3)**
Operating expenses	(327.1)	(167.6)	(96.4)	(98.0)	**(689.1)**	(0.7)	**(689.8)**
Total expenses	(359.0)	(344.3)	(120.9)	(184.1)	**(1,008.3)**	(0.8)	**(1,009.1)**
Operating profit before restructuring and other one-off costs	**338.0**	**109.9**	**52.0**	**20.8**	**520.7**	**73.1**	**593.8**
Restructuring and other one-off costs							**(48.7)**
Operating profit							**545.1**
Finance costs							**(37.6)**
Profit before tax							**507.5**
Underwriting profit / (loss)	**95.5**	**65.6**	**33.9**	**(19.8)**	**175.2**		
Loss ratio	63.6%	51.5%	59.9%	62.7%	**59.5%**		
Commission ratio	2.6%	20.9%	6.4%	19.6%	**10.9%**		
Expense ratio	26.2%	19.8%	24.9%	22.2%	**23.6%**		
COR	**92.4%**	**92.2%**	**91.2%**	**104.5%**	**94.0%**		

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2015.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Run-off £m	**Total £m**
Goodwill	126.4	45.8	28.7	10.1	–	**211.0**
Other segment assets	6,303.4	872.2	177.9	1,573.9	818.2	**9,745.6**
Segment liabilities	(4,701.9)	(650.6)	(132.7)	(1,174.0)	(667.4)	**(7,326.6)**
Segment net assets	**1,727.9**	**267.4**	**73.9**	**410.0**	**150.8**	**2,630.0**

The table below analyses the Group's revenue and results for continuing operations by reportable segment for the year ended 31 December 2014.

	Motor[1] £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total ongoing £m	Run-off £m	Continuing operations £m
Gross written premium	1,342.0	898.6	371.8	487.0	3,099.4	(0.4)	3,099.0
Gross earned premium	1,372.6	920.4	370.5	481.1	3,144.6	(0.4)	3,144.2
Reinsurance premium ceded	(76.7)	(45.1)	(1.4)	(34.3)	(157.5)	–	(157.5)
Net earned premium	1,295.9	875.3	369.1	446.8	2,987.1	(0.4)	2,986.7
Investment return	144.8	25.7	6.1	34.0	210.6	4.5	215.1
Instalment income	69.6	24.0	1.5	5.3	100.4	–	100.4
Other operating income	32.9	0.7	10.8	2.5	46.9	–	46.9
Total income	1,543.2	925.7	387.5	488.6	3,345.0	4.1	3,349.1
Insurance claims	(931.5)	(445.1)	(211.9)	(261.7)	(1,850.2)	71.6	(1,778.6)
Insurance claims recoverable from reinsurers	63.4	0.8	–	6.4	70.6	(19.4)	51.2
Net insurance claims	(868.1)	(444.3)	(211.9)	(255.3)	(1,779.6)	52.2	(1,727.4)
Commission expenses	(41.4)	(190.3)	(34.5)	(87.8)	(354.0)	–	(354.0)
Operating expenses	(336.6)	(177.2)	(93.1)	(98.5)	(705.4)	(1.0)	(706.4)
Total expenses	(378.0)	(367.5)	(127.6)	(186.3)	(1,059.4)	(1.0)	(1,060.4)
Operating profit before restructuring and other one-off costs	297.1	113.9	48.0	47.0	506.0	55.3	561.3
Restructuring and other one-off costs							(69.6)
Operating profit							491.7
Finance costs							(37.2)
Gain on disposal of subsidiary							2.3
Profit before tax							456.8
Underwriting profit	49.8	63.5	29.6	5.2	148.1		
Loss ratio	67.0%	50.8%	57.4%	57.1%	59.6%		
Commission ratio	3.2%	21.7%	9.4%	19.7%	11.8%		
Expense ratio	26.0%	20.2%	25.2%	22.0%	23.6%		
COR	96.2%	92.7%	92.0%	98.8%	95.0%		

Note:
1. The Group's revenue and results for the year ended 31 December 2014 relating to the Tracker business, which was disposed of on 5 February 2014, were recorded in the Motor segment (other operating income: £1.4 million and operating loss: £0.4 million).

The table below analyses the Group's assets and liabilities by reportable segment at 31 December 2014.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Run-off £m	Disposal group £m	Total £m
Goodwill	126.4	45.8	28.7	10.1	–	–	211.0
Disposal group – assets held for sale[1]	–	–	–	–	–	1,205.4	1,205.4
Other segment assets	6,392.5	746.2	170.6	1,453.3	1,046.6	–	9,809.2
Disposal group – liabilities held for sale[1]	–	–	–	–	–	(964.4)	(964.4)
Other segment liabilities	(4,796.8)	(559.9)	(128.0)	(1,090.5)	(875.5)	–	(7,450.7)
Segment net assets	1,722.1	232.1	71.3	372.9	171.1	241.0	2,810.5

Note:
1. Comprise the assets and liabilities of International.

All continuing operations are in the UK. The reportable segment net assets do not represent the Group's view of the capital requirements for its operating segments.

The segmental analysis of assets and liabilities is prepared using a combination of asset and liability balances directly attributable to each operating segment and an apportionment of assets and liabilities managed at a Group wide level.

5. Discontinued operations and disposal group

Following a strategic review of the International segment during 2014, the Board concluded that, although the operations in Italy (represented by Direct Line Insurance S.p.A) and Germany (represented by Direct Line Versicherung AG) occupied strong positions, a disposal would be likely to generate the most value to shareholders. On 25 September 2014, the Group entered into a binding agreement with Mapfre International S.A., a wholly-owned subsidiary of Mapfre, S.A., for the sale of International. Accordingly, the Group has treated this segment as discontinued operations and a disposal group.

The Group completed the disposal of its Italian and German subsidiaries on 29 May 2015, generating a gain on disposal of £167.1 million.

A) Discontinued operations

The following table analyses performance relating to the discontinued operations for the period from 1 January to disposal on 29 May 2015 and the year ended 31 December 2014.

	2015 £m	2014 £m
Gross written premium	261.1	567.6
Gross earned premium	207.2	555.8
Reinsurance premium ceded	(78.8)	(226.0)
Net earned premium	128.4	329.8
Investment return[1]	37.1	22.1
Instalment income	1.4	4.8
Other operating income	0.1	1.0
Total income	167.0	357.7
Insurance claims	(156.2)	(404.2)
Insurance claims recoverable from reinsurers	60.9	159.5
Net insurance claims	(95.3)	(244.7)
Commission expenses	(28.0)	(63.0)
Operating expenses	(10.2)	(29.0)
Total expenses	(38.2)	(92.0)
Operating profit from discontinued operations	33.5	21.0
Gain on disposal of discontinued operations	167.1	–
Profit before tax from discontinued operations	200.6	21.0
Tax charge	(19.4)	(7.7)
Profit after tax from discontinued operations	181.2	13.3
Underwriting loss	(5.1)	(6.9)
Loss ratio	74.2%	74.2%
Commission ratio	21.8%	19.1%
Expense ratio	8.0%	8.8%
COR	104.0%	102.1%

Note:

1. Realised net gains on AFS investments in 2015 included £29.9 million of gains reclassified through the income statement, on disposal of International (2014: £nil).

The following table analyses the other comprehensive loss relating to discontinued operations, included in the consolidated statement of comprehensive income for the period from 1 January to disposal on 29 May 2015 and year ended 31 December 2014.

	2015 £m	2014 £m
Items that may be reclassified subsequently to income statement:		
Exchange differences on the translation of foreign operations	14.4	(15.5)
Cash flow hedge	(1.2)	–
Fair value gain on AFS investments	0.6	26.1
Less: realised net gains on AFS investments included in income statement	(31.8)	(6.6)
Tax relating to items that may be reclassified	10.1	(6.9)
Other comprehensive loss for the year net of tax	(7.9)	(2.9)

The following table analyses the cash flows relating to the discontinued operations included in the consolidated cash flow statement for the period 1 January to disposal on 29 May 2015 and the year ended 31 December 2014.

	2015 £m	2014 £m
Net cash generated from operating activities	19.1	12.6
Net cash used by investing activities	(1.5)	(8.4)
Net cash generated from the disposal of discontinued operations[1]	327.1	–
Effect of foreign exchange rate changes	(9.8)	(6.1)
Net increase / (decrease) in cash and cash equivalents	**334.9**	(1.9)

Note:

1. The net cash generated from the disposal of discontinued operations comprises the net cash consideration of £422.5 million less the cash held by the German and Italian subsidiaries at the point of sale of £95.4 million.

B) Disposal group

The following table analyses the gain on disposal of discontinued operations during the year including the assets and liabilities held for sale in the disposal group immediately prior to the disposal on 29 May 2015.

	29 May 2015 £m	31 December 2014 £m
Assets		
Intangible assets	5.4	5.6
Property, plant and equipment	5.2	5.9
Reinsurance assets	171.0	183.0
Deferred tax assets	41.9	9.2
Current tax assets	–	1.4
Deferred acquisition costs	105.5	111.1
Insurance and other receivables	152.3	91.1
Prepayments and accrued income	3.1	3.6
Financial investments	665.5	706.9
Cash and cash equivalents	95.4	87.6
Total assets	**1,245.3**	1,205.4
Liabilities		
Insurance liabilities	504.5	553.4
Unearned premium reserve	355.0	326.2
Trade and other payables including insurance payables	125.3	82.0
Deferred tax liabilities	32.0	0.8
Current tax liabilities	4.0	2.0
Total liabilities	**1,020.8**	964.4
Net assets	**224.5**	
Cash consideration received[1]	**438.1**	
Transaction costs	(15.6)	
Net cash consideration	**422.5**	
Net assets disposed	(224.5)	
Currency translation reserve reclassified to the income statement	(30.9)	
Gain on disposal of discontinued operations	**167.1**	

Note:

1. The Group entered into a foreign currency hedge converting Euro into Sterling in September 2014 for the disposal proceeds. The foreign currency hedge gain of £34.0 million and other sale-related consideration are included in cash consideration received.

5. Discontinued operations and disposal group continued

C) Assets and liabilities held for sale

The following table analyses the assets and liabilities held for sale at 31 December 2015.

	2015 £m	2014 £m
Assets held for sale:		
Disposal group (note 5B)	–	1,205.4
Freehold property[1]	5.1	3.0
Total	5.1	1,208.4
Liabilities held for sale:		
Disposal group (note 5B)	–	964.4
Total	–	964.4

Note:

1. The freehold property held at 31 December 2015 comprises the Pudsey sites which were transferred from property, plant and equipment to assets held for sale in 2015 with a carrying value of £22.1 million and impaired by £17.0 million to reflect the estimated realisable value. The freehold property held at 31 December 2014 with a value of £3.0 million comprised the formerly occupied Coombe Cross site in Croydon which was disposed of during 2015, realising proceeds of £7.1 million and generating an impairment reversal of £4.1 million.

6. Net earned premium

Continuing operations	2015 £m	2014 £m
Gross earned premium:		
Gross written premium	3,152.5	3,099.0
Movement in unearned premium reserve	(42.4)	45.2
	3,110.1	3,144.2
Reinsurance premium:		
Premium payable	(191.7)	(182.5)
Movement in reinsurance unearned premium reserve	2.5	25.0
	(189.2)	(157.5)
Total	2,920.9	2,986.7

7. Investment return

Continuing operations	2015 £m	2014 £m
Investment income:		
Interest income from debt securities	140.1	154.0
Cash and cash equivalent interest income	6.7	5.2
Rental income from investment property	17.9	16.2
Interest income from infrastructure debt	4.4	0.1
	169.1	175.5
Net realised gains / (losses):		
AFS debt securities	12.4	16.2
Derivatives	(56.5)	(86.2)
Investment property (note 20)	–	2.3
	(44.1)	(67.7)
Net unrealised gains:		
Impairments of AFS debt securities	–	1.3
Derivatives	48.9	79.6
Investment property (note 20)	24.2	26.4
	73.1	107.3
Total	198.1	215.1

The table below analyses the realised and unrealised gains and losses on derivative instruments included in investment return.

Continuing operations	Realised 2015 £m	Unrealised 2015 £m	Realised 2014 £m	Unrealised 2014 £m
Derivative (losses) / gains				
Foreign exchange forward contracts	(82.4)	(19.1)	(59.3)	(46.4)
Associated foreign exchange risk	44.9	61.9	(7.4)	115.9
Net (losses) / gains on foreign exchange forward contracts	(37.5)	42.8	(66.7)	69.5
Interest rate derivatives	(28.7)	1.2	(20.4)	(22.1)
Associated interest rate risk	9.7	4.9	0.9	32.2
Net (losses) / gains on interest rate derivatives	(19.0)	6.1	(19.5)	10.1
Total	(56.5)	48.9	(86.2)	79.6

8. Other operating income

Continuing operations	2015 £m	2014 £m
Vehicle replacement referral income	12.5	15.8
Revenue from vehicle recovery and repair services	15.5	18.0
Fee income from insurance intermediary services	2.4	2.1
Other income	20.3	11.0
Total	50.7	46.9

9. Net insurance claims

Continuing operations	Gross 2015 £m	Reinsurance 2015 £m	Net 2015 £m	Gross 2014 £m	Reinsurance 2014 £m	Net 2014 £m
Current accident year claims paid	1,037.0	–	1,037.0	1,086.4	–	1,086.4
Prior accident year claims paid	941.9	(15.9)	926.0	1,165.8	(21.8)	1,144.0
Decrease in insurance liabilities	(149.6)	(146.5)	(296.1)	(473.6)	(29.4)	(503.0)
Total	1,829.3	(162.4)	1,666.9	1,778.6	(51.2)	1,727.4

Claims handling expenses for the year ended 31 December 2015 of £200.4 million (2014: £226.3 million) have been included in the claims figures above. Claims handling expenses can be further analysed for the year ended 31 December 2015 between ongoing operations of £195.6 million (2014: £222.3 million) and run-off of £4.8 million (2014: £4.0 million).

10. Commission expenses

Continuing operations	2015 £m	2014 £m
Commission expenses	253.2	263.3
Expenses incurred under profit participations	66.1	90.7
Total	319.3	354.0

11. Operating expenses

Continuing operations	2015 £m	2014 £m
Staff costs	273.3	263.6
Other operating expenses	249.2	299.5
Marketing	117.9	123.9
Amortisation and impairment of other intangible assets	67.4	66.4
Depreciation	30.7	22.6
Total	738.5	776.0

Staff costs attributable to claims handling activities are allocated to the cost of insurance claims.

11. Operating expenses continued

The table below analyses restructuring and other one-off costs included in operating expenses.

	2015 £m	2014 £m
Other operating expenses	30.0	54.1
Staff costs	18.7	15.5
Total	48.7	69.6

The table below analyses the number of people employed by the Group's operations.

	At 31 December		Average for the year	
Continuing operations	2015	2014	2015	2014
Operations	9,531	9,618	9,564	9,959
Support	1,190	1,271	1,257	1,278
Total	10,721	10,889	10,821	11,237

The Group's discontinued operations employed no employees at 31 December 2015 (2014: 1,267) and an average monthly number of 1,279 people for the period until disposal on 29 May 2015 (2014: 1,275).

The aggregate remuneration of those employed by the Group's operations comprised:

Continuing operations	2015 £m	2014 £m
Wages and salaries	335.4	344.0
Social security costs	37.8	37.7
Pension costs	23.4	23.9
Share-based payments	12.1	6.6
Total	408.7	412.2

The aggregate remuneration of those employed by the Group's discontinued operations (note 5A) was £12.6 million in 2015 (2014: £32.9 million).

The table below analyses auditor's remuneration in respect of the Group's operations.

Continuing operations	2015 £m	2014 £m
Fees payable for the audit of:		
The Company's annual accounts	0.3	0.4
The Company's subsidiaries	1.6	1.5
Total audit fees	1.9	1.9
Fees payable for non-audit services:		
Audit-related assurance services	0.3	0.1
Taxation advisory services	–	0.2
Other services	0.6	0.1
Total non-audit services	0.9	0.4
Total	2.8	2.3

The audit fees in respect of the Group's discontinued operations (note 5A) were £nil in 2015 (2014: £0.4 million).

Aggregate Directors' emoluments

The table below analyses the total amount of Directors' remuneration, all of which is in relation to continuing operations, in accordance with Schedule 5 to the Accounting Regulations.

	2015 £m	2014 £m
Salaries, fees, bonuses and benefits in kind	3.5	3.4
Gains on exercise of share options	4.9	1.2
Defined contribution pension scheme contributions	0.1	0.1
Total	8.5	4.7

Further information about the remuneration of individual Directors is provided in the Directors' remuneration report.

At 31 December 2015, one Director (2014: one) had retirement benefits accruing under the defined contribution pension scheme in respect of qualifying service.

During the year ended 31 December 2015, two Directors exercised share options (2014: two).

12. Finance costs

Continuing operations	2015 £m	2014 £m
Interest expense on subordinated liabilities[1]	37.6	37.2

Note:

1. As described in note 30, on 27 April 2012 the Group issued subordinated guaranteed dated notes with a nominal value of £500 million at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year hedge to exchange the fixed rate of interest on the notes for a floating rate of three-month LIBOR plus a spread of 706 basis points, which increased to 707 basis points with effect from 29 July 2013.

13. Tax charge

Continuing operations	2015 £m	2014 £m
Current taxation:		
Charge for the year	103.5	87.2
(Over) / under provision in respect of prior year	(4.6)	3.9
	98.9	91.1
Deferred taxation (note 14):		
Charge for the year	6.4	14.0
Under/ (over) provision in respect of prior year	3.0	(7.6)
	9.4	6.4
Current taxation	98.9	91.1
Deferred taxation (note 14)	9.4	6.4
Tax charge for the year	108.3	97.5

The following table analyses the difference between the actual income tax charge and the expected income tax charge computed by applying the standard rate of corporation tax of 20.25%[1] (2014: 21.5%).

Continuing operations	2015 £m	2014 £m
Profit before tax	507.5	456.8
Expected tax charge	102.8	98.2
Effects of:		
Realised gains on disposal of subsidiaries	–	(0.5)
Disallowable expenses	7.8	3.4
Effect of change in corporation taxation rate	(0.7)	0.1
Over provision in respect of prior year	(1.6)	(3.7)
Tax charge for the year	108.3	97.5
Effective income tax rate	21.3%	21.3%

Note:

1. In the Finance Act 2013 the UK Government enacted a reduction in the corporation tax rate from 23% to 21% effective from 1 April 2014 and a further reduction to 20% effective from 1 April 2015. The Finance (No 2) Act 2015 enacted further reductions to 19% effective from 1 April 2017 and 18% effective from 1 April 2020. As a consequence, the closing deferred tax assets and liabilities have been recognised at the tax rates expected to apply when the assets or liabilities are settled. The impact of these changes on the tax charge for the year is set out in the table above.

14. Current and deferred tax

Current tax

	2015 £m	2014 £m
Per balance sheet:		
Current tax assets	0.1	0.1
Current tax liabilities	(10.3)	(35.7)

Deferred tax

	2015 £m	2014 £m
Per balance sheet:		
Deferred tax liabilities	(29.9)	(20.6)

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

	Provisions and other temporary differences £m	Retirement benefit obligations £m	Depreciation in excess of capital allowances £m	Non-distributable reserve £m	Investment properties £m	Share-based payments £m	Total £m
At 1 January 2014	17.3	0.4	0.4	(18.5)	(1.5)	1.9	–
Credit / (charge) to the income statement on continuing operations	2.6	(0.5)	0.5	(6.5)	(3.3)	0.8	(6.4)
Credit to the income statement on discontinued operations	2.1	–	–	–	–	–	2.1
Charge to other comprehensive income	(7.4)	(0.6)	–	–	–	–	(8.0)
Credit direct to equity	–	–	–	–	–	1.0	1.0
Other movements	(0.8)	–	(0.1)	–	–	–	(0.9)
Transfer to liabilities / assets held for sale	(8.4)	–	–	–	–	–	(8.4)
At 31 December 2014	5.4	(0.7)	0.8	(25.0)	(4.8)	3.7	(20.6)
(Charge) / credit to the income statement on continuing operations	(2.1)	(0.1)	–	(3.9)	(3.6)	0.3	(9.4)
Charge to other comprehensive income	–	(1.6)	–	–	–	–	(1.6)
Credit direct to equity	–	–	–	–	–	1.7	1.7
At 31 December 2015	3.3	(2.4)	0.8	(28.9)	(8.4)	5.7	(29.9)

In addition, the Group has an unrecognised deferred tax asset at 31 December 2015 of £4.1 million (2014: £1.9 million) in relation to capital losses.

15. Dividends

	2015 £m	2014 £m
Amounts recognised as distributions to equity holders in the period:		
2014 final dividend[1] of 8.8 pence per share paid on 17 April 2015	131.6	–
2013 final dividend of 8.4 pence per share paid on 20 May 2014	–	125.7
2015 first interim dividend of 4.6 pence per share paid on 11 September 2015	63.0	–
2014 first interim dividend of 4.4 pence per share paid on 12 September 2014	–	65.8
2015 first special interim dividend of 27.5 pence per share paid on 24 July 2015	411.5	–
2014 first special interim dividend of 10.0 pence per share paid on 12 September 2014	–	149.7
2014 second special interim dividend of 4.0 pence per share paid on 17 April 2015	59.9	–
2013 second special interim dividend of 4.0 pence per share paid on 20 May 2014	–	59.9
	666.0	401.1
Proposed dividends:		
2015 final dividend of 9.2 pence per share	126.5	–
2014 final dividend[1] of 8.8 pence per share	–	132.0
2015 second special interim dividend of 8.8 pence per share	121.0	–
2014 second special interim dividend of 4.0 pence per share	–	60.0

Note:
1. The Board paid an interim dividend in lieu of a final dividend.

The proposed final dividend for 2015 has not been included as a liability in these financial statements.

The trustees of the employee share trusts waived their entitlement to dividends on shares held to meet obligations arising from LTIP, DAIP and Restricted Shares Plan awards, which reduced the total dividend paid for the year ended 31 December 2015 by £1.7 million (2014: £0.9 million).

16. Earnings per share

Earnings per share is calculated by dividing earnings attributable to the owners of the Company by the weighted average number of Ordinary Shares during the period.

On 30 June 2015, the Group completed an 11 for 12 share consolidation which had the effect of reducing the number of shares in issue from 1,500 million Ordinary Shares of 10 pence each to 1,375 million Ordinary Shares of 10 $^{10}/_{11}$ pence each. The weighted average number of Ordinary Shares used in calculating basic and diluted earnings per share reflects this share consolidation.

Basic

Basic earnings per share is calculated by dividing the earnings attributable to the owners of the Company by the weighted average number of Ordinary Shares for the purposes of basic earnings per share during the period, excluding Ordinary Shares held as employee trust shares.

	2015 £m	2014 £m
Earnings attributable to owners of the Company arising from:		
Continuing operations	399.2	359.3
Discontinued operations	181.2	13.3
Continuing and discontinued operations	580.4	372.6
Weighted average number of Ordinary Shares (millions)	1,431.2	1,495.0
Basic earnings per share (pence):		
Continuing operations	27.9	24.0
Discontinued operations	12.7	0.9
Continuing and discontinued operations	40.6	24.9

16. Earnings per share continued

Diluted

Diluted earnings per share is calculated by dividing the earnings attributable to the owners of the Company by the weighted average number of Ordinary Shares during the period adjusted for dilutive potential Ordinary Shares. The Company has share options and contingently issuable shares as categories of dilutive potential Ordinary Shares.

	2015 £m	2014 £m
Earnings attributable to owners of the Company arising from:		
Continuing operations	399.2	359.3
Discontinued operations	181.2	13.3
Continuing and discontinued operations	580.4	372.6
Weighted average number of Ordinary Shares (millions)	1,431.2	1,495.0
Effect of dilutive potential of share options and contingently issuable shares (millions)	17.8	12.9
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	1,449.0	1,507.9
Diluted earnings per share (pence):		
Continuing operations	27.6	23.8
Discontinued operations	12.5	0.9
Continuing and discontinued operations	40.1	24.7

17. Net assets per share and return on equity

Net asset value per share is calculated as total shareholders' equity divided by the number of Ordinary Shares at the end of the period excluding shares held by employee share trusts.

Tangible net asset value per share is calculated as total shareholders' equity less goodwill and other intangible assets divided by the number of Ordinary Shares at the end of the period excluding shares held by employee share trusts.

The table below analyses net asset and tangible net asset value per share.

At 31 December	2015 £m	2014 £m
Net assets	2,630.0	2,810.5
Goodwill and other intangible assets	(524.8)	(517.5)
Disposal group – intangible assets	–	(5.6)
Tangible net assets	2,105.2	2,287.4
Number of Ordinary Shares (millions)	1,375.0	1,500.0
Shares held by employee share trusts (millions)	(6.3)	(6.4)
Closing number of Ordinary Shares (millions)	1,368.7	1,493.6
Net asset value per share (pence)	192.2	188.2
Tangible net asset value per share (pence)	153.8	153.1

Return on equity

The table below details the calculation of return on equity.

	2015 £m	2014 £m
Earnings attributable to owners of the Company arising from:		
Continuing operations	399.2	359.3
Discontinued operations	181.2	13.3
Continuing and discontinued operations	580.4	372.6
Opening shareholders' equity	2,810.5	2,790.0
Closing shareholders' equity	2,630.0	2,810.5
Average shareholders' equity	2,720.2	2,800.2
Return on equity	21.3%	13.3%

18. Goodwill and other intangible assets

	Goodwill £m	Other intangible assets £m	Total £m
Cost			
At 1 January 2014	342.8	445.7	788.5
Effect of foreign currency exchange adjustment	–	(2.6)	(2.6)
Additions	–	92.8	92.8
Disposal of subsidiary[1]	(110.1)	(1.6)	(111.7)
Disposals and write-off[2]	–	(67.2)	(67.2)
Transfer to assets held for sale	(21.7)	(38.6)	(60.3)
At 31 December 2014	211.0	428.5	639.5
Additions	–	74.7	74.7
Disposals and write-off[2]	–	(8.0)	(8.0)
At 31 December 2015	211.0	495.2	706.2
Accumulated amortisation and impairment			
At 1 January 2014	131.8	156.6	288.4
Charge for the year relating to continuing operations	–	56.9	56.9
Charge for the year relating to discontinued operations	–	2.2	2.2
Effect of foreign currency exchange adjustment	–	(2.2)	(2.2)
Disposal of subsidiary[1]	(110.1)	(0.9)	(111.0)
Disposals and write-off[2]	–	(67.2)	(67.2)
Impairment losses	–	9.6	9.6
Transfer to assets held for sale	(21.7)	(33.0)	(54.7)
At 31 December 2014	–	122.0	122.0
Charge for the year relating to continuing operations	–	63.1	63.1
Disposals and write-off[2]	–	(8.0)	(8.0)
Impairment losses	–	4.3	4.3
At 31 December 2015	–	181.4	181.4

Carrying amount			
At 31 December 2015	211.0	313.8	524.8
At 31 December 2014	211.0	306.5	517.5

Notes:

1. Disposal of subsidiary relates to the Tracker business.
2. Disposals and write-off include fully amortised intangible assets no longer utilised by the Group in its operating activities.

Goodwill arose on the acquisition of U K Insurance Limited (£141.0 million) and Churchill Insurance Company Limited (£70.0 million), which is allocated across Motor, Home, Rescue and other personal lines and Commercial.

The Group's testing for goodwill impairment includes the comparison of the recoverable amount of each CGU to which goodwill has been allocated with its carrying value and updated at each reporting date in the event of indications of impairment.

18. Goodwill and other intangible assets continued

The table below analyses the goodwill of the Group by CGU.

	2015 £m	2014 £m
Motor	126.4	126.4
Home	45.8	45.8
Rescue and other personal lines	28.7	28.7
Commercial	10.1	10.1
Total	211.0	211.0

There have been no impairments in goodwill for the year ended 31 December 2015 (2014: £nil).

The recoverable amount is the higher of the CGU fair value less the costs to sell and its value-in-use. Value-in-use is the present value of expected future cash flows from the CGU. Fair value is the estimated amount that could be obtained from the sale of the CGU in an arm's length transaction between knowledgeable and willing parties.

The recoverable amounts of all CGUs were based on the value-in-use test, using the Group's five-year strategic plan. The long-term growth rates have been based on GDP rates adjusted for inflation. The risk discount rates incorporate observable market long-term government bond yields and average industry betas adjusted for an appropriate risk premium based on independent analysis.

The table below details the recoverable amounts in excess of carrying value for the CGUs where goodwill is held.

	Assumptions			Sensitivity: Impact on recoverable amount of a:		
CGU	Terminal growth rate %	Pre-tax discount rate %	Recoverable amount in excess of carrying value £m	1% decrease in terminal growth rate £m	1% increase in pre-tax discount rate £m	1% decrease in forecast pre-tax profit[1] £m
Motor	3.0	11.6	816.6	(201.6)	(276.9)	(26.1)
Home	3.0	11.6	764.6	(72.2)	(99.8)	(9.7)
Rescue and other personal lines	3.0	11.6	603.7	(55.2)	(75.5)	(6.9)
Commercial	3.0	11.6	46.9	(37.4)	(50.8)	(4.5)

Note:

1. Reflects a 1% decrease in the profit for each year of the five-year forecast.

19. Property, plant and equipment

	Freehold land and buildings £m	Other equipment £m	Total £m
Cost			
At 1 January 2014	15.3	160.0	175.3
Additions	43.4	43.3	86.7
Disposals	–	(16.6)	(16.6)
Acquisition of subsidiary	25.1	–	25.1
Disposal of subsidiary	–	(3.5)	(3.5)
Effect of foreign currency exchange adjustment	–	(1.7)	(1.7)
Transfer to assets held for sale (note 5C)	–	(27.2)	(27.2)
At 31 December 2014	83.8	154.3	238.1
Additions	17.9	49.2	67.1
Disposals	(0.1)	(15.7)	(15.8)
Transfer to assets held for sale (note 5C)	(22.6)	–	(22.6)
At 31 December 2015	79.0	187.8	266.8
Accumulated depreciation and impairment			
At 1 January 2014	1.1	71.9	73.0
Depreciation charge for the year relating to continuing operations	0.6	22.0	22.6
Depreciation charge for the year relating to discontinued operations	–	3.0	3.0
Disposals	–	(16.3)	(16.3)
Impairment losses	–	0.1	0.1
Disposal of subsidiary	–	(2.9)	(2.9)
Effect of foreign currency exchange adjustment	–	(1.4)	(1.4)
Transfer to assets held for sale (note 5C)	–	(21.3)	(21.3)
At 31 December 2014	1.7	55.1	56.8
Depreciation charge for the year relating to continuing operations	1.2	29.5	30.7
Disposals	–	(11.3)	(11.3)
Impairment losses	–	4.8	4.8
Transfer to assets held for sale (note 5C)	(0.5)	–	(0.5)
At 31 December 2015	2.4	78.1	80.5
Carrying amount			
At 31 December 2015	76.6	109.7	186.3
At 31 December 2014	82.1	99.2	181.3

20. Investment property

	2015 £m	2014 £m
At 1 January	307.2	223.4
Additions at cost	16.0	76.2
Increase in fair value during the year	24.2	28.7
Disposals	–	(21.1)
At 31 December	347.4	307.2

Note:
1. The cost included in carrying value at 31 December 2015 is £295.5 million (2014: £279.5 million).

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

The valuation conforms to international valuation standards. The fair value was determined using a methodology based on recent market transactions for similar properties, which have been adjusted for the specific characteristics of each property within the portfolio. This approach to valuation is consistent with the methodology used in the year ended 31 December 2014.

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

21. Subsidiaries

The principal subsidiary undertakings of the Group, over which it exercises 100% voting power, are shown below. Their capital consists of Ordinary Shares which are unlisted. All subsidiaries (a full list of which is included in note 2 of the Parent Company financial statements) are included in the Group's consolidated financial information.

Name of subsidiary	Place of incorporation and operation	Principal activity
DL Insurance Services Limited	United Kingdom	Management services
U K Insurance Limited	United Kingdom	General insurance

On 29 May 2015, the Group completed the sale of its International business comprising Direct Line Insurance S.p.A and Direct Line Versicherung AG for a cash consideration of £438.1 million. Details of the fair value of assets and liabilities disposed of and the gain on disposal are set out in note 5B.

The Group sold 100% of the share capital of Tracker Network (UK) Limited on 5 February 2014. The fair value of the identifiable assets sold was £9.2 million (including cash and cash equivalents of £2.4 million) and the fair value of the identifiable liabilities was £8.8 million. The total cash consideration received was £2.7 million, generating a profit on disposal of £2.3 million.

The Group did not dispose of any other subsidiaries in the years ended 31 December 2015 and 31 December 2014.

The Group acquired 100% of the share capital of 10-15 Livery Street, Birmingham UK Limited on 22 December 2014 for total cash consideration of £26.1 million. The fair value of the identifiable assets acquired was £26.2 million (including cash and cash equivalents of £1.1 million) and the fair value of identifiable liabilities was £0.1 million.

22. Reinsurance assets

	2015 £m	2014 £m
Reinsurers' share of general insurance liabilities	975.8	841.9
Impairment provision	(53.9)	(66.4)
	921.9	775.5
Reinsurers' unearned premium reserve	89.5	87.0
Total	1,011.4	862.5

Movements in reinsurance asset impairment provision

	2015 £m	2014 £m
At 1 January	(66.4)	(53.2)
Additional provision	(5.0)	(14.1)
Release to income statement	17.5	0.9
At 31 December	(53.9)	(66.4)

23. Deferred acquisition costs

	2015 £m	2014 £m
At 1 January	208.4	321.5
Net (decrease) / increase in the year	(4.6)	5.4
Effect of foreign currency exchange adjustment	–	(7.4)
Transfer to assets held for sale	–	(111.1)
At 31 December	203.8	208.4

24. Insurance and other receivables

	2015 £m	2014 £m
Receivables arising from insurance and reinsurance contracts:		
Due from policyholders	800.1	790.7
Impairment provision of policyholder receivables	(0.7)	(0.6)
Due from agents, brokers and intermediaries	60.0	53.7
Impairment provision of agent, broker and intermediary receivables	(1.3)	(0.7)
Other debtors	97.7	116.8
Total	955.8	959.9

25. Derivative financial instruments

	2015 £m	2014 £m
Derivative assets		
At fair value through the income statement	19.3	24.9
Designated as hedging instruments	0.3	2.4
Total	19.6	27.3
Derivative liabilities		
At fair value through the income statement	46.3	29.3
Designated as hedging instruments	0.1	0.1
Total	46.4	29.4

Designated hedging instruments at 31 December 2015 and 31 December 2014 include hedging in relation to supplier payments. At 31 December 2014, the Group also had a foreign currency hedge contract converting Euro to Sterling in respect of the proceeds from the sale of the International business which ceased on completion of the sale.

26. Financial investments

	2015 £m	2014 £m
AFS debt securities		
Corporate	4,182.4	4,117.1
Supranational	140.1	176.3
Local government	105.3	120.7
Sovereign	442.7	993.8
Securitised credit	356.1	422.4
Total	5,226.6	5,830.3
HTM debt securities		
Corporate	13.5	–
Total debt securities	5,240.1	5,830.3
Total debt securities		
Fixed interest rate	4,801.6	5,147.3
Floating interest rate	438.5	683.0
Total	5,240.1	5,830.3
Loans and receivables		
Deposits with credit institutions with maturities in excess of three months	44.9	54.7
Infrastructure debt[1]	329.6	76.2
Total	5,614.6	5,961.2

Note:

1. Infrastructure debt portfolio consists of UK floating rate senior loans with interest rates for the year ended 31 December 2015 ranging from 1.2% to 3.5% (2014: 1.8% to 3.4%) and remaining maturity of between 8 and 25 years (2014: 8 and 25 years).

27. Cash and cash equivalents and borrowings

	2015 £m	2014 £m
Cash at bank and in hand	131.8	151.3
Short-term deposits with credit institutions with maturities less than 3 months	831.9	729.1
Cash and cash equivalents	963.7	880.4
Bank overdrafts[1]	(61.3)	(69.8)
Cash and cash equivalents in assets held for sale (note 5B)	–	87.6
Cash and cash equivalents including bank overdrafts	902.4	898.2

Note:

1. Bank overdrafts represent short-term timing differences between transactions posted in the records of the Group and transactions flowing through the accounts at the bank.

The effective interest rate on short-term deposits with credit institutions for the year ended 31 December 2015 was 0.56% (2014: 0.61%) and average maturity was 10 days (2014: 10 days).

28. Share capital

	2015 Number Millions	2014 Number Millions	2015 £m	2014 £m
Issued and fully paid: equity shares				
Ordinary Shares of 10 pence each	–	1,500	–	150.0
Ordinary Shares of 10 $^{10}/_{11}$ pence each	1,375	–	150.0	–

At a General Meeting on 29 June 2015, shareholders approved a share consolidation which completed on 30 June 2015. As a result of the share consolidation, shareholders held 11 new Ordinary Shares of 10 $^{10}/_{11}$ pence each issued by the Company in exchange for every 12 Ordinary Shares of 10 pence each held immediately prior to the share consolidation, which were cancelled by the Company.

Employee trust shares

The Group satisfies share-based payments under the Group's share plans primarily through shares purchased in the market and held by employee share trusts.

At 31 December 2015, 6,256,108 Ordinary Shares of 10 $^{10}/_{11}$ pence each (2014: 6,391,506 Ordinary Shares of 10 pence each) were owned by the employee share trusts with a cost of £20.4 million (2014: £13.6 million). These Ordinary Shares are carried at cost and have a market value of £25.5 million (2014: £18.6 million).

29. Other reserves

Movements in the revaluation reserve for AFS investments

	2015 £m	2014 £m
At 1 January	115.6	58.8
Revaluation during the year – gross	(100.5)	97.2
Revaluation during the year – tax	22.0	(23.2)
Realised gains – gross	(12.5)	(22.8)
Realised gains – tax	2.5	5.6
Realised gain on disposal of subsidiary – gross	(31.8)	–
Realised gain on disposal of subsidiary – tax	10.1	–
At 31 December	5.4	115.6

Movements in the non-distributable reserve

	2015 £m	2014 £m
At 1 January	124.9	92.8
Transfer from retained earnings	28.0	32.1
At 31 December	152.9	124.9

The non-distributable reserve is a statutory claims equalisation reserve that is calculated in accordance with the rules of the PRA. With the introduction of Solvency II on 1 January 2016 the requirement to maintain the reserve ceases and the non-distributable reserve transfers into retained earnings.

30. Subordinated liabilities

	2015 £m	2014 £m
Subordinated guaranteed dated notes	521.1	526.3

The subordinated guaranteed dated notes were issued on 27 April 2012 at a fixed rate of 9.25%. On the same date, the Group also 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 which was credit value adjusted to 707 basis points with effect from 29 July 2013.

The nominal £500 million notes have a redemption date of 27 April 2042. The Group has the option to repay the notes on specific dates from 27 April 2022. If the notes are not repaid on that date, the rate of interest will be reset at a rate of the six-month LIBOR plus 7.91%.

The notes are unsecured, subordinated obligations of the Group, and rank pari passu without any preference among themselves. In the event of a winding-up or of bankruptcy, they are to be repaid only after the claims of all other senior creditors have been met.

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

31. Insurance liabilities

	2015 £m	2014 £m
Insurance liabilities	4,524.5	4,674.1

Gross insurance liabilities

Accident year	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	Total £m
Estimate of ultimate gross claims costs[1]:											
At end of accident year	3,789.2	4,014.7	3,393.4	3,823.3	3,941.7	2,698.1	2,372.7	2,184.0	2,094.5	2,118.1	
One year later	(256.0)	(44.7)	50.8	121.6	(117.1)	(99.3)	(163.3)	(117.6)	20.7	–	
Two years later	(32.6)	7.8	51.7	(37.0)	(99.1)	(94.6)	(118.9)	(153.0)	–	–	
Three years later	(10.7)	64.8	(36.7)	(14.0)	(50.3)	(89.3)	(49.3)	–	–	–	
Four years later	18.3	(5.4)	(16.7)	(101.5)	(105.5)	(60.9)	–	–	–	–	
Five years later	(18.2)	(12.1)	(55.5)	(38.8)	(57.7)	–	–	–	–	–	
Six years later	(11.0)	(24.4)	(45.7)	(80.8)	–	–	–	–	–	–	
Seven years later	(13.5)	(18.8)	(29.9)	–	–	–	–	–	–	–	
Eight years later	2.2	(14.4)	–	–	–	–	–	–	–	–	
Nine years later	(33.2)	–	–	–	–	–	–	–	–	–	
Current estimate of cumulative claims[1]	3,434.5	3,967.5	3,311.4	3,672.8	3,512.0	2,354.0	2,041.2	1,913.4	2,115.2	2,118.1	
Cumulative payments to date[1]	(3,291.0)	(3,761.5)	(3,170.8)	(3,441.9)	(3,246.0)	(2,082.9)	(1,751.3)	(1,475.5)	(1,350.1)	(912.4)	
Gross liability recognised in balance sheet	143.5	206.0	140.6	230.9	266.0	271.1	289.9	437.9	765.1	1,205.7	3,956.7
2005 and prior											473.4
Claims handling provision											94.4
Total											4,524.5

Note:

1. The claims development and cumulative payments to date by accident year in the above table have been re-presented to exclude the claims and payments in respect of the International business sold on 29 May 2015.

Net insurance liabilities

Accident year	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	Total £m
Estimate of ultimate net claims costs[1]:											
At end of accident year	3,743.4	3,970.3	3,334.7	3,790.6	3,902.0	2,644.4	2,271.8	2,093.9	1,971.0	1,926.7	
One year later	(239.7)	(64.3)	52.0	70.0	(125.2)	(131.5)	(146.7)	(123.6)	(29.7)	–	
Two years later	(43.5)	(14.5)	15.9	(17.4)	(120.4)	(82.1)	(107.8)	(134.4)	–	–	
Three years later	(21.4)	32.9	(22.8)	(54.1)	(44.0)	(76.5)	(35.6)	–	–	–	
Four years later	18.2	(8.9)	(45.8)	(67.0)	(93.6)	(48.7)	–	–	–	–	
Five years later	(40.3)	(17.6)	(48.7)	(29.6)	(52.3)	–	–	–	–	–	
Six years later	(19.6)	(19.6)	(30.9)	(74.6)	–	–	–	–	–	–	
Seven years later	(13.1)	(16.0)	(24.5)	–	–	–	–	–	–	–	
Eight years later	3.6	(12.5)	–	–	–	–	–	–	–	–	
Nine years later	(25.3)	–	–	–	–	–	–	–	–	–	
Current estimate of cumulative claims[1]	3,362.3	3,849.8	3,229.9	3,617.9	3,466.5	2,305.6	1,981.7	1,835.9	1,941.3	1,926.7	
Cumulative payments to date[1]	(3,253.7)	(3,696.4)	(3,131.6)	(3,408.6)	(3,232.0)	(2,059.6)	(1,739.4)	(1,466.7)	(1,350.1)	(912.4)	
Net liability recognised in balance sheet	**108.6**	**153.4**	**98.3**	**209.3**	**234.5**	**246.0**	**242.3**	**369.2**	**591.2**	**1,014.3**	**3,267.1**
2005 and prior											241.1
Claims handling provision											94.4
Total											**3,602.6**

Note:

1. The claims development and cumulative payments to date by accident year in the above table have been re-presented to exclude the claims and payments in respect of the International business sold on 29 May 2015.

31. Insurance liabilities continued

Movements in gross and net insurance liabilities

	Gross £m	Reinsurance £m	Net £m
Claims reported	3,636.4	(467.5)	3,168.9
Incurred but not reported	1,992.7	(449.8)	1,542.9
Claims handling provision	128.3	–	128.3
At 1 January 2014	5,757.4	(917.3)	4,840.1
Cash paid for claims settled in the year	(2,671.6)	181.2	(2,490.4)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,721.3	(288.3)	2,433.0
Arising from prior-year claims[1]	(538.5)	77.6	(460.9)
Effect of foreign currency exchange adjustment	(41.1)	11.5	(29.6)
Transfer to (liabilities) / assets held for sale (note 5C)	(553.4)	159.8	(393.6)
At 31 December 2014	4,674.1	(775.5)	3,898.6
Claims reported	2,791.1	(315.3)	2,475.8
Incurred but not reported	1,778.2	(460.2)	1,318.0
Claims handling provision	104.8	–	104.8
At 31 December 2014	4,674.1	(775.5)	3,898.6
Cash paid for claims settled in the year	**(1,978.9)**	**16.0**	**(1,962.9)**
Increase / (decrease) in liabilities:			
Arising from current-year claims	**2,307.6**	**(191.4)**	**2,116.2**
Arising from prior-year claims	**(478.3)**	**29.0**	**(449.3)**
At 31 December 2015	**4,524.5**	**(921.9)**	**3,602.6**
Claims reported	**2,732.2**	**(375.0)**	**2,357.2**
Incurred but not reported	**1,697.9**	**(546.9)**	**1,151.0**
Claims handling provision	**94.4**	**–**	**94.4**
At 31 December 2015	**4,524.5**	**(921.9)**	**3,602.6**

Note:

1. Decrease in net liabilities arising from prior-year claims in 2014 includes a £10.1 million reserve release for the discontinued International business.

Movement in prior-year net claims liabilities by operating segment

	2015 £m	2014 £m
Motor	**(266.8)**	(278.4)
Home	**(41.9)**	(49.8)
Rescue and other personal lines	**(13.6)**	(15.7)
Commercial	**(56.6)**	(53.7)
Total ongoing	**(378.9)**	(397.6)
Run-off	**(70.4)**	(53.2)
Total	**(449.3)**	(450.8)

32. Unearned premium reserve

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2014	1,818.7	(93.7)	1,725.0
Net movement in the year	(33.4)	(18.6)	(52.0)
Effect of foreign currency exchange adjustment	(24.9)	2.1	(22.8)
Transfer to (liabilities) / assets held for sale (note 5C)	(326.2)	23.2	(303.0)
At 31 December 2014	1,434.2	(87.0)	1,347.2
Net movement in the year	**42.4**	**(2.5)**	**39.9**
At 31 December 2015	**1,476.6**	**(89.5)**	**1,387.1**

33. Retirement benefit obligations

Defined contribution scheme

The pension charge for continuing operations in respect of the defined contribution scheme for the year ended 31 December 2015 was £23.5 million (2014: £23.9 million). The charge for discontinued operations was £0.9 million (2014: £1.8 million).

Defined benefit scheme

The Group's defined benefit pension scheme was closed in 2003 although the Group remains the sponsoring employer for obligations to current and deferred pensioners based on qualifying years' service and final salaries. The defined benefit scheme is legally separated from the Group with trustees who are required by law to act in the interests of the scheme and of all the relevant stakeholders. The trustees of the pension scheme are responsible for the investment policy with regard to the assets of the scheme.

The weighted average duration of the defined benefit obligations at 31 December 2015 is 20 years (2014: 20 years) using accounting assumptions.

The table below sets out the principal assumptions used in determining the defined benefit scheme obligations.

	2015 %	2014 %
Rate of increase in pension payment	2.1	2.1
Rate of increase of deferred pensions	2.1	2.1
Discount rate	3.8	3.4
Inflation rate	3.2	3.1

No assumption has been made for salary growth as there are no obligations in the scheme that are linked to future increases in salaries.

Post-retirement mortality assumptions

	2015	2014
Life expectancy at age 60 now:		
Males	87.8	88.5
Females	89.9	90.2
Life expectancy at age 60 in 20 years' time:		
Males	90.1	90.4
Females	92.3	92.3

The table below analyses the fair value of the scheme assets by type of asset.

	2015 £m	2014 £m
Equities	–	3.0
Index-linked bonds	21.5	22.2
Government bonds	13.7	12.8
Corporate bonds	43.8	44.4
Liquidity fund	5.5	–
Other	0.6	0.7
Total	85.1	83.1

The majority of debt and equity instruments have quoted prices on active markets.

33. Retirement benefit obligations continued

Movement in net pension surplus / (deficit)

	Fair value of defined benefit scheme assets £m	Present value of defined benefit scheme obligations £m	Net pension surplus / (deficit) £m
At 1 January 2014	66.0	(68.0)	(2.0)
Income statement:			
Net interest income / (cost)[1]	2.9	(3.0)	(0.1)
Statement of comprehensive income:			
Actuarial gains arising from experience adjustments	12.9	1.0	13.9
Actuarial losses arising from changes in financial assumptions	–	(11.1)	(11.1)
Contributions by employer	2.8	–	2.8
Benefits paid	(1.5)	1.5	–
At 31 December 2014	83.1	(79.6)	3.5
Income statement:			
Net interest income / (cost)[1]	**2.8**	**(2.7)**	**0.1**
Statement of comprehensive income:			
Actuarial (losses) / gains arising from experience adjustments	**(1.9)**	**1.2**	**(0.7)**
Actuarial gains arising from changes in demographic assumptions	**–**	**1.1**	**1.1**
Actuarial gains arising from changes in financial assumptions	**–**	**6.3**	**6.3**
Contributions by employer	**2.8**	**–**	**2.8**
Benefits paid	**(1.7)**	**1.7**	**–**
At 31 December 2015	**85.1**	**(72.0)**	**13.1**

Note:

1. The net interest income / (cost) in the income statement has been included under other operating expenses.

The table below details the history of the scheme for the current and prior years.

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Present value of defined benefit scheme obligations	**(72.0)**	(79.6)	(68.0)	(61.2)	(54.1)
Fair value of defined benefit scheme assets	**85.1**	83.1	66.0	63.7	56.7
Net surplus / (deficit)	**13.1**	3.5	(2.0)	2.5	2.6
Experience adjustment gains / (losses) on scheme liabilities	**1.2**	1.0	(0.2)	(0.1)	0.4
Experience adjustment (losses) / gains on scheme assets	**(1.9)**	12.9	(1.3)	2.2	(2.6)

Sensitivity analysis

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 Group. This sensitivity analysis has been selected to reflect the changes to discounted cash flows as a result of changes to the discount rate, inflation rate and mortality assumptions. The methodology adopted involves actuarial techniques.

	Impact on pension cost		Impact on present value of defined benefit scheme obligations	
	2015 £m	2014 £m	**2015 £m**	2014 £m
Discount rate				
0.25% increase in discount rate	**(0.2)**	(0.2)	**(3.7)**	(4.1)
0.25% decrease in discount rate	**0.2**	0.1	**3.7**	4.1
Inflation rate				
0.25% increase in inflation rate	**–**	–	**1.7**	2.1
0.25% decrease in inflation rate	**–**	–	**(1.7)**	(2.1)
Life expectancy				
1 year increase in life expectancy	**0.1**	0.1	**2.0**	1.8
1 year decrease in life expectancy	**(0.1)**	(0.1)	**(2.0)**	(1.8)

The most recent funding valuation of the defined benefit scheme took place as at 1 October 2014. The Group agreed with the trustees to make a contribution of £2.8 million in 2016 with further contributions of up to £1.5 million per annum in 2017 and 2018 to meet the scheme's funding requirements.

34. Share-based payments

The Group operates equity-settled, share-based compensation plans in the form of an LTIP, a Restricted Shares Plan, a DAIP and Direct Line Group Share Incentive Plans, including both the Free Share awards and a Buy-As-You-Earn Plan, details of which are set out below. All awards are to be satisfied using market purchased shares.

Long-Term Incentive Plan

Executive Directors and certain members of senior management are eligible to participate in the LTIP with awards granted in the form of nil-cost options. Under the plan, the shares vest at the end of a three-year period dependent upon the continued employment by the Group and also the Group achieving predefined performance conditions associated with TSR and RoTE.

Awards were made in the year ended 31 December 2015 over 1.7 million Ordinary Shares with an estimated fair value of £5.5 million at the March 2015 grant date (2014: 2.2 million Ordinary Shares with an estimated fair value of £4.3 million) and 1.7 million Ordinary Shares with an estimated fair value of £5.9 million at the August 2015 grant date (2014: 2.0 million Ordinary Shares with an estimated fair value of £4.7 million).

The estimated fair value of the LTIP share awards with market-based performance conditions was calculated using a Monte-Carlo simulation model.

The table below details the inputs into the model.

	2015	2014
Weighted average assumptions during the year:		
Share price (pence)	339	270
Exercise price (pence)	0	0
Volatility of share price	20%	26%
Average comparator volatility	27%	30%
Expected life	3 years	3 years
Risk-free rate	0.8%	1.1%

Expected volatility was determined by considering the actual volatility of the Group's share price since IPO and that of a group of listed UK insurance companies.

Plan participants are entitled to receive additional shares in respect of dividends paid to shareholders over the vesting period. Therefore no deduction has been made from the fair value of awards in respect of dividends.

Expected life was based on the contractual life of the awards and adjusted based on management's best estimate, for the effects of exercise restrictions and behavioural considerations.

Restricted Shares Plan

The purpose of the Restricted Shares Plan is to facilitate the wider participation in Group share based awards to eligible employees. These awards can be granted at any time during the year, generally have no performance criteria, and vest over periods ranging between one and three years from the date of the grant, subject to continued employment. During the year awards were made over 15,705 Ordinary Shares (2014: 509,103 Ordinary Shares) with an estimated fair value of £0.1 million (2014: £1.4 million) using the market value at the date of grant.

Deferred Annual Incentive Plan

To incentivise delivery of performance over a one-year operating cycle, Executive Directors and certain members of senior management are eligible for awards under the Annual Incentive Plan, of which at least 40% is granted in the form of a nil-cost option under the DAIP with the remainder being settled in cash following year end.

In March 2015 awards were made over 1.0 million Ordinary Shares (2014: 1.1 million Ordinary Shares) under this plan with an estimated fair value of £3.4 million (2014: £2.6 million) using the market value at the date of grant.

The awards outstanding at 31 December 2015 have no performance criteria attached, other than the requirement that the employee remains in employment with the Group for three years from the date of grant.

Direct Line Group Share Incentive Plans: Free Share awards

In March 2015, the Group offered all eligible UK employees a Free Share award granting 122 Ordinary Shares free of charge. These awards have no performance criteria attached and vest on the third anniversary of the award grant date, subject to completion of three years, continuing employment. The Group initially granted 1.3 million Ordinary Shares with an estimated fair value of £4.2 million using the market value at the date of grant.

34. Share-based payments continued

Direct Line Group Share Incentive Plans: Buy-As-You-Earn Plan

The Buy-As-You-Earn Plan entitles employees to purchase shares from pre-tax pay for between £10 and £150 per month and receive one matching share for every two shares purchased.

In the year ended 31 December 2015, matching share awards were granted over 0.3 million Ordinary Shares (2014: 0.3 million Ordinary Shares) with an estimated fair value of £1.1 million (2014: £0.8 million). The fair value of each matching share award is estimated using the market value at the date of grant.

Under the plan, the shares vest at the end of a three-year period dependent upon the continued employment with the Group together with continued ownership of the associated purchased shares up to the point of vesting.

The following table details the outstanding number of share awards in issue (all nil-cost awards).

	Number of share awards millions 2015	Number of share awards millions 2014
At 1 January	16.4	11.4
Granted during the year[1]	6.8	6.1
Impact of share consolidation (see note 28)	(1.6)	–
Forfeited during the year	(1.5)	(0.8)
Exercised during the year	(2.9)	(0.3)
At 31 December	17.2	16.4
Exercisable at 31 December	1.6	0.3

Note:

1. In accordance with the rules of the LTIP and DAIP award plans, additional awards of 0.8 million shares were granted during the year ended 31 December 2015 (2014: nil) in respect of the equivalent dividend.

In respect of the outstanding options at 31 December 2015, the weighted average remaining contractual life is 1.44 years (2014: 1.66 years). No share awards expired during the year (2014: nil).

The weighted average share price for awards exercised during the year ended 31 December 2015 was £3.95 (2014: £2.56).

The Group recognised total expenses in the year ended 31 December 2015 of £12.1 million (2014: £6.6 million) relating to equity-settled share-based compensation plans.

Further information on share-based payments, in respect of Directors, is provided in the Directors' remuneration report.

35. Trade and other payables including insurance payables

	2015 £m	2014 £m
Due to agents, brokers and intermediaries	22.5	19.3
Due to reinsurers	78.9	57.0
Due to insurance companies	4.7	5.3
Trade creditors and accruals	295.5	342.8
Other creditors	98.8	96.5
Other taxes	78.9	55.0
Provisions	73.1	79.4
Deferred income	4.1	5.3
Total	656.5	660.6

Movement in provisions during the year

	Regulatory levies £m	Restructuring £m	Other £m	Total £m
At 1 January 2015	26.5	8.4	44.5	79.4
Additional provision	32.0	6.0	44.9	82.9
Utilisation of provision	(31.3)	(3.7)	(45.0)	(80.0)
Released to income statement	–	(1.7)	(7.5)	(9.2)
At 31 December 2015	27.2	9.0	36.9	73.1

36. Notes to the consolidated cash flow statement

	2015 £m	2014 £m
Profit for the year	580.4	372.6
Adjustments for:		
Investment return	(235.2)	(237.2)
Instalment income	(101.5)	(105.2)
Finance costs	37.6	37.2
Equity-settled share-based payment transactions	12.1	6.6
Tax charge	127.7	105.2
Depreciation and amortisation expenses	95.3	84.8
Impairment of property, plant and equipment, goodwill and intangible assets	9.1	9.6
Impairment movements on reinsurance contracts	(12.5)	13.2
Impairment movements on assets held for sale – freehold property	12.9	9.6
Profit on disposal of assets held for sale – disposal group	(167.1)	–
Loss on sale of property, plant and equipment	4.7	0.3
Profit on disposal of subsidiary	–	(2.3)
Operating cash flows before movements in working capital	363.5	294.4
Movements in working capital:		
Net decrease in net insurance liabilities including reinsurance assets, unearned premium reserves and deferred acquisition costs	(194.5)	(589.0)
Net increase in prepayments and accrued income and other assets	(2.8)	(19.1)
Net decrease in insurance and other receivables	(66.4)	59.2
Net increase / (decrease) in trade and other payables including insurance payables	52.3	(57.9)
Contribution to retirement benefit obligations	(2.8)	(2.8)
Cash generated from / (used by) operations	149.3	(315.2)
Taxes paid	(107.4)	(94.8)
Cash flow hedges	0.2	(0.6)
Net cash flow generated from / (used by) operating activities before investment of insurance assets	42.1	(410.6)
Interest received	318.7	358.5
Rental income received from investment property	17.9	16.2
Purchases of investment property	(16.0)	(76.2)
Proceeds on disposal of investment property	–	21.1
Proceeds on disposal / maturity of AFS debt securities	3,549.3	3,141.0
Net (increase) /decrease in financial investments: loans and receivables	(242.5)	304.8
Purchases of AFS debt securities	(3,110.8)	(2,644.3)
Purchase of HTM debt securities	(13.5)	–
Cash generated from investment of insurance assets	503.1	1,121.1

37. Contingent liabilities

The Group did not have any contingent liabilities at 31 December 2015 (2014: none).

38. Commitments

Operating lease commitments

The Group has entered into non-cancellable operating lease agreements for properties, vehicles and other assets.

Continuing operations	2015 £m	2014 £m
Lease payments under operating leases recognised as an expense in the year	18.4	25.6

The minimum lease payments under operating leases recognised as an expense for discontinued operations during the year ended 31 December 2015 were £0.8 million (2014: £2.5 million).

The following table analyses the outstanding commitments for future minimum lease payments under non-cancellable operating leases by the period in which they fall due.

Continuing operations	2015 £m	2014 £m
Within one year	16.2	17.1
In the second to fifth years inclusive	51.7	55.1
After five years	161.9	178.5
Total	229.8	250.7

There were no outstanding commitments in relation to the Group's discontinued operations at 31 December 2015 (2014: £11.5 million).

Operating lease commitments where the Group is the lessor

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

Continuing operations	2015 £m	2014 £m
Within one year	15.7	14.6
In the second to fifth years inclusive	53.6	51.7
After five years	89.3	99.6
Total	158.6	165.9

There were no commitments by third parties to make lease payments to the Group's discontinued operations at 31 December 2015 (2014: £nil).

39. Fair value

The methodology adopted by the Group for fair value measurement of investment properties, financial assets and liabilities and the basis for determining the fair value hierarchy are explained in note 2.3.

Comparison of carrying value to fair value of financial instruments

The following table compares the carrying value and the fair value of financial instruments (excluding the disposal group – note 5B). Differences arise where the measurement basis of the asset or liability is not fair value (e.g. assets and liabilities carried at amortised cost).

	Fair value 2015 £m	Carrying value 2015 £m	Fair value 2014 £m	Carrying value 2014 £m
Financial assets				
Derivative assets (note 25)	19.6	19.6	27.3	27.3
AFS debt securities (note 26)	5,226.6	5,226.6	5,830.3	5,830.3
HTM debt securities (note 26)	12.7	13.5	–	–
Deposits with credit institutions > three months (note 26)	44.9	44.9	54.7	54.7
Infrastructure debt (note 26)	322.2	329.6	76.0	76.2
Financial liabilities				
Subordinated liabilities (note 30)	623.2	521.1	651.9	526.3
Derivative liabilities (note 25)	46.4	46.4	29.4	29.4

Fair values of the following assets and liabilities (including assets and liabilities held in the disposal group – note 5B) approximate their carrying values:

- Insurance and other receivables
- Cash and cash equivalents
- Borrowings
- Trade and other payables including insurance payables (excluding provisions)

Fair value hierarchy analysis

The tables below analyse the Group's assets and liabilities carried at fair value (excluding the disposal group – note 5C) by reference to the Group's fair value hierarchy (note 2.3).

At 31 December 2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Investment property (note 20)	–	–	347.4	347.4
Derivative assets (note 25)	–	19.6	–	19.6
AFS debt securities (note 26)	442.7	4,783.9	–	5,226.6
Total assets	442.7	4,803.5	347.4	5,593.6
Derivative liabilities (note 25)	–	46.4	–	46.4
Total liabilities	–	46.4	–	46.4

At 31 December 2014	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Investment property (note 20)	–	–	307.2	307.2
Derivative assets (note 25)	–	27.3	–	27.3
AFS debt securities (note 26)	985.6	4,844.7	–	5,830.3
Total assets	985.6	4,872.0	307.2	6,164.8
Derivative liabilities (note 25)	–	29.4	–	29.4
Total liabilities	–	29.4	–	29.4

The movements in assets classified as Level 3 in the fair value hierarchy are all within Investment property and are analysed in note 20. There were no changes in the categorisation of assets between Levels 1, 2 and 3 during the year for assets and liabilities held at 31 December 2014.

40. Related parties

Transactions between the Group's subsidiary undertakings, which are related parties, have been eliminated on consolidation and accordingly are not disclosed.

RBS Group was formerly a related party of the Group, as a result of its ownership of Ordinary Shares, up until the point of selling its remaining shares on 27 February 2014. The RBS Group transactions and balances included below are for historical transactions, prior to the date of sale when the related party relationship ceased.

Transactions with related parties

	2015 £m	2014 £m
Sale of insurance contracts and other services	–	0.3
Purchase of services	–	19.7

Sale and purchase of products and services were conducted on an arm's length basis.

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

	Amounts owed by related parties		Amounts owed to related parties	
	2015 £m	2014 £m	2015 £m	2014 £m
Total	0.2	0.2	–	25.4

Movement in amounts owed by and to related parties

	Amounts owed by related parties		Amounts owed to related parties	
	2015 £m	2014 £m	2015 £m	2014 £m
At 1 January	0.2	0.9	25.4	58.7
Transactions in the year	–	0.1	–	19.1
Settled in the year	–	(0.8)	(25.4)	(52.4)
At 31 December	0.2	0.2	–	25.4

Compensation of key management

	2015 £m	2014 £m
Short-term employee benefits	9.5	10.2
Post-employment benefits	0.2	0.3
Termination benefits	–	0.4
Share-based payments	4.5	3.4
Total	14.2	14.3

Parent Company balance sheet

As at 31 December 2015

	Notes	2015 £m	2014 £m
Assets			
Investment in subsidiary undertakings	2	3,067.4	3,065.0
Other receivables	4	540.8	523.3
Current tax assets	5	–	1.2
Derivative financial instruments	6	0.4	2.4
Financial investments	7	7.1	5.1
Cash and cash equivalents	8	29.8	51.2
Assets held for sale	3	–	114.8
Total assets		3,645.5	3,763.0
Equity		3,131.6	3,258.2
Liabilities			
Subordinated liabilities	10	503.9	503.1
Derivative financial instruments	6	0.4	0.6
Trade and other payables	11	6.6	1.1
Current tax liabilities	5	3.0	–
Total liabilities		513.9	504.8
Total equity and liabilities		3,645.5	3,763.0

The attached notes on pages 167 to 171 form an integral part of these separate financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 29 February 2016. They were signed on its behalf by:

John Reizenstein
Chief Financial Officer

Direct Line Insurance Group plc

Registration No. 02280426

Parent Company statement of comprehensive income

For the year ended 31 December 2015

	2015 £m	2014 £m
Profit for the year	539.5	436.7
Other comprehensive (loss) / income		
Items that may be reclassified subsequently to income statement:		
Cash flow hedges	(1.2)	1.2
Other comprehensive (loss) / income net of tax	(1.2)	1.2
Total comprehensive income for the year attributable to owners of the Company	538.3	437.9

Parent Company statement of changes in equity

For the year ended 31 December 2015

	Share capital £m	Capital reserves £m	Share-based payment reserve £m	Foreign exchange translation reserve £m	Retained earnings £m	Total shareholder equity £m
Balance at 1 January 2014	150.0	1,450.0	3.9	–	1,611.9	3,215.8
Total comprehensive income for the year	–	–	–	1.2	436.7	437.9
Dividends paid	–	–	–	–	(401.1)	(401.1)
Credit to equity for equity-settled share-based payments	–	–	6.6	–	–	6.6
Shares distributed by employee trusts	–	–	(1.0)	–	–	(1.0)
Balance at 31 December 2014	150.0	1,450.0	9.5	1.2	1,647.5	3,258.2
Total comprehensive income for the year	–	–	–	(1.2)	539.5	538.3
Dividends paid	–	–	–	–	(666.0)	(666.0)
Credit to equity for equity-settled share-based payments	–	–	12.1	–	–	12.1
Shares distributed by employee trusts	–	–	(11.0)	–	–	(11.0)
Balance at 31 December 2015	150.0	1,450.0	10.6	–	1,521.0	3,131.6

The attached notes on pages 167 to 171 form an integral part of these separate financial statements.

Parent Company cash flow statement

For the year ended 31 December 2015

	Notes	2015 £m	2014 £m
Net cash used by operating activities	13	(3.1)	(0.1)
Cash flows from investing activities			
Interest received on loans to subsidiary undertakings		47.5	47.6
Dividends received from subsidiary undertakings		671.0	446.7
Net increase in loans advanced to subsidiary undertakings		(21.8)	–
Capital contribution to subsidiary undertakings		(225.0)	–
Disposal of investments in subsidiary undertakings	2	–	2.7
Disposal of assets held for sale	3	224.3	–
Purchase of AFS debt securities		(2.0)	(5.1)
Net cash generated from investing activities		694.0	491.9
Cash flows from financing activities			
Dividends paid	12	(666.0)	(401.1)
Finance costs		(46.3)	(46.3)
Net cash used by financing activities		(712.3)	(447.4)
Net (decrease) / increase in cash and cash equivalents		(21.4)	44.4
Cash and cash equivalents at the beginning of the year	8	51.2	6.8
Cash and cash equivalents at the end of the year	8	29.8	51.2

The attached notes on pages 167 to 171 form an integral part of these separate financial statements.

1. Accounting policies

1.1 Basis of preparation

Direct Line Insurance Group plc, registered in England and Wales (company number 02280426), is the ultimate parent company of the Direct Line Group. The principal activity of the Company is managing its investments in subsidiaries, providing loans to those subsidiaries, raising funds for the Group and the receipt and payment of dividends.

The Company's financial statements are prepared in accordance with IFRSs as issued by the IASB and are presented in accordance with the Companies Act 2006. In accordance with the exemption permitted under section 408 of the Companies Act 2006, the Company's income statement and related notes have not been presented in these separate financial statements.

The accounting policies that are used in the preparation of these separate financial statements are consistent with the accounting policies used in the preparation of the consolidated financial statements of Direct Line Insurance Group plc as set out in those financial statements.

The additional accounting policies that are specific to the separate financial statements of the Company are set out below.

1.2 Investment in subsidiaries

Investment in subsidiaries is stated at cost less any impairment.

1.3 Dividend income

Dividend income from investment in subsidiaries is recognised when the right to receive payment is established.

2. Investment in subsidiary undertakings

	2015 £m	2014 £m
At 1 January	3,065.0	3,181.5
Additional investment in subsidiary undertakings	237.0	6.6
Disposal of subsidiary undertaking	–	(4.0)
Impairment of subsidiary undertakings	(234.6)	(4.3)
Transfer to assets held for sale	–	(114.8)
At 31 December	3,067.4	3,065.0

The Company sold 100% of the share capital of its subsidiary Tracker Network (UK) Limited on 5 February 2014. The carrying value of the investment in Tracker was £4.0 million at the date of sale. The total cash consideration received was £2.7 million, generating a loss on disposal of £1.3 million.

2. Investment in subsidiary undertakings continued

The subsidiary undertakings of the Company are set out below. Their capital consists of Ordinary Shares which are unlisted. In all cases, the Company owns 100% of the Ordinary Shares, either directly or through its ownership of other subsidiaries, and exercises full control over their decision making.

Name of subsidiary	Place of incorporation and operation	Principal activity
Directly held by the Company:		
Direct Line Group Limited	United Kingdom	Intermediate holding company
DL Insurance Services Limited	United Kingdom	Management services
Finsure Premium Finance Limited	United Kingdom	Dormant
Inter Group Insurance Services Limited	United Kingdom	Intermediate holding company
UK Assistance Accident Repair Centres Limited	United Kingdom	Motor vehicle repair services
UK Assistance Limited	United Kingdom	Dormant
U K Insurance Business Solutions Limited	United Kingdom	Insurance broking services
U K Insurance Limited	United Kingdom	General insurance
Indirectly held by the Company:		
10-15 Livery Street, Birmingham UK Limited	Jersey	Property rental company
Churchill Insurance Company Limited	United Kingdom	General insurance
Direct Line Insurance Limited	United Kingdom	Dormant
DL Dormant 5 Limited	United Kingdom	Dormant
DL Dormant 6 Limited	United Kingdom	Dormant
DLG Legal Services Limited	United Kingdom	Legal services
DLG Pension Trustee Limited	United Kingdom	Dormant
DL Support Services India Private Limited	India	Management services
Farmweb Limited	United Kingdom	Dormant
Green Flag Group Limited	United Kingdom	Intermediate holding company
Green Flag Holdings Limited	United Kingdom	Intermediate holding company
Green Flag Limited	United Kingdom	Breakdown recovery services
Intergroup Assistance Services Limited	United Kingdom	Dormant
National Breakdown Recovery Club Limited	United Kingdom	Dormant
Nationwide Breakdown Recovery Services Limited	United Kingdom	Dormant
The National Insurance Breakdown and Guarantee Corporation Limited	United Kingdom	Dormant
UKI Life Assurance Services Limited	United Kingdom	Dormant

3. Assets held for sale

	2015 £m	2014 £m
Investment in subsidiary undertaking	–	114.8

On 29 May 2015, the Company completed the sale of its German subsidiary Direct Line Versicherung AG for a cash consideration of £232.6 million, incurring transaction costs of £8.3 million and generating a profit on disposal of £109.5 million. The investment in subsidiary was transferred to assets held for sale on 25 September 2014 when the Company entered into a binding agreement for the sale.

4. Other receivables

	2015 £m	2014 £m
Loans to subsidiary undertakings[1]	540.8	518.9
Receivables from subsidiary undertakings	–	2.9
Other debtors	–	1.5
Total	540.8	523.3
Current	40.8	23.3
Non-current	500.0	500.0
Total	540.8	523.3

Note:

1. Included in loans to subsidiary undertakings is a £500 million unsecured subordinated loan to U K Insurance Limited. The loan was advanced on 27 April 2012 at a fixed rate of 9.5% with a repayment date of 27 April 2042. There is an option to repay the loan on specific dates from 27 April 2022. If the loan is not repaid on 27 April 2022, the rate of interest will be reset at a rate of the six-month LIBOR plus 8.16%.

5. Current tax

	2015 £m	2014 £m
Corporate tax assets	–	1.2
Corporation tax liabilities	(3.0)	–

6. Derivative financial instruments

	Notional amount	Fair value	Notional amount	Fair value
	2015 £m	2015 £m	2014 £m	2014 £m
Derivative assets				
Designated as hedging instruments:				
Third parties	4.6	0.3	435.6	2.4
Subsidiary undertakings	0.7	0.1	–	–
Total	5.3	0.4	435.6	2.4
Derivative liabilities				
Designated as hedging instruments:				
Third parties	0.7	0.1	–	–
Subsidiary undertakings	4.6	0.3	8.3	0.6
Total	5.3	0.4	8.3	0.6

Designated hedging instruments at 31 December 2015 and 31 December 2014 include foreign exchange hedge contracts relating to supplier payments on behalf of its subsidiaries. At 31 December 2014, the Company also had a foreign currency hedge contract converting Euro to Sterling in respect of the proceeds from the sale of the International business, which ceased on completion of the sale.

7. Financial investments

	2015 £m	2014 £m
AFS debt securities	7.1	5.1

8. Cash and cash equivalents

	2015 £m	2014 £m
Cash at bank and in hand	0.1	0.1
Short-term deposits with credit institutions with maturities less than 3 months	29.7	51.1
Total	29.8	51.2

9. Share capital

Full details of the share capital of the Company are set out in note 28 to the consolidated financial statements.

10. Subordinated liabilities

	2015 £m	2014 £m
Subordinated guaranteed dated notes	503.9	503.1

The subordinated guaranteed dated notes were issued on 27 April 2012 at a fixed rate of 9.25%. The nominal £500.0 million notes have a redemption date of 27 April 2042. The Company 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 will be reset at a rate of the six-month LIBOR plus 7.91%.

The notes are unsecured, subordinated obligations of the Company, and rank pari passu without any preference among themselves. In the event of a winding up or of insolvency, they are to be repaid only after the claims of all other senior creditors have been met.

The notes are guaranteed by U K Insurance Limited, a principal subsidiary of the Company.

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

The aggregate fair value of subordinated guaranteed dated notes at 31 December 2015 was £623.2 million (2014: £651.9 million).

11. Trade and other payables

	2015 £m	2014 £m
Payables to subsidiary undertakings	3.8	1.0
Payables to third parties	–	0.1
Provision	2.8	–
Total	6.6	1.1

Movement in provision during the year

	Total £m
At 1 January 2015	–
Additional provision	8.3
Utilisation of provision	(5.5)
At 31 December 2015	2.8

12. Dividends

Full details of the dividends paid and proposed by the Company are set out in note 15 to the consolidated financial statements.

13. Cash generated from operations

	2015 £m	2014 £m
Profit for the year	539.5	436.7
Adjustments for:		
Impairment of investment in subsidiary undertakings	234.6	4.3
Investment return	(720.5)	(495.1)
Finance costs	47.1	46.9
Loss on disposal of subsidiary undertakings	–	1.3
Profit on disposal of assets held for sale	(109.5)	–
Tax charge / (credit)	3.0	(1.2)
Operating cash flows before movements in working capital	(5.8)	(7.1)
Movements in working capital:		
Net (increase) / decrease in other receivables	(4.0)	4.8
Net increase in trade and other payables	5.5	0.6
Tax received	1.2	1.6
Cash used by operations	(3.1)	(0.1)

14. Related parties

Direct Line Insurance Group plc, which is incorporated in England and Wales, is the ultimate parent undertaking of the Direct Line Group of companies.

Full details of related parties are set out in note 40 to the consolidated financial statements.

The following transactions were carried out with related parties:

Sales of services

	2015 £m	2014 £m
Interest receivable from subsidiary undertakings	47.5	47.6
Dividend income from subsidiary undertakings	671.0	446.7

Interest income from loans to subsidiary undertakings was charged at rates ranging from 0.5% to 9.5% (2014: 0.5% to 9.5%).

Purchases of services

	2015 £m	2014 £m
Management fees payable to subsidiary undertakings	6.0	7.3
Interest payable to subsidiary undertakings	0.2	–
Total	6.2	7.3

Interest charged on borrowings from related parties was at rates ranging from 0.5% to 0.6% (2014: 0.5% to 0.6%).

15. Share-based payments

Full details of share-based compensation plans are provided in note 34 to the consolidated financial statements.

16. Risk management

The risks faced by the Company, arising from its investment in subsidiaries, are considered to be the same as those in the operations of the Group. Details of the key risks and the steps taken to manage them are disclosed in note 3 to the consolidated financial statements. The Company also holds, on behalf of its subsidiaries, designated hedging instruments which relate to foreign currency supplier payments.

17. Directors and key management remuneration

The Directors and key management of the Group and the Company are the same. The aggregate emoluments of the Directors are set out in note 11 to the consolidated financial statements, the compensation for key management is set out in note 40 to the consolidated financial statements and the remuneration and pension benefits payable in respect of the highest paid Director are included in the Directors' remuneration report in the Governance section of the Annual Report & Accounts.

Corporate website

The Group's corporate website is www.directlinegroup.com . It contains useful information for the Company's investors and shareholders. For example, it includes press releases, details of forthcoming events, essential shareholder information, a dividend history, a financial calendar, and details of the Company's AGM. You can also subscribe to email news alerts.

Market

The Company has a premium listing on the UK Listing Authority's Official List. The Company's Ordinary Shares (EPIC: DLG) are admitted to trading on the London Stock Exchange.

Share ownership

Share capital

You can find details of the Company's share capital in note 28 to the consolidated financial statements.

Dividends

The Company pays its dividends in Sterling to shareholders registered on its register of members at the relevant record date.

Shareholders can arrange to receive their cash dividend payments in a bank or building society by completing a dividend mandate form. This is available from the Company's registrar, Computershare Investor Services PLC ("**Registrar**"), in the UK. You can find the Registrar's contact details on the inside back cover. Alternatively, shareholders can access their shareholdings online and download a dividend mandate form from the Investor Centre. You can find details of this below.

Dividend Reinvestment Plan

The Company offers a Dividend Reinvestment Plan. This enables shareholders to use their cash dividends to buy the Company's Ordinary Shares in the market. You can find more details on the Company's website.

Shareholder enquiries

Shareholders with queries about anything relating to their shares can contact our Registrar.

Shareholders should notify the Registrar of any change in shareholding details, such as their address, as soon as possible.

Shareholders can access their current shareholding details online at www.investorcentre.co.uk/directline . Investor Centre is a free-to-use, secure, self-service website that enables shareholders to manage their holdings online. The website allows shareholders to:

- Check their holdings
- Update their records, including address and direct credit details
- Access all their securities in one portfolio by setting up a personal account
- Vote online
- Register to receive electronic shareholder communications

The website requires shareholders to quote their Shareholder Reference Number to access this information. Shareholders can find this number on their share certificates.

Shareholder warning

Almost five thousand people contact the Financial Conduct Authority ("**FCA**") about share fraud each year – and victims lose an average of £20,000.

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that prove to be worthless or non-existent. Or they can offer to buy shares at an inflated price in return for you paying upfront. They promise high profits. However, if you buy or sell shares in this way, you will probably lose your money.

How to avoid share fraud

- Remember that FCA-authorised firms are unlikely to contact you out of the blue offering to buy or sell shares
- Do not converse with them. Note the name of the person and firm contacting you, then end the call
- Check the Financial Services Register at www.fca.org.uk to see if the person and firm contacting you are authorised by the FCA
- Beware of fraudsters claiming to be from an authorised firm; copying its website; or giving you false contact details
- If you want to call them back, use the firm's contact details listed on the Financial Services Register at www.fca.org.uk
- If the firm does not have contact details on the Register or they tell you the details are out of date, call the FCA on 0800 111 6768
- Search the list of unauthorised firms to avoid at www.fca.org.uk/consumers/scams
- Remember that if you buy or sell shares from an unauthorised firm, you cannot access the Financial Ombudsman Service or Financial Services Compensation Scheme
- Get independent financial and professional advice before handing over any money
- If it sounds too good to be true, it probably is

Report a scam

If fraudsters approach you, tell the FCA using the share fraud reporting form at www.fca.org.uk/consumers/scams . You can also find out more about investment scams on the same web page.

You can call the FCA Consumer Helpline on 0800 111 6768.

If you have already paid money to share fraudsters, contact Action Fraud on 0300 123 2040.

Tips on protecting your shares

- Keep all your certificates in a safe place. Alternatively, consider holding your shares in the UK's electronic registration and settlement system for equity, CREST, or via a nominee
- Keep correspondence from the Registrar that shows your shareholder reference number in a safe place, and shred unwanted correspondence
- Inform the Registrar as soon as you change your address
- If you receive a letter from the Registrar regarding a change of address and you have not recently moved, contact them immediately
- Find out when your dividends are paid and contact the Registrar if you do not receive them
- Consider having your dividends paid direct into your bank account. You will need to complete a dividend mandate form and send it to the Registrar. This reduces the risk of cheques being stolen or lost in the post
- If you change your bank account, inform the Registrar of your new account details immediately
- If you are buying or selling shares, only deal with brokers registered in the UK or in your country of residence
- Be aware that the Company will never call you concerning investments. If you receive such a call from a person saying they represent the Group, please contact the Company Secretary immediately, by calling +44 (0)1132 920 667

Electronic communications and voting

The Group produces various communications. Shareholders can view these online, download them or receive paper copies by contacting the Registrar.

Shareholders who register their email address with our Registrar or at the Investor Centre can receive emails with news on events, such as the AGM. They can also receive shareholder communications like the Annual Report & Accounts and Notice of Meeting electronically.

Dealing facilities

Shareholders can buy, sell or transfer their shares through a stockbroker or a high street bank, or through the Registrar's share-dealing facility.

You can call or email the Registrar regarding its share-dealing facility using this contact information:

- For telephone sales, call +44 (0)370 703 0084 between 8.30 am and 5.30 pm, Monday to Friday, excluding public holidays
- For internet sales, go to www.investorcentre.co.uk/directline . You will need your Shareholder Reference Number, as shown on your share certificate or your welcome letter from the Chairman

Dividend tax allowance

From April 2016 dividend tax credits will be replaced by an annual £5,000 tax-free allowance across an individual's entire share portfolio. Above this amount, individuals will pay tax on their dividend income at a rate dependent on their income tax bracket and personal circumstances. The Company will continue to provide registered shareholders with a confirmation of the dividends paid and this should be included with any other dividend income received when calculating and reporting total dividend income received to HMRC. It is the shareholder's responsibility to include all dividend income when calculating tax requirements.

This change was announced by the Chancellor of the Exchequer, as part of the UK Government Budget, in July 2015. Draft legislation was published on 9 December 2015 and is intended to be enacted in the proposed UK Finance Bill 2016. If you have any tax queries, please contact your financial adviser.

Financial calendar

2016

Date	Event
1 March	Preliminary Results 2015
10 March	'Ex-dividend' date for 2015 final and second special interim dividends
11 March	Record date for 2015 final and second special interim dividends
4 May[1]	Trading update for the first quarter of 2016
12 May	Annual General Meeting
19 May	Payment date for 2015 final and second special interim dividends
2 August[1]	Half Year Report 2016
11 August[1]	'Ex-dividend' date for 2016 interim dividend
12 August[1]	Record date for 2016 interim dividend
9 September[1]	Payment date for 2016 interim dividend
8 November[1]	Trading update for the third quarter of 2016

Annual General Meeting

The 2016 AGM will be held on 12 May 2016 at the offices of Allen & Overy LLP, One Bishops Square, London E1 6AD, starting at 11.00 am. All shareholders will receive a separate notice convening the AGM. This will explain the resolutions to be put to the meeting.

Note:

1. These dates are subject to change.

Glossary

Term	Definition and explanation
Actuarial best estimate	The probability-weighted average of all future claims and cost scenarios. It is calculated using historical data, actuarial methods and judgement. A best estimate of reserves will therefore normally be designed to include no margin for optimism or, conversely, caution.
Adjusted diluted earnings per share	Adjusted diluted earnings per share includes ongoing operations and excludes discontinued operations, the Run-off segment, restructuring and other one-off costs and the gain on disposal of subsidiary (using the UK standard tax rate of 20.25%; 2014: 21.5%). The comparative periods include profit after tax for discontinued operations (at the UK standard tax rate), as these were managed as part of ongoing operations.
Annual Incentive Plan ("**AIP**")	This is designed to incentivise the performance of executives and employees over a one-year operating cycle. It focuses on the short to medium-term elements of the Group's strategic aims.
Available-for-sale ("**AFS**") investment	Financial assets that are classified as available-for-sale. Please refer to the accounting policy note 1.12 on page 114.
Buy-As-You-Earn	The HM Revenue & Customs approved Buy-As-You-Earn Share Incentive Plan allows all employees the opportunity to become shareholders in the Company.
Capital	The funds invested in the Group, including funds invested by shareholders and retained profits.
Claims frequency	The number of claims divided by the number of policies per year.
Claims reserve (provision for losses and loss-adjustment expense)	Funds the Group sets aside to meet the estimated cost of claims payments and related expenses that the Group considers it will ultimately need to pay.
Clawback	The ability of the Company to claim repayment of paid amounts.
Combined operating ratio ("**COR**")	The sum of the loss, commission and expense ratios. The ratio measures the amount of claims costs, commission and expenses compared to net earned premium generated. A ratio of less than 100% indicates profitable business.
Commission	Payments to brokers, partners and PCWs for generating business.
Commission ratio	The ratio of commission expense divided by net earned premium.
Continuing operations	Continuing operations include all activities other than discontinued operations.
Current-year attritional loss ratio	The loss ratio for the current accident year, excluding the movement of claims reserves relating to previous accident years, and claims relating to major weather events in the Home division.
Deferred Annual Incentive Plan ("**DAIP**")	For Executive Directors, at least 40% of the AIP award is deferred into shares typically vesting three years after grant. The remainder of the award is paid in cash following year-end.
Discontinued operations	The Group has sold its International division to Mapfre, S.A. See note 5 to the consolidated financial statements on page 136.
Earnings per share	The amount of the Group's profit allocated to each Ordinary Share of the Company.
Employee Representative Body	A forum that represents all employees, including in circumstances where there is a legal requirement to consult employees.
Expense ratio	The ratio of operating expenses divided by net earned premium.
Finance costs	The cost of servicing the Group's external borrowings.
Financial Conduct Authority ("**FCA**")	The independent body that regulates firms and financial advisers. It puts the customers' interests and market integrity at the core of financial service providers' activities.
Financial Reporting Council	The UK's independent regulator responsible for promoting high-quality corporate governance and reporting to foster investment.
Gross written premium	The total premiums from contracts that began during the period.
International Accounting Standards Board ("**IASB**")	A not-for-profit public interest organisation that is overseen by a monitoring board of public authorities. It develops IFRS. These standards aim to make worldwide markets transparent, accountable and efficient.
Incurred but not reported ("**IBNR**")	Funds set aside to meet the cost of claims for accidents that have occurred, but have not yet been reported to the Group.
In-force policies	The number of policies on a given date that are active and against which the Group will pay, following a valid insurance claim.
Insurance liabilities	This comprises insurance claims reserves and claims handling provision, which the Group maintains to meet current and future claims.
Investment income yield	The income earned from the investment portfolio, recognised through the income statement during the period and divided by the average assets under management ("**AUM**"). This excludes unrealised and realised gains and losses, impairments and fair-value adjustments. The average AUM is derived from the period's opening and closing balances.

Term	Definition and explanation
Investment return	The income earned from the investment portfolio, including unrealised and realised gains and losses, impairments and fair value adjustments.
Investment return yield	The return earned from the investment portfolio, recognised through the income statement during the period divided by the average AUM. This includes unrealised and realised gains and losses, impairments and fair-value adjustments. The average AUM derives from the period's opening and closing balances.
Loss ratio	Net insurance claims divided by net earned premium.
Long-Term Incentive Plan ("**LTIP**")	Awards made as nil-cost options or conditional share awards, which vest to the extent that performance conditions are satisfied after a period of at least three years.
Malus	An arrangement that permits unvested remuneration awards to be forfeited, when the Company considers it appropriate.
Net asset value	The net asset value of the Group is calculated by subtracting total liabilities from total assets.
Net claims	The cost of claims incurred in the period less any claims costs recovered under reinsurance contracts. It includes claims payments and movements in claims reserves.
Net earned premium	The element of gross earned premium less reinsurance premium ceded for the period where insurance cover has already been provided.
Ogden discount rate	The discount rate set by the relevant government bodies, the Lord Chancellor and Scottish Ministers. Bodily injury cases use them to calculate lump-sum awards.
Ongoing operations	Ongoing operations comprise Direct Line Group's ongoing divisions: Motor, Home, Rescue and other personal lines, and Commercial. It excludes discontinued operations, the Run-off segment, and restructuring and other one-off costs.
Operating profit	The pre-tax profit that the Group's activities generate, including insurance and investment activity, but excluding finance costs.
Own Risk and Solvency Assessment ("**ORSA**")	A Solvency II requirement. It documents the Group's insurance underwriting entities' risks and associated capital requirement, both now and projected over the business planning period. It is forward looking, reflecting business strategy and risk appetite.
Periodic payment order ("**PPO**")	These are claims payments as awarded under the Courts Act 2003. PPOs are used to settle large personal injury claims. They generally provide claimants who require long-term care with a lump-sum award plus inflation-linked annual payments.
Prudential Regulation Authority ("**PRA**")	The PRA is a part of the Bank of England. It is responsible for regulating and supervising insurers and financial institutions in the UK.
RBS Group	The Royal Bank of Scotland Group plc and its subsidiary companies.
Reinsurance	Contractual arrangements where the Group transfers part or all of the accepted insurance risk to another insurer.
Reserves	Funds that have been set aside to meet outstanding insurance claims and IBNR.
Return on equity	Return on equity is calculated by dividing the profit attributable to the owners of the Company by average ordinary shareholders' equity for the period.
Return on tangible equity ("**RoTE**")	Return on tangible equity for 2015 is adjusted profit after tax from ongoing operations divided by the Group's average shareholders' equity, less goodwill and other intangible assets and net assets held for sale in the disposal group relating to discontinued operations. Profit after tax is adjusted to exclude discontinued operations, the Run-off segment, restructuring and other one-off costs and the gain on disposal of subsidiary. It is stated after charging tax (using the UK standard tax rate of 20.25%; 2014: 21.5%). RoTE for comparative periods include the net assets held for sale in the disposal group and profit after tax for discontinued operations, as the International division was managed as part of ongoing operations.
Risk mix	Risk mix reflects the expected level of claims from the portfolio. It measures the estimated movement based on risk models used in that period, and is revised when models are updated.
Run-off	Where the Group no longer underwrites new business, but continues to meet its claims liabilities under existing contracts.
Solvency II	The capital adequacy regime for the European insurance industry, which became effective on 1 January 2016. It establishes revised capital requirements and risk management standards. It comprises three pillars: Pillar I, which sets out capital requirements for an insurer; Pillar II, which focuses on systems of governance; and Pillar III, which deals with disclosure requirements.
Total costs	Total costs comprise operating expenses and claims handling expenses.
Total Shareholder Return ("**TSR**")	Compares share price movement with reinvested dividends as a percentage of the share price at the beginning of the period.
Underwriting result (profit or loss)	The profit or loss from operational activities, excluding investment performance. It is calculated as net earned premium less net insurance claims and total expenses.

Forward-looking statements disclaimer

This Annual Report & Accounts has been prepared for, and only for, the members of the Company as a body, and no other persons. The Company, its Directors, employees, agents or advisers do not accept responsibility to any other person to whom this document is shown or into whose hands it may come, and any such responsibility or liability is expressly disclaimed.

Certain information contained in this document, including any information as to the Group's strategy, plans or future financial or operating performance, constitutes "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "aims", "anticipates", "aspire", "believes", "continue", "could", "estimates", "expects", "guidance", "intends", "may", "mission", "outlook", "plans", "predicts", "projects", "seeks", "should", "strategy", "targets" or "will" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this document, and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, among other things: the Group's results of operations, financial condition, prospects, growth, strategies and the industry in which the Group operates. Examples of forward-looking statements include financial targets, which are contained in this document specifically with respect to RoTE, risk-based capital coverage ratio, the Group's COR and investment income yield. By their nature, all forward-looking statements involve risk and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future or are beyond the Group's control.

Forward-looking statements are not guarantees of future performance. The Group's actual results of operations, financial condition and the development of the business sector in which the Group operates may differ materially from those suggested by the forward-looking statements contained in this document, for example directly or indirectly as a result of, but not limited to, UK domestic and global economic business conditions, market-related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory authorities (including changes related to capital and solvency requirements or the Ogden discount rate), the impact of competition, currency changes, inflation and deflation, the timing impact and other uncertainties of future acquisitions, disposals, joint ventures or combinations within relevant industries, as well as the impact of tax and other legislation and other regulation in the jurisdictions in which the Group and its affiliates operate. In addition, even if the Group's actual results of operations, financial condition and the development of the business sector in which the Group operates are consistent with the forward-looking statements contained in this document, those results or developments may not be indicative of results or developments in subsequent periods.

The forward-looking statements contained in this document reflect knowledge and information available as of the date of preparation of this document. The Group and the Directors expressly disclaim any obligations or undertaking to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, unless required to do so by applicable law or regulation. Nothing in this document should be construed as a profit forecast.

Neither the content of Direct Line Group's website nor the content of any other website accessible from hyperlinks on the Group's website is incorporated into, or forms part of, this document.

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