

# ADMIRAL GROUP plc

## ADMIRAL GROUP PLC

(incorporated and registered in England and Wales with registered number 03849958)

### £200,000,000 5.500 per cent. Subordinated Notes due 2024

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#### Issue Price 100 per cent.

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The £200,000,000 5.500 per cent. Subordinated Notes due 2024 (the "**Subordinated Notes**") will be issued by Admiral Group plc (the "**Issuer**") on or about 25 July 2014 (the "**Issue Date**"). The Subordinated Notes will constitute subordinated obligations of the Issuer. The Subordinated Notes will bear interest from (and including) the Issue Date at the rate of 5.500 per cent. per annum. Interest on the Subordinated Notes is payable semi-annually in arrear on 25 January and 25 July in each year (commencing on 25 January 2015). The Issuer is required to defer interest payments in the circumstances as described in Condition 5 (*Deferral of Interest*) and if the relevant payment could not be made in compliance with the Solvency Condition. Any interest which is deferred will, for so long as it remains unpaid, constitute "**Arrears of Interest**". Arrears of Interest shall not themselves bear interest and will be payable in the circumstances described in Condition 5(d) (*Payment of Arrears of Interest*) of the terms and conditions of the Subordinated Notes (the "**Conditions**").

The Subordinated Notes are scheduled to mature on 25 July 2024 (the "**Maturity Date**"). Subject to certain pre-conditions including the satisfaction of the Regulatory Clearance Condition and continued compliance with the Solvency Capital Requirements, the Subordinated Notes may be redeemed, substituted or varied prior to such date (i) in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation thereof or (ii) following the occurrence of (or if the Issuer is satisfied that there will occur within six months) a Capital Disqualification Event (**provided that**, in the case of any redemption prior to the fifth anniversary of the Issue Date, the approval of the Prudential Regulation Authority (the "**PRA**") is required and such redemption must be funded out of the proceeds of a new issue of regulatory capital of the same or higher quality (unless Solvency II is implemented without such requirements). The redemption of the Subordinated Notes on the Maturity Date or any other date fixed for the redemption of the Subordinated Notes shall be deferred in certain circumstances as set out in Condition 6 (*Redemption, Substitution, Variation and Purchase*). Payments on redemption by the Issuer will be subject to the Solvency Condition and to the Regulatory Deficiency Redemption Deferral Event having not occurred or occurring if the Subordinated Notes were to be redeemed.

Application has been made to the Financial Conduct Authority (the "**FCA**") under Part VI of the Financial Services and Markets Act 2000 (in such capacity, the "**UK Listing Authority**") for the Subordinated Notes to be admitted to the official list of the UK Listing Authority (the "**Official List**") and to the London Stock Exchange plc (the "**London Stock Exchange**") for such Subordinated Notes to be admitted to trading on the London Stock Exchange's Main Market (the "**Market**"). References in this Prospectus to the Subordinated Notes being "listed" (and all related references) shall mean that the Subordinated Notes have been admitted to the Official List and have been admitted to trading on the Market. The Market is a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments.

The denomination of the Subordinated Notes shall be £100,000 and integral multiples of £1,000 in excess thereof. The Subordinated Notes will be issued in registered form and represented upon issue by a registered global certificate which will be registered in the name of a nominee for a common depository for Clearstream Banking, *société anonyme* ("**Clearstream, Luxembourg**") and Euroclear Bank SA/NV ("**Euroclear**") on the Issue Date. Save in limited circumstances, Subordinated Notes in definitive form will not be issued in exchange for interests in the registered global certificate.

The Subordinated Notes have been rated BBB- by Fitch Ratings Limited ("**Fitch**"). A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. The credit ratings included or referred to in this Prospectus have been issued by Fitch which is established in the European Union and registered under Regulation (EC) No. 1060/2009 (as amended) (the "**CRA Regulation**"). Fitch is included in the list of credit rating agencies published by the European Securities and Markets Authority on its website in accordance with the CRA Regulation.

**Prospective investors should have regard to the factors described under the section entitled "Risk Factors" in this Prospectus.**

**Bookrunner and Structuring Advisor**

**BofA Merrill Lynch**

This Prospectus comprises a prospectus for the purposes of Directive 2003/71/EC, as amended (the "**Prospectus Directive**") and for the purpose of giving information with regard to the Issuer and its subsidiaries taken as a whole (the "**Group**"), and the Subordinated Notes which according to the particular nature of the Issuer and the Subordinated Notes, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Issuer. The Issuer accepts responsibility for the information contained in this Prospectus. To the best of the knowledge and belief of the Issuer (which has taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

Words and expressions defined in the section entitled "*Terms and Conditions of the Subordinated Notes*" and not otherwise defined in this Prospectus shall have the same meanings when used in the remainder of this Prospectus.

This Prospectus does not constitute an offer of, or an invitation by or on behalf of the Issuer or Merrill Lynch International (the "**Manager**") to subscribe or purchase, any of the Subordinated Notes. The distribution of this Prospectus and the offering of the Subordinated Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Prospectus comes are required by the Issuer, the Manager and Deutsche Trustee Company Limited (the "**Trustee**") to inform themselves about and to observe any such restrictions.

For a description of further restrictions on offers and sales of the Subordinated Notes and distribution of this Prospectus, see the section entitled "*Subscription and Sale*" on page 106.

No person is authorised to give any information or to make any representation not contained in this Prospectus and any information or representation not so contained must not be relied upon as having been authorised by or on behalf of the Issuer, the Manager or the Trustee. Neither the delivery of this Prospectus nor any sale made in connection herewith shall, under any circumstances, create any implication that there has been no change in the affairs of the Issuer since the date hereof or the date upon which this Prospectus has been most recently amended or supplemented or that there has been no adverse change in the financial position of the Issuer since the date hereof or the date upon which this Prospectus has been most recently amended or supplemented or that the information contained in it or any other information supplied in connection with the Subordinated Notes is correct as of any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same.

To the fullest extent permitted by law, the Manager accepts no responsibility whatsoever for the contents of this Prospectus or for any other statement, made or purported to be made by the Manager or on its behalf in connection with the Issuer or the issue and offering of the Subordinated Notes. The Manager accordingly disclaims all and any liability whether arising in tort or contract or otherwise (save as referred to above) which it might otherwise have in respect of this Prospectus or any such statement.

The Subordinated Notes have not been and will not be registered under the US Securities Act of 1933 (the "**Securities Act**") and are subject to US tax law requirements. Subject to certain exceptions, the Subordinated Notes may not be offered, sold or delivered within the United States or to US persons.

Unless otherwise specified or the context requires, references to "**sterling**" and "**£**" are to the currency of the United Kingdom and all references to "**euro**" and "**€**" are to the currency introduced at the start of the Third Stage of European Economic and Monetary Union pursuant to the Treaty on the Functions of the European Union ("**EU**"), as amended.

**In connection with the issue of the Subordinated Notes, the Manager (or any person acting on behalf of the Manager) may over-allot Subordinated Notes or effect transactions with a view to supporting the market price of the Subordinated Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Manager (or any person acting on behalf of the Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Subordinated Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Subordinated Notes and 60 days after the date of the allotment of the Subordinated Notes. Any stabilisation action or over-allotment must be conducted by the Manager (or any person acting on behalf of the Manager) in accordance with all applicable laws and rules.**

## **MARKET AND INDUSTRY INFORMATION**

This Prospectus contains information regarding the Group's business and the industry in which it operates and competes. The Issuer obtained this information from various third party sources and the Group's own internal estimates. In certain cases, the Issuer has made statements on the basis of information obtained from third party sources that the Issuer believes are reliable.

The following third party sources have been used in relation to information on UK market share, new business sales, industry averages and general market data:

- Datamonitor: UK Private Motor Insurance – Market Dynamics and Opportunities (September 2013);
- UK motor insurance results seminar: Behaving rationally? Ernst and Young (June and December 2013);
- UK motor insurance results seminar: Tipping Point?, Ernst and Young (June 2014);
- Motor Insurance Claims Performance in 2013, Deloitte (May 2013);
- AA British Insurance Premium Index – 2014 quarter 1 (April 2014);
- Deloitte Motor Insurance Seminar (May 2013);
- UK Motor Market Review (October 2013);
- General Insurance Workshop, eBenchmarkers (Spring 2014); and
- General Insurance Workshop, eBenchmarkers (Autumn 2013).

The following third party sources have been used in relation to information on the Spanish car insurance and price comparison markets:

- El Seguro del Automovil, Towers Watson (February 2014);
- DGT Portal Estadístico: 'Parque distribuido por tipo de vehículo y año de matriculación', Dirección General de Tráfico (October 2013); and
- Brand Tracker Qualitas Auto, Informe de resultados. 5ª FASE, Instituto de Investigación, Marketing y Comunicación (May 2014).

The following third party source has been used in relation to information on the Italian car insurance market:

- Associazione Nazionale fra le Imprese Assicuratrici Italian Insurance 2012, 2013 (website).

The following third party sources have been used in relation to information on the French car insurance market:

- Le marché de l'assurance automobile en 2012, Association Francaise de L'Assurance (July 2013); and
- Perspectives de résultats 2014, Association Francaise de L'Assurance (November 2013).

The following third party sources have been used in relation to information on the US car insurance market:

- Auto Insurance report vol21#36/996, Risk Information Inc (June 2014);
- Insurance report vol20#15/927, Risk Information Inc (January 2013);
- Winning Share and Customer Loyalty in Auto Insurance, McKinsey&Company (July 2013); and

- Auto Insurance report vol20#15/927, Risk Information Inc (14 January 2013).

Industry publications, surveys and forecasts generally state that the information contained therein has been obtained from sources believed to be reliable. The Issuer has not independently verified these industry publications, surveys and forecasts and, therefore, cannot guarantee their accuracy or completeness.

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## OVERVIEW OF THE PRINCIPAL FEATURES OF THE SUBORDINATED NOTES

The following overview refers to certain provisions of the terms and conditions of the Subordinated Notes and the Trust Deed and is qualified by the more detailed information contained elsewhere in this Prospectus. Capitalised terms which are defined in the section entitled "Terms and Conditions of the Subordinated Notes" on page 28 shall have the same meaning when used in this overview.

<b>Issuer:</b>	Admiral Group plc.
<b>Description of the Subordinated Notes:</b>	£200,000,000 5.500 per cent. Subordinated Notes due 2024.
<b>Manager:</b>	Merrill Lynch International.
<b>Trustee:</b>	Deutsche Trustee Company Limited.
<b>Principal Paying Agent:</b>	Deutsche Bank AG, London branch.
<b>Registrar and Transfer Agent:</b>	Deutsche Bank Luxembourg S.A.
<b>Risk Factors:</b>	<p>There are certain factors that may affect the Issuer's ability to fulfil its obligations under the Subordinated Notes. In addition, there are certain factors which are material for the purpose of assessing the market risks associated with the Subordinated Notes and certain risks relating to the structure of the Subordinated Notes. These are set out in the section entitled "<i>Risk Factors</i>" on page 5.</p>
<b>Status and Subordination of the Subordinated Notes:</b>	<p>The Subordinated Notes constitute direct, unconditional, unsecured and subordinated obligations of the Issuer which will at all times rank <i>pari passu</i> without any preference among themselves. The rights and claims of the Noteholders against the Issuer are subordinated in a Winding-Up as described in Condition 2(b) (<i>Subordination</i>).</p>
<b>Maturity Date:</b>	<p>Unless previously redeemed or purchased and cancelled, the Issuer will (subject as provided under "<i>Deferral of Redemption at Maturity Date</i>" below) redeem the Subordinated Notes on 25 July 2024.</p> <p>The Subordinated Notes are not redeemable at the option of any Noteholder in any circumstances.</p>
<b>Redemption, variation or substitution upon a relevant tax law change or Capital Disqualification Event:</b>	<p>The Subordinated Notes may be redeemed prior to the Maturity Date (i) in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation thereof or (ii) following the occurrence of (or if the Issuer is satisfied that there will occur within six months) a Capital Disqualification Event (<b>provided that</b>, in the case of any redemption prior to the fifth anniversary of the Issue Date, the approval of the PRA is obtained and such redemption is funded out of the proceeds of a new issue of regulatory capital of the same or higher quality as the Subordinated Notes (unless Solvency II (as defined in the Conditions) is implemented without such requirements).</p> <p>The Conditions also provide for the substitution or variation of the Subordinated Notes in certain circumstances relating to a relevant tax law change or Capital Disqualification Event, all as more particularly described in Condition 6 (<i>Redemption, Substitution, Variation and Purchase</i>).</p>

**Deferral of Redemption at Maturity Date:**

No Subordinated Notes shall be redeemed by the Issuer on the Maturity Date or on any other date fixed for redemption pursuant to Conditions 6(a) (*Scheduled redemption*), 6(c) (*Redemption, variation or substitution for taxation reasons*) or 6(d) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) if (i) a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or would occur if the Subordinated Notes were to be redeemed or (ii) such payment could not be made in compliance with the Solvency Condition.

If redemption of the Subordinated Notes is deferred, the Issuer will redeem the Subordinated Notes as provided in Condition 6(b) (*Deferral of redemption date*).

**Regulatory approval for early redemption, variation, substitution or purchase:**

Prior to publishing any notice (a) that the Issuer intends to redeem the Subordinated Notes before the Maturity Date or (b) of any proposed substitution, variation or purchase of the Subordinated Notes, the Issuer will be required to have complied with the Regulatory Clearance Condition and be in continued compliance with the Solvency Condition and with Solvency Capital Requirements as published by the PRA.

**Interest:**

The Subordinated Notes will bear interest from (and including) the Issue Date at the rate of 5.500 per cent. per annum payable (subject as provided under "*Regulatory Deficiency Interest Deferral*" below) semi-annually in arrear on 25 January and 25 July in each year.

**Regulatory Deficiency Interest Deferral:**

The Issuer is required to defer any payment of interest on the Subordinated Notes on each Interest Payment Date (i) in respect of which a Regulatory Deficiency Interest Deferral Event has occurred and is continuing and/or (ii) on which such payment could not be made in compliance with the Solvency Condition.

**Arrears of Interest:**

Any interest which is deferred by the Issuer will, for so long as it remains unpaid, constitute Arrears of Interest. Arrears of Interest shall not themselves bear interest and will be payable by the Issuer as provided in Condition 5(d) (*Payment of Arrears of Interest*).

**Events of Default:**

If default is made by the Issuer for a period of 14 days or more in the payment of any interest or principal due in respect of the Subordinated Notes or any of them, or a Winding-Up occurs, the Trustee on behalf of the Noteholders may (and, subject to certain conditions, if so directed by the requisite majority of Noteholders, shall) institute proceedings for the winding-up of the Issuer in England and Wales (but not elsewhere), and/or (as applicable) prove in the winding-up or administration of the Issuer and/or claim in the liquidation of the Issuer, but may take no further action to enforce, prove or claim for any payment by the Issuer in respect of the Subordinated Notes or the Trust Deed.

Upon the occurrence of a Winding-Up, the Trustee may (and, subject to certain conditions, if so directed by the requisite majority of the Noteholders, shall) give notice to the Issuer that the Subordinated Notes are, and they shall accordingly become, immediately due and payable by the Issuer at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest.

**Additional Amounts:**

All payments in respect of the Subordinated Notes shall be made free and clear of, and without withholding or deduction for, or on

account of, any taxes of the United Kingdom, unless such withholding or deduction is required by law.

If any such withholding or deduction is made, additional amounts will be payable by the Issuer subject to certain exceptions as are more fully described in Condition 8 (*Taxation*).

<b>Substitution of the Issuer:</b>	The Conditions permit the Trustee to agree (subject to the Issuer giving at least one month's notice to, and receiving no objection from, the PRA or obtaining prior approval from the PRA in respect thereof) to the substitution in place of the Issuer of a Substituted Obligor or the addition of a Related Undertaking of the Issuer as a guarantor of the Issuer's obligations in the circumstances described in Condition 14 ( <i>Substitution of Issuer</i> ) without the consent of Noteholders.
<b>Meetings of Noteholders:</b>	The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the relevant majority.
<b>Form:</b>	The Subordinated Notes will be issued in registered form and represented upon issue by a registered global certificate which will be registered in the name of a nominee for a common depository for Clearstream Banking, <i>société anonyme</i> and Euroclear Bank SA/NV on the Issue Date. Save in limited circumstances, Subordinated Notes in definitive form will not be issued in exchange for interests in the registered global certificate. See the section of this Prospectus entitled " <i>Summary of Provisions relating to the Subordinated Notes while in Global Form</i> " on page 50 for further details.
<b>Denomination:</b>	The denomination of the Subordinated Notes shall be £100,000 and higher integral multiples of £1,000 in excess thereof.
<b>Listing and Admission to Trading:</b>	Application will be made to the FCA under Part VI of FSMA for the Subordinated Notes to be admitted to the Official List and to the London Stock Exchange for such Subordinated Notes to be admitted to trading on the Market.
<b>Rating:</b>	<p>The Subordinated Notes have been rated BBB- by Fitch. A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.</p> <p>The credit ratings included or referred to in this Prospectus have been issued by Fitch which is established in the European Union and registered under Regulation (EC) No. 1060/2009 (as amended) (the "<b>CRA Regulation</b>"). Fitch is included in the list of credit rating agencies published by the European Securities and Markets Authority on its website in accordance with the CRA Regulation.</p>
<b>Governing Law:</b>	The Subordinated Notes and the Trust Deed will be governed by, and construed in accordance with, English law.
<b>Selling Restrictions:</b>	The United States and the United Kingdom.
<b>Use of Proceeds:</b>	The net proceeds of the issue of the Subordinated Notes will be used by the Issuer to fund the general business and commercial activities of the Insurance Group and to strengthen further its

capital base at group level.

**Clearing Systems:** Clearstream Banking, *société anonyme* and Euroclear Bank SA/NV.

**ISIN:** XS1090334050

**Common Code:** 109033405

## **RISK FACTORS**

*The Issuer believes that the following factors may affect its ability to fulfil its obligations under the Subordinated Notes. All of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.*

*Any of these risk factors, individually or in the aggregate, could have an adverse effect on the Group's business, and the impact each risk could have on the Group is set out below. In addition, many of these factors are correlated and may increase the Issuer's overall capital requirements, and this could mean that, when combined, the adverse consequences of certain of the risks referred to below impacting on the Group could compound or exacerbate the impact of other risks. For example, the impact of the continuing global financial crisis may reduce the value of investments and weaken the capital position of the Group and at the same time reduce the ability of the Group to offset insurance risks through co-insurance and reinsurance due to reduced capacity in such markets or the failure of relevant counterparties. Further, a reduction in the financial strength of the Group as a result of weak investment markets may adversely impact its ability to market and provide competitive products for its insurance and price comparison businesses.*

*In line with other insurance groups, through both regulatory requirements and the Group's own risk management procedures, the Group holds capital to protect itself against such risk events, including the potential aggregation of such risks. Despite this, the Group cannot be certain that its current capital and related solvency cover will be sufficient to enable the Group to continue to trade at current volumes following a significant risk event or an aggregation of such risk events.*

*The Group is of the understanding that the factors described below represent the principal risks inherent in investing in the Subordinated Notes, but the Group may be unable to pay interest, principal or other amounts on or in connection with the Subordinated Notes for other reasons, and the Group does not represent that the statements below regarding the risks of holding the Subordinated Notes are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision.*

### **1. Risks relating to the financial markets, the financial strength and financial condition of the Group, the valuation of assets and related risks**

***Continuing difficult conditions in the global financial markets and the UK and global economies may have a material adverse effect on the Group's business, results and financial condition.***

Like other insurance groups, the Group is directly and indirectly subject to inherent risks arising from general economic conditions in the UK and other economies and the state of the global financial markets. Volatility in the UK and global markets, described in the paragraph below, may have a materially adverse effect on the Group due to its exposure to asset prices and the various international markets in which the Group operates. The Group cannot predict the level of growth in the global economy, but an ongoing sustained period of weak growth would have an adverse effect on its business and operations.

Marked deterioration in global financial market conditions from the onset of the global financial crisis in 2008 led to severe dislocation of those markets and unprecedented levels of illiquidity. In the years that followed, a number of governments including those of the US, the UK and other EU member states (in which the Group operates), intervened to stabilise financial markets through fiscal stimulus. In some cases the injection of funds was required to prevent the failure of financial institutions. There can be no guarantee of such support in the future, and such support is likely to be on more punitive terms for financial institutions than in the past.

With respect to the US in particular, political gridlock culminated in a temporary federal government shutdown and battles over increasing the US borrowing limit, the market reaction to the prospects of the taper of the US Federal Reserve's asset-purchase programme and its impact on global interest rates, the downgrade by Standard & Poor's of France's sovereign debt rating and pessimistic global growth forecasts by the OECD, among others, highlight the uncertain nature of any post-crisis recovery and the significant risks that the world economy continues to face.

Economic growth in Europe broadly continues to be constrained, particularly in the peripheral eurozone countries, and business and consumer confidence continues to be impacted by limited access to credit in

the bank funding markets, ongoing concerns over eurozone sovereign debt, concerns over the ability of governments to address the need for structural economic and fiscal reforms, and the slower pace of economic growth in China and other emerging markets.

Although conditions in the global financial markets have improved to some extent recently, there continues to be significant uncertainty. Since the onset of the crisis it has been the policy of the Bank of England to maintain consistently low interest rates and support the UK economy with measures such as quantitative easing. As the economic situation improves, these measures are expected to be decreased over time.

As a result of these uncertainties, the risk of a further downturn in the global financial market and significant movements in interest rates and credit spreads, the results of the Group's operations may be subject to significant volatility, and there can be no assurance as to the effects of any volatility on the financial condition of the Group, particularly if such volatility is prolonged. Specific effects may include:

- a general reduction in business activity and market volumes which affects revenues, such as premium income from sales of insurance products;
- an increased incidence of claims or surrenders of policies that could affect the current and future profitability of the business;
- market downturns resulting in a reduction in the valuations of assets and investments held by the Group;
- reduced market liquidity, limiting the Group's ability to trade in investment assets, access capital and manage risks; and
- increased capital requirements applicable to the Group as a result of applying market related stress tests.

***Significant fluctuations or declines in investment values could adversely affect the Group's profitability and financial condition.***

The value of investment assets fluctuates, which can impact the capital levels supporting the Group's business and have a negative impact on the Group's capital position.

The Group has maintained a low-risk investment strategy, with a broadly consistent allocation of funds to the three main asset categories of: cash at bank, cash deposits and short-term securities (including money market funds), the latter of which forms the majority of total investments; all highly liquid investments with a focus on low volatility of returns. Despite the prudence of the Group's Investment Committee, increased volatility and/or a substantial decline in the value of financial markets could still result in a substantial loss in the value of the investments of the Group which could have an adverse impact on the capital position of the Group and its profitability.

***The Group is exposed to credit risks which may adversely affect the Group's capital and its profitability.***

The Group is primarily exposed to credit risks in the form of either the default of a reinsurer and/or the failure of financial institution investment counterparties. In the event that one or more counterparties suffer a significant event leading to financial difficulties and a subsequent credit default, the Group may need to raise additional capital and would need to ensure that it had sufficient liquid assets in order to meet any claims and liabilities as they fell due.

By way of mitigating this credit risk, the Group only conducts business with reinsurers and financial institutions of what the Issuer reasonably considers to be appropriate financial strength. The Group's policy is to only purchase reinsurance with counterparties rated "A-" or above by Standard & Poor's Credit Market Services Europe Limited ("**S&P**") (with equivalent ratings from Fitch and Moody's Investors Service Limited ("**Moody's**"), unless the Group Risk Committee of the Issuer ("**GRC**") agrees otherwise). In relation to the reinsurance agreements in place, the majority of these are operated on a funds withheld basis so that the Group retains a material proportion of the reinsured premium as collateral. There are no specific concentrations of credit risk in the Group's investment counterparties owing to the liquidity of the funds and the Group invests in a wide range of very short-term high-quality

securities to further mitigate any credit risk. In addition, the cash balances and deposits are placed exclusively with highly-rated credit institutions.

Furthermore, the Group (primarily through its Risk and Investment Committees) considers counterparty exposure frequently and in significant detail and implements appropriate measures to mitigate exposure to individual investment companies.

***Changes in interest rates may reduce the value of the Group's investment portfolio and adversely impact the capital values of assets and liabilities.***

Unfavourable fluctuations in market interest rates could adversely impact on the capital values of financial assets and liabilities.

As noted in the above sections ("*Significant fluctuations or declines in investment values could adversely affect the Group's profitability and financial condition*" and "*The Group is exposed to credit risks which may adversely affect the Group's capital and its profitability*"), the Group makes investments in money market liquidity funds, which in turn invest in a mixture of very short-term fixed and variable rate securities, such as cash deposits, certificates of deposits, floating rate notes and other commercial paper. The funds are not permitted to have an average maturity greater than 60 days and are therefore not subject to large movements in yield and value resulting from changes in market interest rates (as longer duration fixed-income portfolios can experience). Returns are likely to closely track the LIBID benchmark and hence while the Group's investment return will vary according to market interest rates, the capital value of these investment funds will not be materially impacted by rate movements. Owing to these factors, the interest rate risk arising is therefore considered by the Group to be minimal.

Other Group investments include funds placed into two segregated mandates, the guidelines of which retain the credit quality of the money market liquidity funds. As the duration of these securities is also short there is not a material interest rate risk relating to these investments. The Group also holds a number of fixed-rate, longer term deposits with strongly-rated credit institutions. These are classified as term deposits and valued at amortised cost. It is the Group's subsequent understanding that neither the capital value of the deposits nor the interest return should be materially impacted by fluctuations in interest rates.

***The valuation basis for financial assets in the Group's accounts may include methodologies, estimations and assumptions which are subject to differing interpretations and, depending on the interpretation, could result in changes to the valuation of these financial assets that may materially affect the Group's profitability and financial condition.***

The Group's financial statements are prepared in accordance with IFRS and it has elected to prepare the parent company's financial statements in accordance with UK GAAP standards. These financials are prepared on the historical cost basis, except for the revaluation of financial assets classified as at fair value through profit or loss. Fair values of financial instruments that are quoted in active markets are based on bid prices for the assets held. When independent prices are not available, fair values are determined by using comparisons with other similar financial instruments, or the use of valuation models. Establishing valuations where there are no quoted bid prices or where, for example, transaction volumes fall significantly, inherently involves the use of judgement.

Estimation techniques are used in the calculation of the provisions for claims outstanding, which represent a projection of the ultimate cost of settling claims that have occurred prior to the balance sheet date and remain unsettled at the balance sheet date. The use of projection techniques is sensitive to any future step change in claim costs which would cause future claim cost inflation to deviate from previous trends. This situation could arise in the context of a change in the regulatory or judicial regime that leads to any increase in awards or legal costs for bodily injury claims significantly above or below the previous trend (used for projection purposes). The Group's independent actuarial advisors project best estimate claims reserves using a variety of recognised actuarial techniques. The Group's reserving policy requires management to reserve within a range of potential outcomes above the projected best estimate outcome to cater for unforeseen adverse claims development.

During periods of market disruption, exacerbated credit risk or illiquidity, it may be difficult to value some assets using the Group's methodology and estimates and assumptions may prove to be inaccurate. Further, rapidly changing credit and equity market conditions could materially impact the valuation of

securities and the period-to-period changes in value could vary significantly. Decreases in value may have a material adverse effect on the Group's profits and capital requirements, though such decreases are mitigated by the Group's focus on liquid and short-term securities.

***Adverse capital and credit market conditions may significantly affect the Group's ability to meet its liquidity needs.***

The Group needs liquidity to pay claims and operating expenses, including commission to intermediaries. The principal sources of liquidity are insurance premiums, investment income and holdings of liquid assets. The availability of these sources may reduce in stressed market conditions (where the Group may not have sufficient financial resources to enable it to meet its obligations as they fall due or can only secure them at excessive cost) and without sufficient liquidity the Group may be forced temporarily to reduce new business volumes.

In the event that current resources do not satisfy the Group's needs, the Group may have to seek additional financing. The availability of additional financing will depend on a variety of factors such as: market conditions, the general availability of credit, the volume of trading activities, the overall availability of credit to the financial services industry, the Group's credit ratings and credit capacity, as well as the possibility that customers or lenders could develop a negative perception of the Group's long or short-term financial prospects if the Group incurs large investment losses in a market downturn or for other reasons negatively affecting the perception of the Group in the market. Similarly, access to funds may be impaired if regulatory authorities or rating agencies take certain actions against or make adverse statements about the Group. Internal sources of liquidity may prove to be insufficient, and in such case, the Group may not be able to obtain additional financing on favourable terms, or at all.

Disruptions, uncertainty or volatility in the debt capital markets may also limit the Group's access to capital required to operate its business. Such market conditions may limit the Group's ability to satisfy statutory capital requirements, generate premiums and investment income to meet liquidity needs, and access the capital necessary to grow the business. As such, the Group may be forced to delay raising debt capital or bear an unattractive cost of capital which could decrease profitability and significantly reduce financial flexibility.

By way of mitigating this liquidity risk, the Group operates a strongly cash-generative model in which a large proportion of revenue is derived from non-underwriting activity and an investment strategy which focuses a significant portion of insurance funds in money market liquidity funds with same-day liquidity, meaning that a large share of the Group's cash and investments are immediately available. However, in the event that the Group's internal sources of liquidity prove to be insufficient or if its liquidity requirements change so as to require additional funding, it may not be possible for the Group to successfully obtain additional financing (whether on favourable terms or otherwise).

***Fluctuations in the rate of inflation or a sustained increase in the rate of inflation may adversely affect the Group's profitability.***

Inflation, as measured by consumer price indices or other means, is a continuing risk for the Group. A sustained increase in the inflation rate may negatively affect the Group's business, solvency position, combined operating ratio and results of operations. For example, a sustained increase in the inflation rate may result in an increase in market interest rates which may: (i) decrease the estimated fair value of certain fixed income securities held in the Group's investment portfolios resulting in reduced asset values that could negatively impact the solvency position and income of the Group; and (ii) increase the benefits payable by the Group to policyholders where they are linked to inflation such as Periodic Payment Order ("PPO") payments (as referred to in the below section: "*Adverse claims and reserving risk could have a significant adverse impact on the financial results and operations of the Group*") which would have a negative impact on profits and increase capital requirements.

## **2. Risks relating to the structure of the Group, the scope and nature of its business and products**

The Group is an international organisation which operates through eight countries; the UK, Canada, Italy, US, Spain, India, Gibraltar and France. The Group's core business is in the highly competitive UK car insurance market, though the Group also operates in the international car insurance market, the price comparison market, the UK household insurance market and the commercial vehicle insurance market.

This structure and strategic focus exposes the Group to a number of risks which are set out in the following paragraphs.

***The Group's profits are primarily derived from its car insurance business.***

In 2013, the UK car insurance business comprised 84% of the Group's annual turnover with the international car insurance business comprising a further 9%.

The predominance of the car insurance business in relation to the Group's total turnover leaves the Group more heavily exposed to the profits from such business and more exposed to the risks of the car insurance market, particularly the UK car insurance market. The car insurance market is susceptible to, amongst other things: (i) fluctuations in investment income in line with financial markets; (ii) fraudulent claims risks; (iii) heightened competition from other providers; and (iv) cyclical downturns. The Group is specifically exposed to the resulting fluctuations in profitability due to the heavy concentration of profit in this sector.

***Adverse claims and reserving risk could have a significant adverse impact on the financial results and operations of the Group.***

The Group is exposed to reserving risk through its underwriting of insurance policies. It may be the case that claims reserves in the financial statements are inadequate to cover the ultimate cost of open claims which are by nature uncertain.

In terms of car insurance, the Group is particularly exposed to large personal injury claims, where the claim amounts can be significant owing to the potential cost of care for any successful claimant. It is current practice for the Group to use excess of loss reinsurance for very large claims; this mitigates the loss to the selected deductible amount. Large personal injury claims can also be settled through the award of PPOs, in which indexed payments are made periodically over the lifetime of the injured party. Any changes in the number of personal injury claims and/or the propensity for claimants to settle personal injury claims using a PPO, relative to the estimates made when setting the technical reserves, would have an effect on the Group's underwriting ratios and profits. The increase in the utilisation of PPOs to settle personal injury claims in the UK makes the estimation of reserves for general insurance business increasingly complex and uncertain due to the increased range of assumptions required, such as the future propensity of such settlement methods, rates of inflation and mortality trends for injured lives. Reinsurance recoveries will also occur many years into the future with a resultant increase in the associated credit or other non-payment risk. The fact that these claims take many years to ultimately settle increases the uncertainty around their estimation, which could have a material adverse effect on the Group's profits.

Further, outstanding claims provisions for the Group's business are calculated with reference to the best-estimate ultimate cost of all claims incurred but not settled at a given date. If the assumptions underlying the reserving basis were to prove incorrect, data used to estimate reserves proves inaccurate or actual claims experience were to be less favourable than the underlying assumptions, the Group may have to increase the amount of its general insurance provisions. If actual claims costs exceed insurance reserves, financial results could be adversely affected. To the extent that the Group's reserves are estimated to be insufficient to cover the future cost of claims or administrative expenses, it will have to increase its reserves and incur a corresponding reduction in its profits in the period in which the deficiency is identified. In addition, if the Group's reserves are excessive as a result of an over-estimation of risk, it may set premiums at levels which are too high and potentially may not be able to compete effectively, which may result in a loss of customers and premium income. Conversely, if the Group charges premiums that are insufficient for the cover provided, it will suffer underwriting losses, leading to a reduction in earnings.

In order to mitigate against this risk, the Group holds a material amount of margin in its financial statement claims reserves above the best estimates. The best estimate reserves are estimated internally and externally by an independent actuary to enhance their accuracy as far as is possible. The Group also holds a buffer in its reserves in excess of the projected ultimate outcomes to cover other potential claim shocks.

***The Group's underwriting assumptions and pricing models may not reflect its overall risk exposure***

The Group's results are impacted by the consistency between its actual claims and expense experience, in terms of ultimate cost and timing of cash flows, and the assumptions and pricing models it has used in underwriting and setting prices for its products. These assumptions are based on a variety of factors which may include historical data, estimates, assumptions or individual expert judgements in respect of known or potential future changes and statistical projections of what the Group believes will be the costs and cash flows of its liabilities. If the Group's actual claims and expense experience differ from the underlying assumptions and estimates used in establishing such liabilities or pricing its business, or if the Group's pricing is different to the market price for similar insurance products, this would have an adverse affect on the Group's revenue generation, profit and financial position.

Statistical methods, models or individual expert judgements may not accurately quantify the Group's risk exposure, including if circumstances arise that were not observed in the historical data or anticipated, or if the data otherwise proves to be inaccurate or inappropriate. In addition, the statistical methods, models or individual judgements themselves may be flawed, leading to inaccurate pricing of risk despite access to accurate data and accurate assessment of other risks. The Group's ability to quantify risk exposure, and as a result price insurance products successfully, is subject to risks and uncertainties including, without limitation: exposure to claims inflation; changes in claims frequency; unanticipated legal and regulatory changes and costs; unexpected or new types of claims; changes in social or market trends, including customer and claimant behaviour; changes in economic conditions; potential inaccuracies in the data collected from internal or external parties and/or used within the modelling and pricing processes; incorrect or incomplete analysis of data; potentially inaccurate or inappropriate policy terms and conditions; inappropriate or incomplete purchase of reinsurance or receipt of related recoveries; assumptions on weather trends; changes in the internal operating environment within the Group; the selection of inappropriate pricing methodologies; and the uncertainties inherent in estimates and assumptions, including those used throughout the pricing and underwriting processes.

The actual claims payments may vary, perhaps significantly, from those estimated both in amount and in timing of payments, particularly if the payments occur well into the future. This may have an adverse effect on the Group's business, results of operations and financial position and it may be necessary for the Group to increase prices for future insurance policies and to set aside additional reserves for existing, previously written policies, as well as increasing the capital it will be required to hold due to the increased uncertainty around future profitability. By way of mitigation against this risk, the Group adopts a highly data-driven and analytical approach to pricing and possesses an experienced pricing team well placed to price the Group's products as accurately as is possible. The Group appraises its investment in staff, systems and processes in relation to underwriting risks.

***Catastrophic events could result in material losses and an abrupt and significant interruption to the Group's business activities.***

The Group's business is exposed to volatile natural and man-made disasters such as floods, windstorms, terrorism, riots, fires and explosions. Over the past several years, changing weather patterns and climatic conditions have added to the unpredictability and frequency of natural disasters and created additional uncertainty as to future trends and exposure. The Group's UK household insurance business (launched in December 2012) is particularly exposed to the effect of extreme weather events which could result in a higher frequency and/or severity of losses than that which is priced for, thus reducing the profits from any such business.

Furthermore, it is possible that natural disasters and terrorism could disrupt operations and result in significant loss of property, key personnel and information about the Group and its customers. Business continuity plans are unlikely to provide effective contingencies for all such events which could therefore adversely affect the Group's business, results of operations, corporate reputation and financial condition. It is impossible to accurately predict the likelihood, timing or severity of any future catastrophe.

Excess of loss reinsurance has been purchased by the Group to mitigate the impact of catastrophic events, but the impact of such an event could nonetheless have a material adverse impact on the results of operations. The UK household insurance business is underwritten within the Group and is supported by proportional reinsurance covering 70% of the risk (shared between Munich Re, 40% and Swiss Re, 30%) as a further means of protection against the risk of potential losses from catastrophic events.

***Inability of reinsurers to meet their obligations, or the unavailability of adequate reinsurance coverage, could have an adverse impact on the Group's profitability and available capital.***

A key feature of the Group's business model is the extensive use of co-insurance and reinsurance with entities such as Munich Re, Swiss Re, Amlin Re, Hannover Re, Mapfre Re, New Re and XL Re. During 2013 and in early 2014, the Group announced extensions to its UK co-insurance and reinsurance arrangements with capacity fully allocated until at least the end of 2016 and Munich Re committed to underwriting 40% of the UK car insurance business until at least the end of 2018.

The proportion underwritten by Great Lakes (a UK subsidiary of Munich Re) is on a co-insurance basis (40% of all car premium and claims for 2013 accrued directly to Great Lakes and do not appear in the Group's income statement). Similarly, Great Lakes reimburses the Group for its proportional share of expenses incurred in acquiring and administering the car business. All other arrangements are quota share reinsurance agreements.

There is a risk that such co-insurance and reinsurance support will not be available in the future if the results and/or future prospects of the business are not satisfactory to the co-insurers and/or reinsurers; this is a particular risk with newer business lines where the risk of underperformance is potentially higher. In this event, the Group would be required to raise additional capital to support underwriting. The inability or unwillingness of the Group's reinsurers to meet their financial obligations or disputes / defects in relation to reinsurance contract wording or processes could materially affect operations. The Group is therefore exposed to settlement risk by its reinsurance counterparties, but this is mitigated by the spread of reinsurance risks across a strongly-rated and diverse range of reinsurers.

In addition, the reinsurance entities with whom the Group is partnered may become financially unsound by the time they are called upon to pay amounts due, which may not occur for many years. As such, the Group's business profitability could be significantly affected by having to meet its liabilities to policyholders out of its own assets whilst having paid premium to off-set risks in respect of such liabilities. As above, the Group has sought to mitigate this risk through engaging a diverse and well-respected set of reinsurance entities, and through operating many of its quota share reinsurance contracts on a funds withheld basis.

***The Group's businesses are conducted in highly competitive environments and continued profitability depends on management's ability to respond to these pressures.***

There are many factors which affect the Group's ability to sell its products, including price, financial strength, range of product lines and product quality, brand strength and name recognition.

In the UK and international car insurance markets, the Group faces fierce competition including new entrants and an increasing propensity for consumers to use price comparison websites (which exacerbates the potential risk for the Group to be undercut on price). This is seen by, among other factors, high levels of competition in general insurance for brand presence and competitive premiums. Whilst the turnover of the international car insurance business grew by 15% in 2013, the turnover of the UK car insurance business fell by 12% in the same year.

The UK car insurance price comparison market is one of the most, if not the most, mature in Europe, with approximately 66% of new business sales in the UK car insurance market originating via price comparison as at April 2014. The UK price comparison market is characterised by four main players, one of which is Confused.com, and another four or five minor players. There is intense competition within this market, as evidenced by the high levels of advertising spend.

The Group is dependent on the four main UK price comparison websites as an important source of new business and growth. There is the risk that growth in this distribution channel could slow, cease or reverse, or the Group could lose one or more of the websites as a source of customers. This in turn could lead to a potentially material reduction in the UK car insurance new business volumes. There is the potential for lower profits among the Group's price comparison business arms through the aggressive activities of existing players or the entry of significant new participants into the UK, French, Spanish and US price comparison markets.

In respect of the remaining Group items (UK household insurance via the Admiral Household Insurance brand and commercial vehicle insurance broking via the Gladiator brand), this area has seen a 146% increase in turnover, mostly owing to the launch of UK household insurance business at the end of 2012.

Competition is likely to intensify across all business lines in response to consumer demand, technological advances, the impact of consolidation, regulatory actions and other factors, with a particular increase in competition in pricing. The ability to generate an appropriate return depends significantly upon the Group's capacity to anticipate and respond appropriately to these competitive pressures.

***The cyclical nature of the general insurance industry may cause fluctuations in the operating and financial results of the Group and adversely affect its profits.***

Historically, the general insurance industry has been cyclical; operating and financial results of insurers have fluctuated significantly because of volatile and sometimes unpredictable developments, many of which are beyond the direct control of any insurer. Although the Group has a geographically diverse group of international general insurance business, it is highly possible that the Group will experience the effects of the cyclical nature of the general insurance industry, including changes in sales and premium levels, which could have a material adverse effect on the results of its operations. The unpredictability and competitive nature of the general insurance business historically has contributed to significant fluctuations in underwriting results and profitability in the general insurance industry.

The Group is particularly exposed to this risk by the concentration of its core business in the UK car insurance market (as mentioned above, this constitutes 84% of Group turnover).

***Any downgrade or removal of the Group's financial strength credit ratings could adversely affect the Group's profitability.***

The Issuer has been assigned a financial strength rating of "A-" by Fitch. Any downgrade or removal of the Group's rating could have a variety of adverse impacts on the Group including (i) damaging its competitive position, (ii) negatively impacting its ability to underwrite new insurance policies, (iii) increasing the levels of surrenders and termination rates of its in-force policies, (iv) increasing its cost of obtaining reinsurance, (v) harming its relationships with creditors or trading counterparties and/or (vi) adversely affecting public confidence in it.

***Insurance fraud may adversely affect the Group's financial results.***

Fraudulent insurance claims may be made from time to time which the Group is unable to detect, despite having extensive fraud prevention systems and processes in place. The volume, value and frequency of fraudulent claims may increase from time to time for various reasons and if not detected and inadvertently paid, can impact on anticipated claims volumes and matching reserves resulting in adverse effects on the profits and results of operations of the Group.

The Group is at risk from customers who misrepresent or fail to provide full disclosure in relation to the risk against which they are seeking cover before such cover is purchased and from policyholders who fabricate claims and/or inflate the value of their claims. The Group is also at risk from members of its staff who undertake, or fail to follow procedures to prevent, fraudulent activities.

In order to mitigate the risk of fraudulent practice, the Group continues to make material investments in staff and systems to work on the identification and prevention of claims fraud and these measures are regularly reviewed.

***The Group is dependent on the strength of its brand and the Group's reputation with customers and agents in the sale of products and services.***

While the Group is well recognised as a provider of general (predominantly car) insurance by potential customers, it is vulnerable to adverse market and customer perception. It operates in an industry where integrity, customer trust and confidence are paramount. The Group is exposed to the risk that litigation, employee misconduct, operational failures, the outcome of regulatory investigations, press speculation and negative publicity, disclosure of confidential client information and inadequate services, amongst others, whether or not founded, could adversely affect brands or reputation. Any of the Group's brands or the Group's reputation could also be adversely affected if products or services recommended by the

Group (or any intermediaries) do not perform in line with customer expectations which could reduce the profits of the Group from reduced sales.

The Group's short-term business model could also be materially and adversely affected by the failure of service providers and business partners on which the Group relies or partially relies to provide services and grow the business.

***The Group's information and technology systems may be subject to disruption which could adversely affect its business.***

The Group, like other institutions, is subject to risks such as hacking, cyber-attack and similar malicious activities that may impair the information and technology systems on which the Group relies. Such attacks could result in the shut-down of core services relied upon by the Group. As a large financial institution, the Group, along with other international insurance groups, is susceptible to potentially significant disruptions that could be caused by attacks on, or faults with, the information and technology systems that are so vital to the business.

If an actual or perceived breach of the Group's information and technology systems (including external systems on which the Group relies) occurs, it could impair the Group's ability to operate parts of its business and provide products and services to its customers, including a loss of data on which the Group relies in order to provide these products and services, and to manage its liabilities and its investments. It may also have difficulties in meeting policyholder liabilities, attracting new customers and preserving its existing customer base. Consequently, the financial condition of the Group and its reputation could be harmed, its revenues could decline and its business could suffer.

In order to address the risk of intentional security breaches and/or any potential inefficiency of the Group's technology infrastructure, the executive management and board of directors of the Group regularly review the effectiveness of the Group's information technology capability. Separately, the Group's Risk Committee reviews the existing data protection systems and controls.

***The Group's businesses are reliant upon data management and administration which is subject to operational risks of information loss, inadequate processes and systems, human error and both internal and external fraud.***

The Group is reliant on data management and efficient administration of policies and claims for its business efficiency, services to customers and its profits.

The Group outsources certain functions to India (Bangalore and New Delhi). Admiral Technologies (an Indian branch of Inpop.com Limited) has operations in India providing services to the Group's UK, French, Spanish and American operations in respect of information technology support. Admiral Solutions (a branch of EUI Limited) has operations in India which offers a contact centre to support the UK car insurance operations. The Group is therefore at least partially reliant upon the operational processing performance of outsourcing offices.

The systems and processes on which the Group is dependent to serve customers are designed to ensure that the operational risks associated with the Group's activities are appropriately identified and addressed. However, activities may nonetheless fail due to technology malfunctions, human error, business interruptions, non-performance by third parties, fraud or other external events. Any of these could disrupt business operations resulting in material reputational damage and the loss of customers, which would have a consequent material adverse effect on the Group's profits.

Whilst the specifics and timing of possible operational and systems failures cannot be anticipated, the Group's regular review of its information technology and data protection systems (referred to above in "*The Group's information and technology systems may be subject to disruption which could adversely affect its business*") attempts to mitigate against these risks of data loss and process errors.

***The failure to attract or retain key personnel could have a material adverse effect on the Group's results and/or financial condition.***

The Group is dependent on key executives and its senior management and the continued success of the various businesses are dependent on, among other factors, the ability to attract, develop and retain highly qualified professionals. The Group's continued ability to attract, develop and retain key people, and in

particular directors and other senior managers, is dependent on a number of factors, including prevailing market conditions, brand and reputation, and compensation packages offered by companies competing for the same talent.

The loss of key personnel could cause disruption and loss of profitability in the Group's business, as could the failure to attract additional key personnel in business areas of growth. In addition, if the Group were to lose a significant number of claims management employees, an area of specific expertise, the ability of the Group's claims departments to assume an increased workload could be adversely affected and a subsequent decrease in quality of claims handling and reduction in operating margins may follow.

To manage this risk the Group invests considerable time and money into the training and development of its staff. Except for founding directors, Henry Engelhardt and David Stevens, who have declined to participate, all staff members are awarded shares in the Group on identical terms ("**Approved Free Share Incentive Plan**"), which seeks to ensure employees' interests are aligned with those of the shareholders. In terms of directors and senior management, the Group offers competitive salaries with attractive performance-related incentives as well as a discretionary award system subject to Group performance and continued employment ("**Discretionary Free Share Scheme**"). The risk to the Group of retaining key executives and senior management may increase considerably on expiry of such incentive arrangements if no equivalent incentive plans are put in place thereafter.

***Risk processes and procedures may leave the Group exposed to unidentified or unanticipated risk, which could negatively affect the business.***

Management of risk requires, among other things, policies and procedures to identify, record properly and verify a large number of transactions and events. The Group's Risk Committee has devoted significant resources to developing the Group's risk management framework, monitoring the Group's risk exposures and ensuring the adequacy and effectiveness of the Group's compliance functions. Nonetheless, these policies and procedures may not be comprehensive, fully understood or always complied with and, as a result, may not be universally followed across the different businesses within the Group.

Many of the methods for managing risk and exposures are based upon the use of observed historical market behaviour or statistics based on historical models. As a result, although subject to expert judgement and oversight by the business, these methods may not fully predict future exposures, which can be significantly greater (or lower) than historical measures indicate, particularly in unusual markets and environments.

Other risk management methods depend upon the evaluation of information regarding markets, clients, catastrophe occurrence or other matters publicly available or otherwise accessible to the Group. This information may not always be accurate, complete, up-to-date or properly evaluated. The implementation and accuracy issues referred to above in respect of risk processes and procedures could have a negative impact on the profitability of the Group and exacerbate the impact of other risks of the Group referred to in these "*Risk Factors*" if not properly and regularly monitored.

***The Group's ventures into the legal sector make it vulnerable to a new set of risks which could negatively impact on the business.***

The Issuer has entered into two joint ventures with law firms Lyons Davidson and Cordner Lewis to form Admiral Law and BDE Law (in each case, the Group owns 90% of the shares in each law firm). The Lyons Davidson venture (Admiral Law) covers the Group's main brand, while the Cordner Lewis venture (BDE Law) covers three further brands owned by the Group; Bell, Diamond and elephant.co.uk, all of which focus on car insurance claims. Both ventures were granted Alternative Business Structure ("**ABS**") licences by the Solicitors Regulation Authority (the "**SRA**") pursuant to their powers under Part 5 of the Legal Services Act 2007. These law firms are regulated by the SRA and, as such, are subject to the SRA Principles, the Code of Conduct and other SRA Handbook provisions.

The ABS businesses are not expected to make a material contribution to Group profit in the short-term owing to new and proposed reforms to the handling of bodily injury claims. The Group's decision to incorporate the provision of legal services internally is intended to allow the Group to administer a claim throughout the process and offer a materially better quality of service.

There are a variety of risks which the Group is exposed to through its joint ventures with Lyons Davidson and Cordner Lewis. Primarily, law firms are expensive organisations to run with high operating costs (salaries typically being the most substantial cost); this could place the businesses at particular financial risk in times of economic downturn and a potential situation in which the Group would be required to assume the losses of the associated law firms. Further to the stringent regulations which the Group (as a financial institution) must adhere to, law firms are also strictly regulated by the SRA which therefore adds another layer of regulation by which the Group must abide and subsequently increases the potential for any breaches of such regulation by the legal bodies to which the Group now owns. Owing to the high potential liability which law firms face, it is standard for professional indemnity insurance to be utilised to cover this risk. However, there is always the risk that the professional indemnity insurance policies which Admiral Law and BDE Law have in place will not cover every liability claim and therefore there is the risk that the law firms could incur potential liability and significant costs which may be for the Group to assume. In the event that either law firm incurs liability (not covered by its respective professional indemnity insurance), there could be negative implications on the reputation of the firm, and therefore the Group.

***Any of the Group's international operations could result in losses or issues detrimental to the Group as a whole.***

There is the potential that one or more of the Group's international operations could fail to become a sustainable, profitable long-term business. The impact of this could be severe, with higher losses than anticipated, potential closure costs and negative publicity flowing from the effects of this.

The Group's approach to expansion remains conservative. The overseas insurance businesses (the most recently launched of these being in France and the US, launched in 2010 and 2009 respectively) have executed cautious launch strategies and are all backed by proportional reinsurance support which provides substantial mitigation against start-up losses in the early years of the business. The Group's new price comparison businesses have aligned their marketing investment with the extent of improvement in key performance indicators such as average cost per quote and conversion ratio. The Group also considers partial disposals of equity to share start-up losses with partners. The new UK household insurance business is backed by proportional reinsurance support which provides mitigation against start-up losses and excess of loss reinsurance which mitigates potential losses from catastrophe events.

By way of further prudence, the Group's directors being mindful of management stretch, regularly assess the suitability of the management structure in place for the Issuer's international operations.

***The Group's operations in Gibraltar may leave it exposed to any changes in local regulation and laws which could affect the Group's operations and profitability in the jurisdiction.***

#### *Gibraltar's Sovereignty Claim*

The Kingdom of Spain has not conceded its claim to sovereignty over Gibraltar. There can be no assurance or certainty as to the outcome of any future discussions on the question of Gibraltar's sovereignty, nor of how any change of sovereignty would affect the regulation and taxation of entities incorporated or operating in or from within Gibraltar. This could impact on the Group's ability to undertake business in or from within Gibraltar.

#### *Gibraltar's EU Status*

Gibraltar is a British Overseas Territory. It is part of the EU, having joined the EEC with the UK in 1973 by virtue of Article 355(3) (ex Article 299(4)) which applies the treaty to "the European territories for whose external relations a Member State is responsible", a provision which in practice only applies to Gibraltar. By virtue of this, Gibraltar is required to enact all EU directives and regulations. The Government of Gibraltar may fail to enact an EU directive or regulation or may enact an EU directive or regulation erroneously. This could negatively impact on the jurisdiction and, consequently, the Group's activities.

The UK is currently considering its position within the EU and there is a risk that a change to the UK's status within the EU or even the UK leaving the EU could impact on Gibraltar's position within the EU including Gibraltar having to assume any new status adopted by the UK. Due to the political situation between the Kingdom of Spain, the UK and Gibraltar (please see the section: "*Gibraltar's Sovereignty*

*Claim*") there is the possibility that the Kingdom of Spain would make it very difficult to discuss or vary Gibraltar's status within the EU. If Gibraltar's status within the EU changes or if Gibraltar were to leave the EU, any entity licensed under EU legislation and regulated by the Financial Services Commission (the "FSC") of Gibraltar may no longer be permitted to passport their services throughout the EU. This would dramatically impact on all Gibraltar licensed entities' (current and future) ability to conduct business within the EU. This could significantly impact upon the Group's activities undertaken from within Gibraltar.

#### *Gibraltar Tax*

On 1 January 2011 the Income Tax Act 2010 (the "IT Act") came into force. The IT Act ended the distinction between offshore and onshore business. On 24 June 2013 it was announced that the European Council of Economic and Finance Ministers of the 27 EU Members States (ECOFIN) endorsed Gibraltar's IT Act as being compliant with the EU Code of Conduct for business taxation. This is the first time that Gibraltar's tax system has been fully endorsed by both ECOFIN and the Code of Conduct Group (which is a group formed of the tax authorities of the 27 EU member states and chaired by the EU commission). Whilst these approvals mark a major milestone in the transformation of Gibraltar as a mainstream and compliant tax jurisdiction, there can be no assurance or certainty that Gibraltar's tax system will not come under scrutiny or that Gibraltar will not alter its taxation system or vary the levels of taxation currently charged. This could significantly impact upon the Group's activities undertaken from within Gibraltar.

#### *Gibraltar's economy*

Unlike most other EU jurisdictions, Gibraltar's economy has continued to expand since 2008, with a record budget surplus and a GDP growth of 7.8% being recorded in 2013, GDP per capita at £41,138 (up from ninth to fourth in the world on the IMF 2012 chart), net debt down from £303 million to £291 million and cash reserves quadrupled in 12 months (all figures as provided during the Chief Minister's budget speech on 24 June 2013). Whilst, by virtue of its size, Gibraltar as an economy has the ability to adapt to the global economic climate, there is no guarantee that this will be the case in the future. A downturn in the economic climate in Gibraltar could lead to the Government of Gibraltar having to intervene (for examples of interventions by Governments see "*Continuing difficult conditions in the global financial markets and the UK and global economies may have a material adverse effect on the Group's business, results and financial condition*"). This could include Gibraltar altering its taxation system or varying the levels of taxation currently charged. This could significantly impact upon the Group's activities undertaken from within Gibraltar.

### **3. Risks relating to the regulatory and legislative environment, including those relating to accounting standards and taxation**

***The Group's regulated business is subject to extensive regulatory supervision, with such regulation being subject to proposals for future changes which may result in adverse impacts for the Group, increasing compliance costs in relation to such laws and regulations.***

The Group, as an insurance group operating in the UK, is subject to detailed and comprehensive regulation in the UK and Gibraltar, flowing increasingly from EU directives and regulations as well as local rules and implementing legislation. Insurance laws, regulations and policies currently affecting the Group may change at any time in ways which may have an adverse effect on the Group's business. Furthermore, it is difficult to predict the timing or form of future regulatory change across areas in which the Group operates.

The Group's business is subject to regulation by both the PRA and FCA in the UK and the FSC in Gibraltar, each of which has broad powers under local legislation, including the authority to grant, vary the terms of, or cancel a regulated firm's authorisation. The Group's US insurance operations are regulated by the Virginia State Corporation Commission's Bureau of Insurance (the "BOI") and the new US price comparison business is a regulated insurance agency in Virginia, US. In addition, the FCA has authority to investigate selling practices and anti-competitive practices and the PRA has authority to require information and action necessary, in their opinion, relevant to the stability of the UK financial system. Together, the PRA, the FCA, the FSC and the BOI have the power to take a range of investigative, disciplinary or enforcement actions; including private and public censure, restitution, fines or sanctions and to award compensation. The regulators may make enquiries of the companies which

they regulate regarding compliance with regulations governing the operation of business and, as with all regulated financial institutions, the Group is at risk that any of the FCA, the PRA or the FSC may identify the Group as having failed to comply with any applicable regulation. For further details as to the Group's regulatory framework, please see the section entitled "*Regulation of the Issuer – Introduction*".

In recent years, the financial services industry and financial products have increasingly been the subject of investigation and regulatory activity by various governmental, supervisory and enforcement authorities. The areas of the Group's business described below are of particular risk to action from the listed regulators.

#### *Regulatory actions*

Regulatory issues and disputes may arise from time to time from the way in which the insurance industry has sold or administered an insurance policy or the way in which they have treated policyholders or customers, either individually or collectively.

In the UK, such disputes are typically resolved by the Financial Ombudsman Service or, failing this, through litigation. However, the FCA may intervene directly where larger groups or matters of public policy are involved. There have been several industry-wide issues in recent years where the FCA has intervened directly, such as the widespread mis-selling of payment protection insurance. The FCA has also carried out industry wide thematic reviews of specific products or processes with which it has concerns.

The Competition and Markets Authority ("**CMA**") (formerly the Competition Commission ("**CC**")) may also conduct investigations into the competition in certain insurance products and impose sanctions on firms. For further details on this, please see "*CMA - UK car insurance business and price comparison business*" below.

Future changes required, or regulatory actions / interventions, by the OFT, the CMA or the FCA as a result of such investigations may have adverse consequences for the Group's car insurance and price comparison business in particular through a potential increase to compliance costs associated with any new regulations or requirements to make redress payments or pay fines following any sanctions on the Group. Depending on the regulatory environment and treatment of comparable insurance firms, the Group may decide to put aside provisions for potential regulatory actions or interventions for future actions in this area.

The Group is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business. These actions could involve a review of business sold in the past under what were perceived to be acceptable market practices at the time, changes to the tax regime affecting products and regulatory reviews on products sold and industry practices.

#### *Prudential requirements*

The financial crisis has exposed a number of weaknesses in the current regulatory framework. Whilst these weaknesses were predominantly identified in the banking sector, the insurance industry underwent a series of changes aimed at financial services firms in the UK. It is also possible that the Group could be impacted by further initiatives on a global, European and national scale in the insurance sector.

The Group is currently required to operate in accordance with the PRA's rules which govern the prudential regulation and are primarily located in GENPRU and INSPRU in the UK and the FSC rules governing Admiral Insurance (Gibraltar) Limited ("**AIGL**"). These provisions are described in detail in the "*Prudential requirements*" section in the "*Regulation of the Issuer*".

Under the Insurance Groups Directive (the "**IGD**"), insurance groups are required to submit details relating not only to their own solvency position but also to the overall solvency position of their insurance parent undertaking. As such, the Group may be required to maintain a higher amount of capital, on a consolidated basis, than otherwise necessary in respect of some of its individual businesses. For further information, please see "*The Insurance Groups Directive*" section in the "*Regulation of the Issuer*".

Further PRA requirements for the Group to increase the amount or quality of its capital may arise from implementing policies of the Financial Policy Committee of the Bank of England; a body created pursuant to the Financial Services Act 2012 to monitor risks in the financial system and take action to

remove or reduce systematic risks. Such policies could result in significant increases in the capital requirements of insurers. The failure of the Group to meet these capital requirements may have an adverse impact on the operations of the Group.

In addition, for a variety of reasons (including an increase in the risk profile of peer companies of the Group and the industry as a whole, or adverse changes in the specific current or potential future risk profile of the Group's individual businesses), the Directors of the Issuer could decide to hold higher surplus above minimum regulatory capital requirements or the supervisory authorities could decide to increase the regulatory capital requirements of the Group or any of its regulated subsidiaries (e.g. through Individual Capital Guidance from the PRA to the Group). In such circumstances, the Group may have to raise additional capital to meet regulatory capital requirements. Any increase in its capital requirements, and the failure of the Group to meet such capital requirements, may have an adverse impact on the operations and business of the Group.

#### *Impact of the Solvency II Directive (2009/138/EC) ("Solvency II")*

The implementation of Solvency II in the UK as currently proposed, and discussed in the section entitled "Solvency II" in the "Regulation of the Issuer", will significantly change the capital requirements for European-based insurance companies by requiring the utilisation of a more stringent risk-based approach.

Insurance entities will be permitted to use their own internal capital models in order to calculate capital requirements (subject to these models being approved by the PRA and/or the FSC). There will be a pre-approval process for such internal capital models which will commence from 2015 onwards. The Group intends to utilise its own internal model from approximately 2017 and until then will conform to the standardised capital model under Solvency II.

Full implementation of Solvency II has been delayed until 1 January 2016. A failure by the Group to implement the measures required by Solvency II in a timely manner could also lead to regulatory action and have a material adverse effect on the Group's reputation, the confidence of its customers and therefore its profitability. Given the broad application of Solvency II across the EU, there is the further risk that the directive will be applied inconsistently by different EU member state regulators which could place the Group at a competitive disadvantage in the event that the rules are implemented less onerously in European countries in which the Group does not operate.

There is the further risk that under Solvency II, once finalised and implemented, the Subordinated Notes will cease to be capable of counting as Tier 2 capital to cover capital requirements. In these circumstances, the Group may be able to exercise its contractual right to redeem the Subordinated Notes at par value and there is a risk that refinancing the existing debt or issuing further regulatory capital could prove expensive, difficult or impossible on comparable terms, the results of which could have a material adverse effect on the Group, including its business and financial condition. Further information on this risk is provided in "Risks Relating to the Subordinated Notes" set out below.

Solvency II includes provision for assessments of solvency regimes and systems of group supervision of non-EU countries (termed "**third countries**") in order to determine whether these third countries can be treated as "equivalent" to Solvency II. If deemed equivalent, EU supervisors must take the assessment into account in their regulatory approaches. Though it appears likely that the US will be treated as provisionally equivalent, there is no certainty that this will be the case. Given that the Group has US car insurance and price comparison operations, if the US is not treated as equivalent for the purposes of Solvency II this could, among other things, result in higher capital requirements for the Group which could have adverse effects on the Group's operations and profitability.

In relation to Gibraltar, the FSC has indicated that Solvency II legislation will be implemented in Gibraltar in line with the rest of Europe on 1 January 2016. In general, Gibraltar is less advanced in the implementation of Solvency II than the UK as its current regulatory regime has fewer similarities with Solvency II. There is a risk that the implementation of the legislation may diverge from elsewhere in Europe due to the specific approach taken by the FSC (despite efforts by The European Insurance and Occupational Pensions Authority ("**EIOPA**") to harmonise the process across member states). This may materially affect the Group if, for example, the internal model approval process is different and model approval, when requested in approximately 2017, is not granted in Gibraltar despite approval being given in the UK. There is also the potential risk of additional implementation costs depending on the FSC's approach.

### *CMA - UK car insurance business and price comparison business*

In September 2012, the Office of Fair Trading reported concerns over competition in the car insurance market being distorted and requested that the CC conduct a related review. Following this, the CC published a provisional findings report as to its investigation into the UK's private car insurance market in December 2013 (the "**PF Report**"). The CC noted in the PF Report that there appears to be an adverse effect on competition in the UK car insurance market through: (i) consumers being forced to assume unnecessary costs incurred during the claims process following an accident; (ii) cars not being repaired to the standard to which consumers are entitled; and (iii) increased difficulty for consumers to identify the best-value offers and the potential to purchase add-on products at inflated prices. The CC noted that there was little incentive for insurers to keep costs down because of their ability to pass on the additional costs to consumers through increased premiums.

In respect of the price comparison market, the CC identified in the PF Report that some contracts between insurers and price comparison websites contained conditions limiting price competition, reduced innovation and restricted entry. In addition, the CC noted that price comparison websites have a degree of market power by virtue of the number of consumers who do not shop around between the websites, with the subsequent effect being that consumers pay higher car insurance premiums.

The Group issued a response to the PF Report, in which it highlighted that the most significant issue that it had identified within the PF Report was the inflation of costs in the provision of replacement cars (relating to approximately 2% higher car insurance premiums than is necessary). In respect of other points raised in the PF Report, the Group urged the CC to consider the materiality of some of their other flagged points, where the impact on consumers is relatively small and where the complexity of interventions could mean that the costs outweigh the benefits.

The CMA is the government body which now holds the responsibilities of the CC (following its closure on 1 April 2014). On 12 June 2014, the CMA published the changes it proposes to make in the private car insurance market to increase competition and reduce the cost of premiums for consumers. The measures include: (i) a cap on the charges passed to the insurer of an at-fault driver in an accident for the cost of providing a replacement vehicle to the non-fault driver, to more closely reflect the costs incurred and remove significant inefficiencies; (ii) better information for consumers about their rights following an accident; (iii) a ban on price parity agreements between price comparison websites and insurers which stop insurers from making their products available to consumers elsewhere more cheaply; (iv) better information for consumers on the costs and benefits of no-claims bonus protection; and (v) a recommendation that the FCA reviews how insurers inform consumers about other private car insurance-related add-on products. The CMA will now consult on these measures before publishing the final decision of its independent group of members in September 2014. Following the CMA's final publication, the Group, and other insurers, could be forced to adopt different practices and follow new procedures to alter current market practice in respect of their UK car insurance and price comparison businesses, which could prove a disruptive and costly exercise and may, if implemented in its draft form, have an adverse effect on the Group's business.

Alongside the CMA, the FCA has been tasked with promoting effective competition in the interests of consumers. The FCA will have a statutory basis for the conduct of market studies and rights to refer markets to the CMA under the Enterprise Act 2002, when the concurrent powers come into effect, which is anticipated to be in April 2015.

### *FCA - price comparison business*

The FCA launched a thematic review in November 2013 into insurance price comparison websites as to whether the way in which information is presented offers consumers the fairest deal. The FCA proposed that 14 price comparison websites would be subject to their review (comprising approximately 90% of the market) as well as several insurance providers. Given their market standing, Confused.com was one of the price comparison website entities reviewed as part of this process.

The main concern of the FCA was the emphasis by the price comparison websites as to the cheapest deal, without necessarily providing consumers with all the information to determine whether that was the best deal for them in the circumstances. Similarly, the Association of British Insurers (the "**ABI**") noted (in a response to the FCA's 2013 review) that whilst price comparison websites can be an aid to consumers, the focus on price as a determining factor between companies does limit the attention paid by consumers to

the terms and conditions of the product. The concentration on price has resulted in the exclusion of product features and benefits that some customers value and require to be informed of in making a thorough assessment.

The FCA published its results from the November 2013 thematic review on 16 July 2014. The main findings of the FCA which are relevant to the Group were that price comparison websites: (i) had not always taken reasonable steps to ensure consumers had the appropriate information to allow them to make informed choices as to core policies and add-on products; and (ii) had not sufficiently clarified their role in terms of products and services offered and that business models were not necessarily aligned with the best interests of consumers.

Following this publication, price comparison websites and providers are expected to consider the FCA's findings and take any appropriate action. The FCA intends to follow-up with the price comparison websites in the thematic review by January 2015 in order to ensure that any identified issues have been addressed appropriately.

Any changes in insurance and price comparison regulation may adversely affect the Group's underlying profitability, product range, distribution channels, capital requirements and consequently, its results and financing requirements. The Group may also face increased compliance costs relating to any changes to the legislation or regulation of its insurance or price comparison businesses. Such changes could have a material adverse effect on the Group's business, operations and financial position.

#### *Motor Legal Expenses Insurance ("MLEI")*

MLEI packages together services to enable consumers to pursue their legal rights following a motor accident for which they were not at fault; the product enables individuals to recover their uninsured losses from the at-fault driver. In certain cases, cover is provided for legal representation for a driver being prosecuted for a motoring-related criminal offence. The Group's UK car insurance policies include MLEI as an integral feature and MLEI is currently underwritten by a third party.

The FCA conducted a thematic review on MLEI, the report of which was published in June 2013. The FCA's thematic review assessed MLEI from numerous perspectives, including its value and usefulness, customer understanding and the sales process. The FCA's June 2013 report identified three areas in which firms should particularly review and re-evaluate their approach to MLEI to ensure they are meeting their customers' needs; (i) the basis on which MLEI is provided, (ii) the quality of explanation of MLEI at all stages of the customer journey, including the claims process, with an emphasis on providing clear, appropriate information and (iii) the extent of cover provided. The FCA intends to review MLEI again in 2014 in order to assess how firms have reviewed and adjusted their provision of MLEI products.

Any subsequent regulatory reviews into MLEI could bring about changes to MLEI regulation which might entail additional compliance costs to the Group and expenses associated with an adjustment to the way in which MLEI products are currently offered by the Group. Such changes could have an adverse effect on the Group's business, operations and financial performance.

#### *General insurance add-on products ("GI add-on products")*

A wide range of general insurance products are sold alongside or at the same time as primary insurance products. In July 2013, the FCA confirmed that they would conduct a market study into GI add-on products following their concern that consumers experience poor outcomes when purchasing GI add-on products. The FCA's objectives in this market study were to assess whether competition in the markets for GI add-on products was effective, to identify the reasons for any ineffective levels of competition and to understand the impact of competition levels on consumers.

The FCA's report was published in March 2014, and detailed their provisional findings and proposed remedies in relation to GI add-on products. In the report, the FCA proposed that they intervene in order to improve competition for consumers in the markets for GI add-on products. The FCA's March 2014 report also identified four proposed remedies in order to strengthen competition in the markets for add-ons by improving the way decisions are presented to consumers, the way add-ons are sold, and by putting pressure on firms to improve product value across both add-on and stand-alone products. The four areas in which the FCA proposed remedies are as follows: (i) Guaranteed Asset Protection insurance (in particular, imposing a deferred opt-in function on any add-on sales of this product), (ii) banning pre-

ticked boxes (or opt-outs) for the sale of add-on products, (iii) requiring firms to publish claims ratios and (iv) improving the way in which add-on products are sold through price comparison websites (in particular, what information consumers can access about add-ons and when such information is available in the sales process).

The FCA is aiming to publish their consultation on remedies before the end of 2014. Following the FCA's final publication, if the Group is required to alter any current business practices, this could increase compliance costs for the Group which may include additional management time in order to implement changes necessary to comply with any revised regulation of GI add-on products. In addition, any determination that the Group does not comply with the applicable regulation could result in the FCA imposing sanctions on the Group which has the potential to create negative publicity for the Group as a whole which, in turn, could have an adverse effect on the Group's business, operations and financial performance.

#### *Insurance Intermediation*

In July 2012, the European Commission (the "EC") published a proposal for the revision of the Insurance Mediation Directive (2002/92/EC) which established an EU-wide supervisory regime for insurance distributors involved in the promotion, sale and administration of certain insurance products which would be implemented by additional rules in the UK ("IMD2").

As outlined in the "IMD2" section of the "Regulation of the Issuer", the EC also introduced legislative proposals for retail investment products. As a directive, IMD2 will require Member States to transpose it into national law within two years after its final adoption. Whilst there remains uncertainty over the exact timing, it is currently anticipated that the directive will be adopted in 2015 and implemented into national law in 2017. The effects of IMD2 could involve an increase in the regulatory compliance costs of the Group, adverse effects to the distribution of insurance products by the Group and adverse impacts on the operations of the Group as a result.

#### *The Financial Services Compensation Scheme ("FSCS")*

Insurers and other regulated firms in the UK are subject to the FSCS, discussed under a section of the same name in the "Regulation of the Issuer". While it is anticipated that the substantial majority of compensation paid by the FSCS will be paid wholly from recoveries from the relevant institutions concerned, there is the risk of a shortfall, such that the FSCS may place additional levies on FSCS participants. Consequently, in the event that the FSCS raises funds, raises those funds more frequently or significantly increases the levies to be paid by firms, the associated costs to companies operating in the financial services industry (as the Group) may be material.

#### ***Adverse changes in relevant laws, regulations, policies and their interpretations may have an adverse effect on the Group's business.***

The risk of further changes to and interpretations of UK, European and international laws and regulations may increase following the widespread emphasis on more risk-based systems in financial regulation.

In the UK, implementation of the Financial Services Act 2012 brought about dramatic changes in regulatory focus, whereby the Group could be deemed to be acting incompatibly with the regulations governing its business. An example of UK regulatory requirements being subject to change is the interpretation of the current FCA principle of "treating customers fairly" which has evolved in recent years to increase requirements upon all regulated firms. In respect of general insurance, the FCA's particular "treating customers fairly" focus is on product design, clarity of disclosure, claims handling and systems and controls. The FCA notes that in particularly competitive areas of insurance, such as car and household insurance, given the focus on price, insurers must be especially vigilant to ensure that consumers are aware of the extent of policy coverage and ensure that areas such as claims-handling procedures are highlighted prior to any purchase of insurance. Any further developments to the "treating customers fairly" principles may result in increased cases of non-compliance and subsequent regulatory compliance risk for the Group.

The Group will not be able to predict accurately the impact of future legislation or regulation or changes in the interpretation or operation of existing legislation or regulation on the Group's business, results of operations and/or financial condition.

A determination that the Group has failed to comply with applicable regulation could have a negative impact on the Group's reported results or on relations with current and potential customers. Regulatory action against a member of the Group could result in adverse publicity for the Group and/or could have a material adverse effect on the Group's business results (for example, through reduced sales) and consume a considerable amount of the management's time from the day-to-day management of the business. Regulatory action could also result in large fines which could directly reduce the profits of the Group.

As previously mentioned, the Group may also face increased compliance costs from any additional compliance controls needed because of changes to financial services legislation or regulation both highlighted above and in the future regulation. The Group faces significant compliance challenges because the regulatory environment is evolving rapidly and supervisory authorities are assuming an increasingly active and interventionist role in interpreting and enforcing regulations.

***The Group could be involved in various legal proceedings, any one of which could have a material adverse effect on the Group's financial condition.***

The Group faces a risk of legal actions and disputes in the ordinary course of its business. Legal actions, disputes and investigations and sanctions may relate to aspects of the Group's businesses specifically or that are common to companies that operate in the Group's markets more generally. Legal actions and disputes may arise under contracts, regulations (including tax) or from a course of conduct taken by the Group. Given the large or indeterminate amount of damages sometimes sought, and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could, from time to time, have an adverse effect on the Group's results of operations or cash flows.

***Changes to IFRS generally, or specifically in relation to insurance entities, could have a negative effect on the Group's financial results.***

The Group's financial statements conform to IFRS and interpretations issued by the IFRS Interpretations Committee as published by the IASB and adopted by the European Union. The Issuer's financial statements are currently prepared in line with UK GAAP but are expected to be prepared in line with IFRS from, or prior to, the financial year ended 31 December 2015 onwards.

Changes to IFRS for insurance companies have been proposed in recent years and further changes may be proposed in the future. The IASB published proposals in its IFRS 4 Insurance Contracts Phase II for Insurers discussion paper which would introduce significant changes to the statutory reporting of insurance entities that prepare accounts in line with IFRS. It is not certain whether and how the proposals in the discussion paper will affect the Group should they become definitive international financial reporting standards. Current proposals under Phase II may have an adverse effect on the manner in which the Group reports provisions and therefore identifies and reports revenues and costs. These and other potential changes to IFRS, whether or not specifically targeted at insurance companies, could adversely affect the Group's operations and financial position.

***Changes in taxation law may negatively impact the Group's financial results.***

Changes in corporate and other tax rules could have both a prospective and retrospective impact on the Group's business, results of operations or financial position. In general, changes to, or in the interpretation of, existing tax laws, or amendments to existing tax rates (corporate or personal), or the introduction of new tax legislation may adversely affect the business, results of operations and financial position of the Group, either directly or as a result of changes in the insurance purchasing decisions of customers.

Modifications to legislation that specifically govern the taxation of insurance companies have the potential to adversely affect the Group's business. While changes in taxation laws would affect the insurance sector as a whole, changes may be more detrimental to particular operators in the industry. However, the relative impact on the Group will depend on the areas impacted by the changes, the mix of business within the Group's portfolio and other relevant circumstances at the time of the change.

#### **4. Risks relating to the Subordinated Notes**

Defined terms used in the following risk factors, unless otherwise stated, have the meaning given to them in the Conditions set out below in the section entitled "*Terms and Conditions of the Subordinated Notes*".

***The Subordinated Notes have features which entail particular risks for potential investors.***

*Redemption prior to the Maturity Date*

The scheduled Maturity Date of the Subordinated Notes is 25 July 2024 and, although the Issuer may redeem or purchase the Subordinated Notes in certain special circumstances described herein prior to that date, it is under no obligation to do so. In addition, the Noteholders have no right to call for the redemption of the Subordinated Notes. Therefore, prospective investors should be aware that they may be required to bear the financial risks associated with an investment in long term securities.

The Subordinated Notes may, subject as provided in Condition 6 (*Redemption, Substitution, Variation and Purchase*), at the option of the Issuer, be redeemed before the Maturity Date at their principal amount, together with any Arrears of Interest and any other accrued but unpaid interest to (but excluding) the date of redemption, (i) in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation thereof, or (ii) following the occurrence of (or if the Issuer is satisfied that there will occur within six months) a Capital Disqualification Event (**provided that**, in the case of any redemption prior to the fifth anniversary of the Issue Date, the approval of the PRA is required and such redemption must be funded out of the proceeds of a new issue of regulatory capital of the same or higher quality (unless Solvency II is implemented without such requirements)).

In relation to a Capital Disqualification Event, it should be noted that Solvency II (outlined in the "*Regulation of the Issuer*") will, among other things, stipulate the characteristics of regulatory capital and set out the features which any such capital (including the Subordinated Notes) must have in order to qualify as regulatory capital. These features may be different and/or more onerous than those currently applicable to insurance companies in the UK and the details are not expected to be known until the Level 2 implementation measures relating to Solvency II are presented to and finalised by the European Parliament and the EC, and there can be no assurance that, following the initial publication of such details, the implementation measures will not be amended.

An investor may not be able to reinvest the redemption proceeds at an effective interest rate which is as high as the interest rate on the Subordinated Notes being redeemed, and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

*Subordination*

The Issuer's obligations under the Subordinated Notes will be unsecured and subordinated (i) on a winding-up of the Issuer and (ii) in the event that an administrator of the Issuer is appointed and gives notice that it intends to declare and distribute a dividend, and, in each case, will rank junior in priority to the claims of Senior Creditors.

Although the Subordinated Notes may pay a higher rate of interest than comparable notes which are not subordinated, there is a significant risk that an investor in the Subordinated Notes will lose all or some of its investment should the Issuer become insolvent.

*Interest payments under the Subordinated Notes must be deferred in certain circumstances*

The Issuer is required to defer any payment of interest on the Subordinated Notes (i) in the event that it cannot make such payment in compliance with the Solvency Condition or (ii) on each Interest Payment Date in respect of which a Regulatory Deficiency Interest Deferral Event has occurred and is continuing or would occur if payment of interest was made by the Issuer on such Interest Payment Date.

The deferral of interest as described above will not constitute a default under the Subordinated Notes for any purpose. Any interest so deferred shall, for so long as the same remains unpaid, constitute Arrears of Interest. Arrears of Interest do not themselves bear interest. Arrears of Interest may, subject to certain conditions, be paid by the Issuer at any time upon notice to Noteholders, but in any event shall be payable by the Issuer (subject to satisfaction of the Solvency Condition) on the earliest to occur of (a) the next Interest Payment Date on which payment of interest in respect of the Subordinated Notes is made, (b) a Winding-Up or (c) any redemption of the Subordinated Notes pursuant to Condition 6 (*Redemption, Substitution, Variation and Purchase*).

Any actual or anticipated deferral of interest payments will likely have an adverse effect on the market price of the Subordinated Notes. In addition, as a result of the interest deferral provision of the Subordinated Notes, the market price of the Subordinated Notes may be more volatile than the market prices of other debt securities on which interest accrues that are not subject to such deferral and may be more sensitive generally to adverse changes in the Issuer's financial condition.

*Redemption payments under the Subordinated Notes must, in certain circumstances, be deferred*

Notwithstanding the expected maturity of the Subordinated Notes on the Maturity Date, the Issuer must defer redemption of the Subordinated Notes on the Maturity Date, or on any other date set for redemption of the Subordinated Notes pursuant to Condition 6(c) (*Redemption, variation or substitution for taxation reasons*) or 6(a) (*Scheduled redemption*), in the event that (i) it cannot make the redemption payments in compliance with the Solvency Condition or (ii) if Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or would occur if the Subordinated Notes were redeemed by the Issuer on such date.

Any such deferral of redemption of the Subordinated Notes will not constitute a default under the Subordinated Notes. Where redemption of the Subordinated Notes is deferred, subject to certain conditions, the Subordinated Notes will be redeemed by the Issuer on the earliest of (a) the date falling 10 Business Days following cessation of the Regulatory Deficiency Redemption Deferral Date, (b) the date falling 10 Business Days after the PRA has agreed to the repayment or redemption of the Subordinated Notes or (c) the date on which a Winding-Up occurs.

Any actual or anticipated deferral of redemption of the Subordinated Notes will likely have an adverse effect on the market price of the Subordinated Notes. In addition, as a result of the redemption deferral provision of the Subordinated Notes, including with respect to deferring redemption on the scheduled Maturity Date, the market price of the Subordinated Notes may be more volatile than the market prices of other debt securities without such deferral feature, including dated securities where redemption on the scheduled maturity date cannot be deferred, and the Subordinated Notes may accordingly be more sensitive generally to adverse changes in the Issuer's financial condition.

*Modifications and waivers*

The Conditions and the Trust Deed contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders, including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The Conditions and the Trust Deed also provide that, subject to the prior consent of the PRA being obtained (so long as such consent is required), the Trustee may, without the consent of Noteholders, agree to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the Conditions or any of the provisions of the Trust Deed in the circumstances described in Condition 13 (*Meetings of Noteholders; Modification and Waiver*).

*Substitution of Issuer*

The Conditions provide that the Trustee may, without the consent of the Noteholders, agree to the substitution of a Related Undertaking of the Issuer. Such substitution will be subject to prior approval of the PRA.

*No limitation on issuing senior or pari passu securities*

There is no restriction on the amount of securities which the Issuer may issue and which rank senior to, or *pari passu* with, the Subordinated Notes. The issue of any such securities may reduce the amount recoverable by Noteholders on a Winding-Up. In particular, the Subordinated Notes shall rank junior to the claims of Senior Creditors. Accordingly, in such a winding-up and after payment of the claims of Senior Creditors there may not be a sufficient amount to satisfy the amounts owing to the Noteholders.

*Restricted remedy for non-payment when due*

In accordance with the PRA's current requirements for tier 2 capital, the sole remedy against the Issuer available to the Trustee or (where the Trustee has failed to proceed against the Issuer as provided in the Conditions) any Noteholder for recovery of amounts which have become due in respect of the

Subordinated Notes will be the institution of proceedings for the winding-up of the Issuer and/or proving in such winding-up or administration and/or claiming in the liquidation of the Issuer.

#### *Variation or Substitution of the Subordinated Notes without Noteholder consent*

Subject as provided in Condition 6 (*Redemption, Substitution, Variation and Purchase*), the Issuer may, at its option and without the consent or approval of the Noteholders, elect to substitute the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain, Qualifying Dated Tier 2 Securities (as the case may be) at any time in the event of certain changes in the tax treatment of the Subordinated Notes or payments thereunder due to a change in applicable law or regulation or the official interpretation thereof, or following the occurrence of a Capital Disqualification Event.

#### *Change of law*

The Conditions are based on English law in effect as at the date of issue of the Subordinated Notes. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of issue of the Subordinated Notes.

#### *Integral multiples of £100,000*

The Subordinated Notes are issued in the denomination of £100,000 and higher integral multiples of £1,000 thereafter and so it is possible that the Subordinated Notes may be traded in amounts in excess of £100,000 that are not integral multiples of £100,000 (or its equivalent). In such a case a Noteholder who, as a result of trading such amounts, holds a principal amount of less than £100,000 will not receive a definitive Note in respect of such holding (should definitive Subordinated Notes be printed) and would need to purchase a principal amount of Subordinated Notes such that it holds an amount equal to or greater than £100,000.

#### *EU Savings Directive*

Under EC Council Directive 2003/48/EC on the taxation of savings income, each EU Member State is required to provide to the tax authorities of another EU Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for the benefit of, an individual resident or certain limited types of entity established in that other EU Member State; however, for a transitional period, Austria and Luxembourg will instead apply a withholding system in relation to such payments, deducting tax at a rate of 35%. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

Luxembourg has announced that it will no longer apply the withholding tax system as from 1 January 2015 and will provide details of payments of interest (or similar income) as from this date.

The Council of the European Union formally adopted a Council Directive amending the Directive on 24 March 2014 (the "**Amending Directive**"). The Amending Directive broadens the scope of the requirements described in the first paragraph above. Member States have until 1 January 2016 to adopt the national legislation necessary to comply with the Amending Directive and are required to apply these new requirements from 1 January 2017. The changes made under the Amending Directive include extending the scope of the Directive to payments made to, or collected for, certain other entities and legal arrangements. They also broaden the definition of "interest payment" to cover additional types of income payable on securities.

If a payment were to be made or collected through an EU Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment pursuant to the Savings Directive or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to such Directive, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. Furthermore, once the Amending Directive is implemented and takes effect in EU Member States, such withholding may occur in a wider range of circumstances than at present, as explained above.

The Issuer is required to maintain a Paying Agent with a specified office in an EU Member State that is not obliged to withhold or deduct tax pursuant to any law implementing the Savings Directive or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000, which may mitigate an element of this risk if the Noteholder is able to arrange for payment through such a Paying Agent. However, investors should choose their custodians and intermediaries with care, and provide each custodian and intermediary with any information that may be necessary to enable such persons to make payments free from withholding and in compliance with the Savings Directive, as amended.

Investors who are in any doubt as to their position should consult their professional advisers.

***Risks relating to the US Foreign Account Tax Compliance Withholding ("FATCA")***

Whilst the Subordinated Notes are in global form and held within Euroclear and Clearstream, Luxembourg (together, the "ICSDs"), in all but the most remote circumstances, it is not expected that FATCA will affect the amount of any payment received by the ICSDs (see "*Taxation – FATCA*" below). However, FATCA may affect payments made to custodians or intermediaries in the subsequent payment chain leading to the ultimate investor if any such custodian or intermediary generally is unable to receive payments free of FATCA withholding. It also may affect payment to any ultimate investor that is a financial institution that is not entitled to receive payments free of withholding under FATCA, or an ultimate investor that fails to provide its broker (or other custodian or intermediary from which it receives payment) with any information, forms, other documentation or consents that may be necessary for the payments to be made free of FATCA withholding. Investors should choose the custodians or intermediaries with care (to ensure each is compliant with FATCA or other laws or agreements related to FATCA), provide each custodian or intermediary with any information, forms, other documentation or consents that may be necessary for such custodian or intermediary to make a payment free of FATCA withholding. Investors should consult their own tax adviser to obtain a more detailed explanation of FATCA and how FATCA may affect them. The Issuer's obligations under the Subordinated Notes are discharged once it has paid the common depositary or common safekeeper for the ICSDs (as registered holder of the Subordinated Notes) and the Issuer has therefore no responsibility for any amount thereafter transmitted through hands of the ICSDs and custodians or intermediaries.

If an amount in respect of US withholding tax were to be deducted or withheld from interest, principal or other payments on the Subordinated Notes as a result of FATCA, none of the Issuer, any paying agent or any other person would, pursuant to the Conditions be required to pay additional amounts as a result of the deduction or withholding. As a result, investors may receive less interest or principal than expected.

FATCA IS PARTICULARLY COMPLEX AND ITS APPLICATION TO THE ISSUER, THE SUBORDINATED NOTES AND THE NOTEHOLDERS IS UNCERTAIN AT THIS TIME. EACH NOTEHOLDER SHOULD CONSULT ITS OWN TAX ADVISER TO OBTAIN A MORE DETAILED EXPLANATION OF FATCA AND TO LEARN HOW THIS LEGISLATION MIGHT AFFECT EACH NOTEHOLDER IN ITS PARTICULAR CIRCUMSTANCE.

**5. Risks relating to the market generally**

Set out below is a brief description of certain market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk.

***The secondary market generally***

Although application has been made to admit the Subordinated Notes to trading on the Market, the Subordinated Notes have no established trading market and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Subordinated Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a severely adverse effect on the market value of the Subordinated Notes.

***Fixed rate notes are exposed to specific market risks.***

The Subordinated Notes will bear a fixed interest rate of 5.500 per cent. per annum. A holder of a security with a fixed interest rate is exposed to the risk that the price of such security falls as a result of changes in the current interest rate on the capital market (the "**Market Interest Rate**"). While the

nominal rate of a security with a fixed interest rate is fixed for a specified period, the Market Interest Rate typically changes on a daily basis. As the Market Interest Rate changes, the price of such security is likely to change in the opposite direction. If the Market Interest Rate increases, the price of such security typically falls, until the yield of such security is approximately equal to the Market Interest Rate. If the Market Interest Rate falls, the price of a security with a fixed compensation rate typically increases, until the yield of such security is approximately equal to the Market Interest Rate. Investors should be aware that movements of the Market Interest Rate can adversely affect the price of the Subordinated Notes and can lead to losses for the Noteholders if they sell the Subordinated Notes.

***Inflation risk***

The value of future payments of interest and principal may be reduced as a result of inflation as the real rate of interest on an investment in the Subordinated Notes will be reduced at rising inflation rates and may be negative if the inflation rate rises above the nominal rate of interest on the Subordinated Notes.

***Credit ratings may not reflect all risks.***

Fitch has assigned a credit rating of BBB- to the Subordinated Notes. This rating may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Subordinated Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. Credit rating methodologies for rating subordinated debt in particular may change in the future, any such change in methodology may lead to a reduction in the rating assigned to the Subordinated Notes or an increase in the rating assigned to unsubordinated debt instruments by comparison.

***Legal investment considerations may restrict certain investments.***

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (i) the Subordinated Notes are legal investments for it, (ii) the Subordinated Notes can be used as collateral for various types of borrowing and (iii) other restrictions apply to its purchase or pledge of the Subordinated Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Subordinated Notes under any applicable risk-based capital or similar rules.

***Risk that investors will have to rely on the procedures of Euroclear and Clearstream, Luxembourg for transfer, payment and communication with the Issuer***

The Subordinated Notes will be represented by a Global Note Certificate (as defined in the Trust Deed). The Global Note Certificate will be deposited with a common depositary for, and registered in the name of the common nominee of, Euroclear and Clearstream, Luxembourg. Except in certain limited circumstances described in the Global Note Certificate, investors will not be entitled to receive definitive registered notes. Euroclear and Clearstream, Luxembourg will maintain records of the beneficial interests in the Global Note Certificate.

While the Subordinated Notes are represented by the Global Note Certificate, investors will be able to trade their beneficial interests only through Euroclear and Clearstream, Luxembourg. The Issuer will discharge its payment obligations under the Subordinated Notes by making payments to the common depositary for Euroclear and Clearstream, Luxembourg for distribution to their account holders. A holder of a beneficial interest in a Global Note Certificate must rely on the procedures of Euroclear and Clearstream, Luxembourg to receive payments under the Subordinated Notes. The Issuer has no responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in the Global Note Certificate.

## TERMS AND CONDITIONS OF THE SUBORDINATED NOTES

*The following is the text of the terms and conditions of the Subordinated Notes which (subject to modification and except for the paragraphs in italics) will be endorsed on the Certificates issued in respect of the Subordinated Notes:*

The £200,000,000 5.500 per cent. Subordinated Notes due 2024 (the "**Subordinated Notes**") of Admiral Group plc (the "**Issuer**") are constituted by, are subject to, and have the benefit of, a trust deed dated 25 July 2014 (as amended or supplemented from time to time, the "**Trust Deed**") between the Issuer and Deutsche Trustee Company Limited as trustee (the "**Trustee**", which expression includes all persons for the time being trustee or trustees appointed under the Trust Deed) and are the subject of an agency agreement dated 25 July 2014 (as amended or supplemented from time to time, the "**Agency Agreement**") between the Issuer, Deutsche Bank Luxembourg S.A. as registrar (the "**Registrar**", which expression includes any successor registrar appointed from time to time in connection with the Subordinated Notes), Deutsche Bank AG, London branch as principal paying agent (the "**Principal Paying Agent**", which expression includes any successor principal paying agent appointed from time to time in connection with the Subordinated Notes), the transfer agents named therein (the "**Transfer Agents**", which expression includes any successor or additional transfer agents appointed from time to time in connection with the Subordinated Notes), the paying agents, if any, named therein (together with the Principal Paying Agent, the "**Paying Agents**", which expression includes any successor or additional paying agents appointed from time to time in connection with the Subordinated Notes) and the Trustee. References herein to the "**Agents**" are to the Registrar, the Principal Paying Agent and the Transfer Agents and any reference to an "**Agent**" is to any one of them. Certain provisions of these Conditions are summaries of the Trust Deed and the Agency Agreement and subject to their detailed provisions. The Noteholders (as defined below) are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and those applicable to them in the Agency Agreement. Copies of the Trust Deed and the Agency Agreement are available for inspection and collection by Noteholders during normal business hours at the registered office for the time being of the Trustee, being at the date hereof Winchester House, 1 Great Winchester Street, London EC2N 2DB and at the Specified Offices (as defined in the Agency Agreement) of each of the Agents, the initial Specified Offices of which are set out below.

### 1. **Form and Denomination**

The Subordinated Notes are in registered form in the denominations of £100,000 and integral multiples of £1,000 in excess thereof (each, an "**Authorised Denomination**").

### 2. **Status of the Subordinated Notes**

(a) **Status:** The Subordinated Notes constitute direct, unconditional, unsecured and subordinated obligations of the Issuer which will at all times rank *pari passu* without preference among themselves. The rights and claims of the Noteholders are subordinated as described in the Trust Deed and Condition 2(b) (*Subordination*).

(b) **Subordination:** If:

- (i) at any time an order is made, or an effective resolution is passed, for the winding-up in England and Wales of the Issuer (except, in any such case, a solvent winding-up solely for the purpose of a reconstruction or amalgamation or the substitution in place of the Issuer of a successor in business of the Issuer, the terms of which reconstruction, amalgamation or substitution (A) have previously been approved in writing by the Trustee or by an Extraordinary Resolution and (B) do not provide that the Subordinated Notes or any amount in respect thereof shall thereby become payable); or
- (ii) an administrator of the Issuer is appointed and such administrator gives notice that it intends to declare and distribute a dividend,

(the events in (i) and (ii) each being a "**Winding-Up**"), the rights and claims of the Trustee (on behalf of the Noteholders but not the rights and claims of the Trustee in its personal capacity under the Trust Deed) and the Noteholders against the Issuer in respect of or arising under the Subordinated Notes and the Trust Deed (including any damages

awarded for breach of any obligations thereunder) will be subordinated in the manner provided in the Trust Deed to the claims of all Senior Creditors but shall rank: (A) at least *pari passu* with all claims of holders of all other subordinated obligations of the Issuer which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute, Lower Tier 2 Capital (issued prior to Solvency II Implementation) or Tier 2 Capital (issued on or after Solvency II Implementation) and all obligations which rank, or are expressed to rank, *pari passu* therewith ("**Parity Securities**"); and (B) in priority to the claims of holders of (i) any subordinated obligations of the Issuer expressed to rank junior to the Subordinated Notes, (ii) all obligations of the Issuer which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute, Upper Tier 2 Capital (issued prior to Solvency II Implementation) or Tier 1 Capital (including, without limitation, by virtue of the operation of any applicable grandfathering provisions under the Relevant Rules) and all obligations which rank, or are expressed to rank, *pari passu* therewith, and (iii) all classes of share capital of the Issuer (the "**Junior Securities**").

Nothing in this Condition 2(b) shall affect or prejudice the payment of the costs, fees, charges, expenses, liabilities or remuneration of the Trustee under the Trust Deed or the rights and remedies of the Trustee in respect thereof.

- (c) **Solvency Condition:** Other than in the event of a Winding-Up and without prejudice to Condition 9 (*Events of default*), payments of all amounts under or arising from the Subordinated Notes and the Trust Deed (other than payments made to the Trustee in its personal capacity under the Trust Deed) will be mandatorily deferred unless the Issuer is solvent at the time for payment by the Issuer and unless and until such time as the Issuer could make such payment and still be solvent immediately thereafter (the "**Solvency Condition**").

For the purposes of this Condition 2(c), the Issuer will be solvent if (i) it is able to pay its debts owed to Senior Creditors and Parity Creditors as they fall due and (ii) its Assets exceed its Liabilities (other than Liabilities to persons who are Junior Creditors). A certificate as to the solvency of the Issuer signed by two Authorised Signatories or, if there is a winding-up or administration of the Issuer, by two authorised signatories of the liquidator or, as the case may be, the administrator of the Issuer shall be treated and accepted by the Issuer, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

- (d) **Set-off:** By acceptance of the Subordinated Notes, each Noteholder will be deemed to have waived any right of set-off or counterclaim that such Noteholder might otherwise have against the Issuer in respect of or arising under the Subordinated Notes whether prior to or in liquidation, winding-up or administration. Notwithstanding the preceding sentence, if any of the rights and claims of any Noteholder in respect of or arising under the Subordinated Notes are discharged by set-off, such Noteholder will immediately, unless prohibited by applicable law, pay an amount equal to the amount of such discharge to the Issuer or, if applicable, the liquidator, trustee, receiver or administrator of the Issuer and, until such time as payment is made, will hold a sum equal to such amount on trust for the Issuer or, if applicable, the liquidator, trustee, receiver or administrator in the Issuer's bankruptcy, winding-up or administration. Accordingly, such discharge will be deemed not to have taken place.

3. **Register, Title and Transfers**

- (a) **Register:** The Registrar will maintain a register (the "**Register**") in respect of the Subordinated Notes in accordance with the provisions of the Agency Agreement. In these Conditions, the "**Holder**" of a Subordinated Note means the person in whose name such Subordinated Note is for the time being registered in the Register (or, in the case of a joint holding, the first named thereof) and "**Noteholder**" shall be construed accordingly. A certificate (each, a "**Note Certificate**") will be issued to each Noteholder in respect of its registered holding. Each Note Certificate will be numbered serially with an identifying number which will be recorded in the Register.
- (b) **Title:** The Holder of each Subordinated Note shall (except as otherwise required by law) be treated as the absolute owner of such Subordinated Note for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing on the Note Certificate relating thereto (other than the endorsed form of transfer) or any notice of any previous loss or theft of such Note Certificate) and no person shall be liable for so treating such Holder. No person shall have any right to enforce any term or condition of the Subordinated Notes or the Trust Deed under the Contracts (Rights of Third Parties) Act 1999 (except to the extent, if any, that the Trust Deed expressly provides for such act to apply).
- (c) **Transfers:** Subject to Conditions 3(f) (*Closed periods*) and 3(g) (*Regulations concerning transfers and registration*) below, a Subordinated Note may be transferred upon surrender of the relevant Note Certificate, with the endorsed form of transfer duly completed, at the Specified Office of the Registrar or any Transfer Agent, together with such evidence as the Registrar or (as the case may be) such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the individuals who have executed the form of transfer; *provided, however, that* a Subordinated Note may not be transferred unless the principal amount of Subordinated Notes transferred and (where not all of the Subordinated Notes held by a Holder are being transferred) the principal amount of the balance of Subordinated Notes not transferred are Authorised Denominations. Where not all the Subordinated Notes represented by the surrendered Note Certificate are the subject of the transfer, a new Note Certificate in respect of the balance of the Subordinated Notes will be issued to the transferor.
- (d) **Registration and delivery of Note Certificates:** Within five business days of the surrender of a Note Certificate in accordance with Condition 3(c) (*Transfers*) above, the Registrar will register the transfer in question and deliver a new Note Certificate of a like principal amount to the Subordinated Notes transferred to each relevant Holder at its Specified Office or (as the case may be) the Specified Office of any Transfer Agent or (at the request and risk of any such relevant Holder) by uninsured first class mail (airmail if overseas) to the address specified for the purpose by such relevant Holder. In this paragraph, "**business day**" means a day on which commercial banks are open for general business (including dealings in foreign currencies) in the city where the Registrar or (as the case may be) the relevant Transfer Agent has its Specified Office.
- (e) **No charge:** The transfer of a Subordinated Note will be effected without charge by or on behalf of the Issuer, the Registrar or any Transfer Agent but against such indemnity as the Registrar or (as the case may be) such Transfer Agent may require in respect of any tax or other duty of whatsoever nature which may be levied or imposed in connection with such transfer.
- (f) **Closed periods:** Noteholders may not require transfers to be registered during the period of 15 days ending on the due date for any payment of principal or interest in respect of the Subordinated Notes or during the period following delivery of a notice of a voluntary payment of Arrears of Interest in accordance with Condition 5(d) (*Payment of Arrears of Interest*) and Condition 15 (*Notices*) and ending on the date referred to in such notice as having been fixed for such payment of Arrears of Interest.
- (g) **Regulations concerning transfers and registration:** All transfers of Subordinated Notes and entries on the Register are subject to the detailed regulations concerning the transfer

of Subordinated Notes scheduled to the Agency Agreement. The regulations may be changed by the Issuer with the prior written approval of the Trustee and the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests in writing a copy of such regulations.

#### 4. **Interest**

- (a) **Interest:** The Subordinated Notes bear interest from 25 July 2014 (the "**Issue Date**") at the rate of 5.500 per cent. per annum. Subject to Condition 5 (*Deferral of Interest*), interest shall be payable semi-annually in arrear in equal instalments of £27.50 per Calculation Amount (as defined below) in accordance with the provisions of this Condition 4 on 25 January and 25 July in each year (each, an "**Interest Payment Date**"), in accordance with Condition 7 (*Payments*).
- (b) **Interest Accrual:** Each Subordinated Note will cease to bear interest from the due date for redemption (which due date shall, in the case of deferral of a redemption date due to the Solvency Condition not being satisfied and/or in accordance with Condition 6(b) (*Deferral of redemption date*), be the latest date to which redemption of the Subordinated Notes is so deferred) unless, upon due presentation, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at such rate (both before and after judgment) until whichever is the earlier of (a) the day on which all sums due in respect of such Subordinated Note up to that day are received by or on behalf of the relevant Noteholder and (b) the day which is seven days after the Principal Paying Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Subordinated Notes up to such seventh day (except to the extent that there is any subsequent default in payment).
- (c) **Calculation of Interest:** Where it is necessary to compute an amount of interest in respect of any Subordinated Note during an Interest Period, such interest shall be calculated on the basis of the actual number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Issue Date) to (but excluding) the relevant payment date divided by the actual number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Issue Date) to (but excluding) the next (or first) scheduled Interest Payment Date.

Save as provided above in relation to equal instalments, interest shall be calculated per £1,000 in principal amount of the Subordinated Notes (the "**Calculation Amount**") by applying the rate of interest referred to in Condition 4(a) (*Interest*) to such Calculation Amount, multiplying the resulting figure by the day count fraction described in the immediately preceding paragraph and rounding the resultant figure to two decimal places (with 0.005 being rounded up).

- (d) **Principal Paying Agent:** So long as any of the Subordinated Notes remains outstanding, the Issuer will maintain a Principal Paying Agent. The Issuer may, with the prior written approval of the Trustee, from time to time replace the Principal Paying Agent with another leading financial institution in London. If the Principal Paying Agent is unable or unwilling to continue to act as the Principal Paying Agent, the Issuer shall forthwith appoint another financial institution in London approved in writing by the Trustee to act as such in its place.

#### 5. **Deferral of Interest**

- (a) **Regulatory Deficiency Deferral of Interest:** Payment of interest on the Subordinated Notes by the Issuer will be mandatorily deferred on each Regulatory Deficiency Interest Deferral Date. The Issuer shall notify the Noteholders, the Trustee and the Principal Paying Agent of any Regulatory Deficiency Interest Deferral Date in accordance with Condition 5(e) (*Notice of Deferral*) (*provided that* failure to make such notification shall not oblige the Issuer to make payment of such interest, or cause the same to become due and payable, on such date).

A certificate signed by two Authorised Signatories confirming that (i) a Regulatory Deficiency Interest Deferral Event has occurred and is continuing, or would occur if payment of interest on the Subordinated Notes were to be made or (ii) a Regulatory Deficiency Interest Deferral Event has ceased to occur and/or payment of interest on the Subordinated Notes would not result in a Regulatory Deficiency Interest Deferral Event occurring, shall be treated and accepted by the Issuer, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.

- (b) **No default:** Notwithstanding any other provision in these Conditions or in the Trust Deed the deferral by the Issuer of any payment of interest (i) on a Regulatory Deficiency Interest Deferral Date in accordance with Condition 5(a) (*Regulatory Deficiency Deferral of Interest*) or (ii) as a result of the application of the Solvency Condition in accordance with Condition 2(c) (*Solvency Condition*), will not constitute a default by the Issuer and will not give Noteholders or the Trustee any right to accelerate repayment of the Subordinated Notes or take any enforcement action under the Subordinated Notes or the Trust Deed.
- (c) **Arrears of Interest:** Any interest on the Subordinated Notes not paid on an Interest Payment Date as a result of the obligation of the Issuer to defer such payment of interest pursuant to Condition 5(a) (*Regulatory Deficiency Deferral of Interest*) or the operation of the Solvency Condition described in Condition 2(c) (*Solvency Condition*) shall (without double counting), to the extent and so long as the same remains unpaid, constitute "**Arrears of Interest**".

Arrears of Interest shall not themselves bear interest.

- (d) **Payment of Arrears of Interest:** Any Arrears of Interest may (subject to Condition 2(c) (*Solvency Condition*) and to the satisfaction of the Regulatory Clearance Condition) be paid by the Issuer in whole or in part at any time upon the expiry of not less than 14 days' notice to such effect given by the Issuer to the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 15 (*Notices*) and in any event will become due and payable by the Issuer in whole (and not in part) upon the earliest of the following dates:
- (i) the next Interest Payment Date which is not a Regulatory Deficiency Interest Deferral Date on which payment of interest in respect of the Subordinated Notes is made; or
  - (ii) the date on which a Winding-Up occurs; or
  - (iii) the date fixed for any redemption, substitution or purchase of the Subordinated Notes pursuant to Condition 6 (*Redemption, Substitution, Variation and Purchase*) (subject to any deferral of such redemption date pursuant to Condition 6(b) (*Deferral of redemption date*)) or Condition 9 (*Events of default*).
- (e) **Notice of Deferral:** The Issuer shall notify the Trustee, the Principal Paying Agent and the Noteholders in writing in accordance with Condition 15 (*Notices*) not less than 5 Business Days prior to an Interest Payment Date:
- (i) if that Interest Payment Date is a Regulatory Deficiency Interest Deferral Date, specifying that interest will not be paid because a Regulatory Deficiency Interest Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date, *provided that* if a Regulatory Deficiency Interest Deferral Event occurs less than 5 Business Days prior to an Interest Payment Date, the Issuer shall give notice of the interest deferral in accordance with Condition 15 (*Notices*) as soon as reasonably practicable following the occurrence of such event; or

- (ii) if payment of interest is to be deferred on that Interest Payment Date only as a result of the non-satisfaction of the Solvency Condition and specifying the same, *provided that* if the Issuer becomes aware of such non-satisfaction of the Solvency Condition less than five Business Days prior to an Interest Payment Date, the Issuer shall give notice of the interest deferral in accordance with Condition 15 (*Notices*) as soon as reasonably practicable following it becoming so aware.

## 6. **Redemption, Substitution, Variation and Purchase**

- (a) **Scheduled redemption:** Subject to Condition 6(b) (*Deferral of redemption date*) and 6(i) (*Preconditions to redemption, variation, substitution and purchases*), unless previously redeemed, or purchased and cancelled, the Subordinated Notes will be redeemed at their principal amount on the Maturity Date together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the Maturity Date in accordance with the terms of Condition 7 (*Payments*).
- (b) **Deferral of redemption date:**
  - (i) No Subordinated Notes shall be redeemed on the Maturity Date pursuant to Condition 6(a) (*Scheduled redemption*) or prior to the Maturity Date pursuant to Condition 6(c) (*Redemption, variation or substitution for taxation reasons*) or 6(d) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) if a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or would occur if redemption is made pursuant to this Condition 6.
  - (ii) The Issuer shall notify the Trustee, the Principal Paying Agent and the Noteholders in accordance with Condition 15 (*Notices*) no later than 5 Business Days prior to any date set for redemption of the Subordinated Notes if such redemption is to be deferred in accordance with this Condition 6(b), *provided that* if a Regulatory Deficiency Redemption Deferral Event occurs less than 5 Business Days prior to the date set for redemption, the Issuer shall give notice of such deferral in accordance with Condition 15 (*Notices*) as soon as reasonably practicable following the occurrence of such event.
  - (iii) If redemption of the Subordinated Notes does not occur on the Maturity Date or, as appropriate, the date specified in the notice of redemption by the Issuer under Condition 6(c) (*Redemption, variation or substitution for taxation reasons*) or 6(d) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) as a result of Condition 6(b)(i) (*Deferral of redemption date*) above, the Issuer shall (subject to satisfaction of the Regulatory Clearance Condition) redeem such Subordinated Notes at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest upon the earliest of:
    - (1) the date falling 10 Business Days after the date the Regulatory Deficiency Redemption Deferral Event has ceased (unless on such 10<sup>th</sup> Business Day a further Regulatory Deficiency Redemption Deferral Event has occurred and is continuing or redemption of the Subordinated Notes on such date would result in a Regulatory Deficiency Redemption Deferral Event occurring, in which case the provisions of Condition 6(b)(i) (*Deferral of redemption date*) and this Condition 6(b)(iii) will apply *mutatis mutandis* to determine the due date for redemption of the Subordinated Notes); or
    - (2) the date falling 10 Business Days after the PRA has agreed to the repayment or redemption of the Subordinated Notes; or
    - (3) the date on which a Winding-Up occurs.

- (iv) If Condition 6(b)(i) (*Deferral of redemption date*) does not apply, but the obligations of the Issuer under the Subordinated Notes to make payment of any amount in relation to the redemption of the Subordinated Notes are mandatorily deferred as a result of the Solvency Condition not being satisfied at such time, subject to satisfaction of the Regulatory Clearance Condition, such obligations shall be payable on the 10<sup>th</sup> Business Day immediately following the day that (A) the Issuer is solvent for the purposes of Condition 2(c) (*Solvency Condition*) and (B) the payment of such amounts would not result in the Issuer ceasing to be solvent for the purposes of Condition 2(c) (*Solvency Condition*), *provided that* if on such Business Day specified for redemption the Solvency Condition is not satisfied, then such obligations shall not be paid on such date and Condition 2(c) (*Solvency Condition*) shall apply *mutatis mutandis* to determine the due date for payment of such amount.
  - (v) A certificate signed by two Authorised Signatories confirming that (A) a Regulatory Deficiency Redemption Deferral Event has occurred and is continuing, or would occur if redemption of the Subordinated Notes were to be made or (B) a Regulatory Deficiency Redemption Deferral Event has ceased to occur and/or redemption of the Subordinated Notes would not result in a Regulatory Deficiency Redemption Deferral Event occurring, shall be treated and accepted by the Issuer, the Trustee, the Noteholders and all other interested parties as correct and sufficient evidence thereof, shall be binding on all such persons and the Trustee shall be entitled to rely on such certificate without liability to any person.
  - (vi) Notwithstanding any other provision in these Conditions or in the Trust Deed, the deferral of redemption of the Subordinated Notes in accordance with this Condition 6(b) will not constitute a default by the Issuer and will not give Noteholders or the Trustee any right to accelerate the Subordinated Notes or take any enforcement action under the Subordinated Notes or the Trust Deed.
- (c) ***Redemption, variation or substitution for taxation reasons:*** Subject to Conditions 6(b)(i) (*Deferral of redemption date*), 6(h) (*Trustee role on redemption, variation or substitution: Trustee not obliged to monitor*), and 6(i) (*Preconditions to redemption, variation, substitution and purchases*) if immediately before the giving of the notice referred to below:
- (i) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction, or any change in the application or official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after the Issue Date, on the next Interest Payment Date either (a) the Issuer would be required to pay additional amounts as provided or referred to in Condition 8 (*Taxation*); or (b) the payment of interest would be treated as a "distribution" for United Kingdom tax purposes or the Issuer would otherwise not be able to claim a tax deduction (for United Kingdom tax purposes) for interest payable on the Subordinated Notes; or (c) in respect of the payment of interest, the Issuer would not to any material extent be entitled to have any attributable loss or non-trading deficit set against the profits of companies with which it is grouped for applicable United Kingdom tax purposes (whether under the group relief system current as at the Issue Date or any similar system or systems having like effect as may from time to time exist); and
  - (ii) the effect of the foregoing cannot be avoided by the Issuer taking reasonable measures available to it,

the Issuer may at its option (without any requirement for the consent or approval of the Noteholders) and having given not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and, in accordance with Condition 15 (*Notices*), the Noteholders (which notice shall be irrevocable), either:

- (1) redeem all of the Subordinated Notes, but not some only, at any time at their principal amount together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the date of redemption, *provided that* no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which (a) with respect to (i)(a) the Issuer would be obliged to pay such additional amounts; (b) with respect to (i)(b) above, the payment of interest would be so treated as a "distribution" or the Issuer would otherwise not be able to claim a tax deduction as provided in paragraph (i)(b) above; or (c) with respect to (i)(c), the Issuer would not to any material extent be entitled to have the loss or non-trading deficit set against the profits as provided in (i)(c) above, in each case were a payment in respect of the Subordinated Notes then due; or
- (2) substitute at any time all (but not some only) of the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain, Qualifying Dated Tier 2 Securities, and the Trustee shall (subject to both Condition 6(h) (*Trustee role on redemption, variation or substitution: Trustee not obliged to monitor*) and the receipt by it of the certificates of the Authorised Signatories referred to in Condition 6(i) (*Preconditions to redemption, variation, substitution and purchases*) below and in the definition of Qualifying Dated Tier 2 Securities) agree to such substitution or variation.

Upon expiry of such notice the Issuer shall either redeem, vary or substitute the Subordinated Notes, as the case may be.

(d) ***Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event:***

- (i) Subject to Conditions 6(b)(i) (*Deferral of redemption date*), 6(h) (*Trustee role on redemption, variation or substitution: Trustee not obliged to monitor*) and 6(i) (*Preconditions to redemption, variation, substitution and purchases*), if a Capital Disqualification Event has occurred and is continuing, or as a result of any change in, or amendment to, or any change in the application or official interpretation of, any applicable law, regulation or other official publication, the same will occur within a period of six months, then the Issuer may, having given not less than 30 nor more than 60 days' notice to the Noteholders (in accordance with Condition 15 (*Notices*)), the Trustee and the Principal Paying Agent, which notice must be given during the Notice Period and shall be irrevocable, either:
  - (1) as soon as reasonably practicable redeem all (but not some only) of the Subordinated Notes at their principal amount, together with any Arrears of Interest and any other accrued and unpaid interest to (but excluding) the date of redemption; or
  - (2) at any time substitute all (and not some only) of the Subordinated Notes for, or vary the terms of the Subordinated Notes so that they become or remain, Qualifying Dated Tier 2 Securities and the Trustee shall (subject to both Condition 6(h) (*Trustee role on redemption, variation or substitution: Trustee not obliged to monitor*) and the receipt by it of the certificates of the Authorised Signatories referred to in Condition 6(i) (*Preconditions to redemption, variation, substitution and purchases*) below and in the definition of Qualifying Dated Tier 2 Securities) agree to such substitution or variation.

Upon expiry of such notice the Issuer shall either redeem, vary or substitute the Subordinated Notes, as the case may be.

- (ii) For the purposes of this Condition 6(d), "**Notice Period**" means the period commencing on the date on which the relevant Capital Disqualification Event first occurs (or, as applicable, the date on which the Issuer certifies to the Trustee that the same will occur within a period of six months) and ending on the thirtieth calendar day following satisfaction of the Regulatory Clearance Condition in respect of the redemption, substitution or variation which is the subject of the notice to which the Notice Period relates.
- (e) **No other redemption:** The Issuer shall not be entitled to redeem the Subordinated Notes otherwise than as provided in Conditions 6(a) (*Scheduled redemption*) to 6(d) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*).
- (f) **Purchase:** The Issuer or any of its Subsidiaries may at any time purchase Subordinated Notes in the open market or otherwise and at any price subject to Condition 6(i) (*Preconditions to redemption, variation, substitution and purchases*). All Subordinated Notes purchased by or on behalf of the Issuer or any Subsidiary may be held, reissued, resold or, at the option of the Issuer and the relevant purchaser, surrendered for cancellation to the Principal Paying Agent.
- (g) **Cancellation:** All Subordinated Notes redeemed or substituted by the Issuer pursuant to this Condition 6, and all Subordinated Notes purchased and surrendered for cancellation pursuant to Condition 6(f) (*Purchase*), will forthwith be cancelled. Any Subordinated Notes so surrendered for cancellation may not be reissued or resold and the obligations of the Issuer in respect of any such Subordinated Notes shall be discharged.
- (h) **Trustee role on redemption, variation or substitution: Trustee not obliged to monitor:** The Trustee shall not be obliged to co-operate in or agree to any such substitution or variation of the terms referred to in this Condition 6 if the securities into which the Subordinated Notes are to be substituted or are to be varied or such substitution or variation imposes, in the Trustee's opinion, more onerous obligations or duties upon it or exposes it to liabilities or reduces its protections. If the Trustee does not so co-operate or agree as provided above, the Issuer may, subject as provided above, redeem the Subordinated Notes as provided above.

The Trustee shall not be under any duty to monitor whether any event or circumstance has happened or exists for the purposes of this Condition 6 and will not be responsible to Noteholders for any loss arising from any failure by it to do so. Unless and until the Trustee has actual knowledge of the occurrence of any event or circumstance within this Condition 6, it shall be entitled to assume that no such event or circumstance exists.

- (i) **Preconditions to redemption, variation, substitution and purchases:**
  - (i) Prior to the publication of any notice of redemption, variation or substitution pursuant to Condition 6(c) (*Redemption, variation or substitution for taxation reasons*) or 6(d) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*), the Issuer shall deliver to the Trustee a certificate signed by two Authorised Signatories stating that, as the case may be:
    - (1) the requirement referred to in Condition 6(c)(i) (*Redemption, variation or substitution for taxation reasons*) above will apply on the next Interest Payment Date and cannot be avoided by the Issuer taking reasonable measures available to it; or
    - (2) a Capital Disqualification Event has occurred and is continuing as at the date of the certificate or, as the case may be, will occur within a period of six months; and
    - (3) in the case of notice of a redemption before the fifth anniversary of the Issue Date:

- (A) it would have been reasonable for the Issuer to conclude, judged at the time of issue of the Subordinated Notes, that the circumstance entitling the Issuer to exercise the right of redemption was unlikely to occur; and
- (B) subject to paragraph (iii) below, to the extent required by the Relevant Rules at the time, the approval of the PRA has been obtained and any such redemption or purchase is to be funded out of the proceeds of issue of regulatory capital of the same or higher quality as the Subordinated Notes,

and the Trustee shall accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders, and the Trustee shall be entitled to rely absolutely on such certification without liability to any person.

- (ii) In addition, prior to the publication of any notice of redemption before the Maturity Date or any substitution, variation or purchase of the Subordinated Notes, the Issuer will be required to have complied with the Regulatory Clearance Condition and be in continued compliance with Solvency Capital Requirements and with the Relevant Rules. A certificate from any two Authorised Signatories to the Trustee confirming such compliance shall be conclusive evidence of such compliance, and the Trustee shall be entitled to rely absolutely on such certification without liability to any person.
- (iii) The Issuer shall not redeem any Subordinated Notes or purchase any Subordinated Notes unless at the time of such redemption or purchase (A) it is in compliance with all Solvency Capital Requirements applicable to it and with the Relevant Rules and (B) the Solvency Condition is satisfied at the time of such payment or purchase and will be satisfied immediately thereafter.

Any redemption or purchase of the Subordinated Notes within five years of the Issue Date must be funded out of the proceeds of issue of regulatory capital of the same or higher quality as the Subordinated Notes. If, following Solvency II Implementation (on the basis that the Subordinated Notes are intended to qualify as Tier 2 Capital under Solvency II without the operation of any grandfathering provisions), Solvency II does not require a redemption or purchase that is within five years of the Issue Date of the Subordinated Notes to be with the approval of the PRA and/or funded out of the proceeds of a new issuance of capital of the same or higher quality as the Subordinated Notes, such a redemption or purchase will not require such PRA approval and/or be required to be so funded but such a redemption or purchase will be subject to compliance with the Relevant Rules. A certificate from any two Authorised Signatories to the Trustee confirming such compliance shall be conclusive evidence of such compliance, and the Trustee shall be entitled to rely absolutely on such certification without liability to any person.

- (j) **Compliance with stock exchange rules:** In connection with any substitution or variation of the Subordinated Notes in accordance with Condition 6(c) (*Redemption, variation or substitution for taxation reasons*) or 6(d) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*), the Issuer shall comply with the rules of any stock exchange or other relevant authority on which the Subordinated Notes are for the time being listed or admitted to trading, and (for so long as the Subordinated Notes are listed on the Official List and admitted to trading on the London Stock Exchange's Main Market) shall publish a supplement in connection therewith if the Issuer is required to do so in order to comply with Section 87G of FSMA.
- (k) **Notices Final:** Upon the expiry of any notice of redemption as is referred to in Condition 6(c) (*Redemption, variation or substitution for taxation reasons*) or 6(d) (*Redemption, substitution or variation at the option of the Issuer due to a Capital*

*Disqualification Event*) above, the Issuer shall be bound to redeem the Subordinated Notes to which the notice refers in accordance with the terms of the relevant Condition.

7. **Payments**

- (a) **Principal:** Payments of principal shall be made by Sterling cheque drawn on, or, upon application by a Holder of a Subordinated Note to the Specified Office of the Principal Paying Agent not later than the fifteenth day before the due date for any such payment, by transfer to a Sterling account maintained by or on behalf of the payee with a bank in London and (in the case of redemption) upon surrender (or, in the case of part payment only, endorsement) of the relevant Note Certificates at the Specified Office of the Principal Paying Agent.
- (b) **Interest:** Payments of interest shall be made by Sterling cheque drawn on, or, upon application by a Holder of a Subordinated Note to the Specified Office of the Principal Paying Agent not later than the fifteenth day before the due date for any such payment, by transfer to a Sterling account maintained by or on behalf of the payee with a bank in London and (in the case of interest payable on redemption) upon surrender (or, in the case of part payment only, endorsement) of the relevant Note Certificates at the Specified Office of the Principal Paying Agent.
- (c) **Payments subject to fiscal laws:** Payments will be subject in all cases to (i) any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 8 (*Taxation*) and (ii) any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the US Internal Revenue Code of 1986 (the "**Code**") or otherwise imposed pursuant to Sections 1471 through 1474 of the Code, any regulations or agreements thereunder, any official interpretations thereof, or (without prejudice to the provisions of Condition 8 (*Taxation*)) any law implementing an intergovernmental approach thereto.
- (d) **Payments on business days:** Where payment is to be made by transfer to a Sterling account, payment instructions (for value the due date, or, if the due date is not a business day, for value the next succeeding business day) will be initiated and, where payment is to be made by Sterling cheque, the cheque will be mailed (i) (in the case of payments of principal and interest payable on redemption) on the later of the due date for payment and the day on which the relevant Note Certificate is surrendered (or, in the case of part payment only, endorsed) at the Specified Office of the Principal Paying Agent and (ii) (in the case of payments of interest payable other than on redemption) on the due date for payment. A Holder of a Subordinated Note shall not be entitled to any interest or other payment in respect of any delay in payment resulting from (A) the due date for a payment not being a business day or (B) a cheque mailed in accordance with this Condition 7 arriving after the due date for payment or being lost in the mail. In this paragraph, "**business day**" means any day on which banks are open for general business (including dealings in foreign currencies) in London and, in the case of surrender (or, in the case of part payment only, endorsement) of a Note Certificate, in the place in which the Note Certificate is surrendered (or, as the case may be, endorsed).
- (e) **Partial payments:** If the Principal Paying Agent makes a partial payment in respect of any Subordinated Note, the Issuer shall procure that the amount and date of such payment are noted on the Register and, in the case of partial payment upon presentation of a Note Certificate, that a statement indicating the amount and the date of such payment is endorsed on the relevant Note Certificate.
- (f) **Record date:** Each payment in respect of a Subordinated Note will be made to the person shown as the Holder in the Register at the opening of business in the place of the Registrar's Specified Office on the fifteenth day before the due date for such payment (the "**Record Date**"). Where payment in respect of a Subordinated Note is to be made by cheque, the cheque will be mailed to the address shown as the address of the Holder in the Register at the opening of business on the relevant Record Date.

- (g) **No commissions:** No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition 7.
- (h) **Agents:** The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents, *provided that* the Issuer will at all times maintain:
- (i) a Principal Paying Agent;
  - (ii) an Agent (which may be the Principal Paying Agent) having a specified office in a European city;
  - (iii) a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; and
  - (iv) a Registrar.

Notice of any termination or appointment and of any changes in specified offices of any of the Agents will be given to the Noteholders promptly by the Issuer in accordance with Condition 15 (*Notices*).

## 8. **Taxation**

All payments of principal and interest in respect of the Subordinated Notes by or on behalf of the Issuer shall be made free and clear of, and without withholding or deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of the United Kingdom or any political subdivision thereof or any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments or governmental charges is required by law. In that event the Issuer shall pay such additional amounts as will result in receipt by the Noteholders after such withholding or deduction of such amounts as would have been received by them had no such withholding or deduction been required, except that no such additional amounts shall be payable in respect of any Subordinated Note:

- (a) held by a Holder which is liable to such taxes, duties, assessments or governmental charges in respect of such Subordinated Note by reason of its having some connection with the United Kingdom other than the mere holding of the Subordinated Note; or
- (b) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26 – 27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, this Directive; or
- (c) held by a Holder who would have been able to avoid such withholding or deduction by arranging to receive the relevant payment through another Paying Agent in a Member State of the European Union; or
- (d) where (in the case of a payment of principal or interest on redemption) the relevant Note Certificate is surrendered for payment more than 30 days after the Relevant Date except to the extent that the relevant Holder would have been entitled to such additional amounts if it had surrendered the relevant Note Certificate on the last day of such period of 30 days.

In these Conditions, "**Relevant Date**" means whichever is the later of (1) the date on which the payment in question first becomes due and (2) if the full amount payable has not been received in

London by the Principal Paying Agent or the Trustee on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders.

Any reference in these Conditions to principal or interest shall be deemed to include any additional amounts in respect of principal or interest (as the case may be) which may be payable under this Condition 8 or any undertaking given in addition to or in substitution of this Condition 8 pursuant to the Trust Deed.

If the Issuer becomes subject at any time to any taxing jurisdiction other than the United Kingdom references in these Conditions to the United Kingdom shall be construed as references to the United Kingdom and/or such other jurisdiction.

9. **Events of default**

- (a) ***Rights to institute and/or prove in a winding up of the Issuer:*** The right to institute winding-up proceedings in respect of the Issuer is limited to circumstances where a relevant payment by the Issuer under the Subordinated Notes or the Trust Deed has become due and is not duly paid. For the avoidance of doubt, no amount shall be due from the Issuer in circumstances where payment of such amount could not be made in compliance with the Solvency Condition or payment of such amount is deferred by the Issuer in accordance with Condition 5(a) (*Regulatory Deficiency Deferral of Interest*) or 6(b) (*Deferral of redemption date*).

If:

- (i) default is made by the Issuer for a period of 14 days or more in the payment of any interest or principal due in respect of the Subordinated Notes or any of them; or
- (ii) a Winding-Up occurs,

the Trustee at its discretion may, and if so requested by Noteholders of at least one-fifth in principal amount of the Subordinated Notes then outstanding or if so directed by an Extraordinary Resolution shall (but in each case subject to it having been indemnified and/or secured and/or prefunded to its satisfaction):

- (A) in the case of (i) above, institute proceedings or take any steps or actions for the winding up of the Issuer in England and Wales (but not elsewhere) and prove in the winding-up; and/or
- (B) in the case of (ii) above, prove in the winding up or administration of the Issuer (whether in England and Wales or elsewhere) and/or claim in the liquidation of the Issuer (whether in England and Wales or elsewhere),

but (in either case) may take no further or other action to enforce, prove or claim for any payment by the Issuer in respect of the Subordinated Notes or the Trust Deed.

- (b) ***Amount payable on a winding-up or administration of the Issuer:*** Upon the occurrence of a Winding-Up (including, for the avoidance of doubt, a winding-up initiated pursuant to Condition 9(a) (*Rights to institute and/or prove in a winding up of the Issuer*)), the Trustee at its discretion may, and if so requested by Noteholders of at least one-fifth in principal amount of the Subordinated Notes then outstanding or if so directed by an Extraordinary Resolution shall (but in each case subject to it having been indemnified and/or secured and/or prefunded to its satisfaction), give notice to the Issuer that the Subordinated Notes are, and they shall accordingly forthwith become, immediately due and payable at the amount equal to their principal amount together with any Arrears of Interest and any other accrued and unpaid interest. Claims against the Issuer in respect of such amounts will be subordinated in accordance with Condition 2(b) (*Subordination*).

- (c) **Enforcement:** Without prejudice to Condition 9(a) (*Rights to institute and/or prove in a winding up of the Issuer*) or 9(b) (*Amount payable on a winding-up or administration of the Issuer*), the Trustee may at its discretion and without further notice institute such proceedings or take such steps or actions against the Issuer as it may think fit to enforce any term or condition binding on the Issuer under the Trust Deed or the Subordinated Notes (other than any payment obligation of the Issuer under or arising from the Subordinated Notes or the Trust Deed, including any payment of damages awarded for breach of any obligations thereunder) but in no event shall the Issuer, by virtue of the institution of any such proceedings or the taking of such steps or actions, be obliged to pay any sum or sums, in cash or otherwise, sooner than the same would otherwise have been payable by it. Nothing in this Condition 9(c) shall, however, prevent the Trustee, subject to Condition 9(a) (*Rights to institute and/or prove in a winding up of the Issuer*), instituting proceedings for the winding-up of the Issuer in England and Wales and/or proving in any winding-up or administration of the Issuer (whether in England and Wales or elsewhere) and/or claiming in any liquidation of the Issuer (whether in England and Wales or elsewhere) in respect of any payment obligation of the Issuer, in each case where such payment obligation arises from the Subordinated Notes or the Trust Deed (including, without limitation, payment of any principal, interest or Arrears of Interest in respect of the Subordinated Notes or any payment of damages awarded for breach of any obligations under the Subordinated Notes or the Trust Deed).
- (d) **Entitlement of Trustee:** The Trustee shall not be bound to take any of the actions referred to in Conditions 9(a) (*Rights to institute and/or prove in a winding up of the Issuer*), 9(b) (*Amount payable on a winding-up or administration of the Issuer*) or 9(c) (*Enforcement*) above against the Issuer to enforce the terms of the Trust Deed, the Subordinated Notes or any other action under or pursuant to the Trust Deed unless (i) it shall have been so directed by an Extraordinary Resolution of the Noteholders or requested in writing by the holders of at least one-fifth in principal amount of the Subordinated Notes then outstanding and (ii) it shall have been indemnified and/or secured and/or prefunded to its satisfaction.
- (e) **Right of Noteholders:** No Noteholder shall be entitled to proceed directly against the Issuer or to institute proceedings for the winding-up or claim in the liquidation of the Issuer or to prove in such winding-up unless the Trustee, having become so bound to proceed, fails to do so within a reasonable period and such failure shall be continuing, in which case the Noteholder shall have only such rights against the Issuer as those which the Trustee is entitled to exercise as set out in this Condition 9.
- (f) **Extent of Noteholders' remedy:** No remedy against the Issuer other than as referred to in this Condition 9, shall be available to the Trustee or the Noteholders, whether for the recovery of amounts owing in respect of the Subordinated Notes or under the Trust Deed or in respect of any breach by the Issuer of any of its other obligations under or in respect of the Subordinated Notes or under the Trust Deed.

10. **Prescription**

Claims for principal and interest on redemption shall become void unless the relevant Note Certificates are surrendered for payment within ten years (in the case of principal) and five years (in the case of interest) of the appropriate Relevant Date.

11. **Replacement of Note Certificates**

If any Note Certificate is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the Specified Office of the Registrar, subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may reasonably require. Mutilated or defaced Note Certificates must be surrendered before replacements will be issued.

12. **Trustee and Agents**

Under the Trust Deed, the Trustee is entitled to be indemnified and relieved from responsibility in certain circumstances and to be paid its costs and expenses in priority to the claims of the Noteholders. In addition, the Trustee is entitled to enter into business transactions with the Issuer and any entity relating to the Issuer without accounting for any profit.

In the exercise of its powers and discretions under these Conditions and the Trust Deed, the Trustee will have regard to the interests of the Noteholders as a class and will not be responsible for any consequence for individual Holders of Subordinated Notes as a result of such Holders being connected in any way with a particular territory or taxing jurisdiction.

In acting under the Agency Agreement and in connection with the Subordinated Notes, the Agents act solely as agents of the Issuer and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders.

The initial Agents and their initial Specified Offices are listed below. The Issuer reserves the right (with the prior approval of the Trustee) at any time to vary or terminate the appointment of any Agent and to appoint a successor registrar or principal paying agent and additional or successor paying agents and transfer agents; *provided, however, that* the Issuer shall at all times maintain (a) a principal paying agent and a registrar, and (b) a Paying Agent in an EU member state that will not be obliged to withhold or deduct tax pursuant to any law implementing European Council Directive 2003/48/EC or any other European Union Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive.

Notice of any change in any of the Agents or in their Specified Offices shall promptly be given to the Noteholders.

### 13. Meetings of Noteholders; Modification and Waiver

- (a) *Meetings of Noteholders*: Except as provided herein, any modification to these Conditions or any provisions of the Trust Deed will require the Issuer giving at least one month's prior written notice to, and receiving no objection from, the PRA (or such shorter period of notice as the PRA may accept and so long as there is a requirement to give such notice).

The Trust Deed contains provisions for convening meetings of Noteholders to consider matters relating to the Subordinated Notes, including the modification of any provision of these Conditions or the Trust Deed. Any such modification may be made if sanctioned by an Extraordinary Resolution. Such a meeting may be convened by the Issuer or by the Trustee and shall be convened by the Trustee upon the request in writing of Noteholders holding not less than one-tenth of the aggregate principal amount of the outstanding Subordinated Notes (subject to the Trustee being indemnified and/or secured and/or prefunded to its satisfaction). The quorum at any meeting convened to vote on an Extraordinary Resolution will be two or more persons holding or representing one more than half of the aggregate principal amount of the outstanding Subordinated Notes or, at any adjourned meeting, two or more persons being or representing Noteholders whatever the principal amount of the Subordinated Notes held or represented; *provided, however, that* certain proposals (including any proposal: (i) to change any date fixed for payment of principal or interest in respect of the Subordinated Notes, to reduce the amount of principal or interest payable on any date in respect of the Subordinated Notes, to alter the method of calculating the amount of any payment in respect of the Subordinated Notes or the date for any such payment, (ii) to amend the provisions of clauses 2.5.2 (*Status and Subordination of the Subordinated Notes*) or 2.5.3 of the Trust Deed, or Condition 2(b) (*Subordination*); (iii) to effect the exchange, conversion or substitution of the Subordinated Notes for, or the conversion of the Subordinated Notes into, shares, bonds or other obligations or securities of the Issuer or any other person or body corporate formed or to be formed (other than as permitted under clause 6.3 (*Substitution*) of the Trust Deed); (iv) to change the currency of payments under the Subordinated Notes; and (v) to change the quorum requirements relating to meetings or the majority required to pass an Extraordinary Resolution (each, a "**Reserved Matter**") may only be sanctioned

by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more persons holding or representing not less than three-quarters or, at any adjourned meeting, one quarter of the aggregate principal amount of the outstanding Subordinated Notes form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not.

In addition, a resolution in writing signed by or on behalf of holders of 90 per cent. in principal amount of the Subordinated Notes which are for the time being outstanding will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

The agreement or approval of the Noteholders shall not be required in the case of any variation of these Conditions and/or the Trust Deed required to be made in connection with the substitution or variation of the Subordinated Notes pursuant to Condition 6(c) (*Redemption, variation or substitution for taxation reasons*) or 6(d) (*Redemption, substitution or variation at the option of the Issuer due to a Capital Disqualification Event*) or any consequential amendments to these Conditions and/or the Trust Deed approved by the Trustee in connection with a substitution of the Issuer pursuant to Condition 14 (*Substitution of Issuer*).

- (b) **Modification and waiver:** The Trustee may, without the consent of the Noteholders, agree to (i) any modification of these Conditions or the Trust Deed (other than in respect of a Reserved Matter) which, in the opinion of the Trustee, will not be materially prejudicial to the interests of Noteholders, and (ii) any modification of the Subordinated Notes or the Trust Deed which is, in the opinion of the Trustee, of a formal, minor or technical nature or is to correct a manifest error. In addition, the Trustee may, without the consent of the Noteholders, authorise or waive any proposed breach or breach of the Subordinated Notes or the Trust Deed if, in the opinion of the Trustee, the interests of the Noteholders will not be materially prejudiced thereby.

Any such authorisation, waiver or modification shall be notified to the Noteholders as soon as practicable thereafter.

- (c) **Trustee to have regard to interests of Noteholders as a class:** In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution of obligor), the Trustee shall have regard to the general interests of the Noteholders as a class but shall not have regard to any interests arising from circumstances particular to individual Noteholders (whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Noteholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer, the Trustee or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders except to the extent already provided for in Condition 7 (*Payments*) and/or any undertaking given in addition to, or in substitution for, Condition 7 (*Payments*) pursuant to the Trust Deed.

#### 14. **Substitution of Issuer**

Subject to the Issuer giving at least one month's notice to, and receiving no objection from, the PRA or obtaining prior approval and consent from the PRA in respect thereof, the Trustee may agree with the Issuer, without the consent of the Noteholders:

- (a) to the substitution of a Related Undertaking of the Issuer (or any previous substitute or successor in business under this sub-paragraph) or a successor in business of the Issuer (or any previous substitute or successor in business under this sub-paragraph) in place of the Issuer (or of any previous substitute or successor in business under this sub-paragraph) as principal debtor under the Trust Deed and the Subordinated Notes,

*provided that* (in the case of a substitution of a Related Undertaking of the Issuer (or any previous substitute or successor in business)) the Subordinated Notes are guaranteed by the Issuer (or any previous substitute or successor in business under this sub-paragraph) on a subordinated basis ranking equal with the ranking of the Subordinated Notes prior to such substitution; and/or

- (b) the addition of a Related Undertaking of the Issuer (or substitute Issuer) as a guarantor of the Issuer's (or substitute Issuer's) obligations under the Trust Deed and the Subordinated Notes,

(each such substitute or, where applicable, guarantor being hereinafter referred to as the "**Substituted Obligor**") *provided that* in each case:

- (i) a trust deed or some other form of undertaking, supported by one or more legal opinions, is executed by the Substituted Obligor in a form and manner satisfactory to the Trustee, agreeing to be bound by the terms of the Trust Deed and the Subordinated Notes, with any consequential amendments which the Trustee may deem appropriate, as fully as if the Substituted Obligor has been named in the Trust Deed and the Subordinated Notes, as the principal debtor in place of the Issuer, or where applicable, as a guarantor of the Issuer (or any previous Substituted Obligor, as the case may be);
- (ii) the Substituted Obligor confirms to the Trustee in one or more legal opinions addressed to the Trustee and the Issuer in a form approved by and provided to the Trustee that (i) it has obtained all necessary governmental and regulatory approvals and consents necessary for its assumptions of the duties and liabilities as Substituted Obligor under the Trust Deed and the Subordinated Notes in place of the Issuer or as a guarantor of the Issuer or, as the case may be, any previous Substituted Obligor and (ii) such approvals and consents are at the time of substitution in full force and effect, and the Trustee shall be entitled to rely absolutely on such legal opinions without liability to any person;
- (iii) two directors (or other officers acceptable to the Trustee) of the Substituted Obligor certify that the Substituted Obligor is solvent at the time at which the substitution is proposed to be in effect, and immediately thereafter, and the Trustee shall be entitled to rely absolutely on such certification without liability to any person and shall not be bound to have regard to the financial condition, profits or prospects of the Substituted Obligor or to compare the same with those of the Issuer or any previous Substituted Obligor;
- (iv) (without prejudice to the generality of the foregoing) the Trustee may, in the event of such substitution agree, without the consent of the Noteholders, to a change in the law governing the Trust Deed and/or the Subordinated Notes if in the opinion of the Trustee such change would not be materially prejudicial to the interests of the Noteholders;
- (v) if the Substituted Obligor is, or becomes, subject generally to the taxing jurisdiction of a territory or any authority of or in that territory with power to tax (the "**Substituted Territory**") other than the territory of the taxing jurisdiction of which (or to any such authority of or in which) the Issuer (or any previous Substituted Obligor) is subject generally (the "**Original Territory**"), the Substituted Obligor will (unless the Trustee otherwise agrees) give to the Trustee an undertaking satisfactory to the Trustee in terms corresponding to Condition 8 (*Taxation*) with the substitution for or addition to the references in that Condition and in Condition 6(c) (*Redemption, variation or substitution for taxation reasons*) to the Original Territory of references to the Substituted Territory whereupon the Trust Deed and the Subordinated Notes will be read accordingly;
- (vi) the Issuer and the Substituted Obligor comply with such other requirements as the Trustee may direct in the interests of the Noteholders; and

- (vii) in the case of a full substitution of the Issuer pursuant to Condition 14(a) (*Substitution of Issuer*) above only, if the Subordinated Notes are rated (where such rating was assigned at the request of the Issuer) by one or more credit rating agencies of international standing immediately prior to such substitution, the Subordinated Notes shall continue to be rated by each such rating agency immediately following such substitution, and the credit ratings assigned to the Subordinated Notes by each such rating agency immediately following such substitution will be no less than those assigned to the Subordinated Notes immediately prior thereto.

15. **Notices**

Notices to the Noteholders will be sent to them by first class mail (or its equivalent) or (if posted to an overseas address) by airmail at their respective addresses on the Register. In addition, so long as the Subordinated Notes are listed on the London Stock Exchange, the Issuer shall ensure that notices are duly given or published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Subordinated Notes are for the time being listed. Any notice shall be deemed to have been given on the second day after the date of mailing or the date of publication or, if so published more than once on different dates, the date of the first publication.

16. **Governing Law**

The Subordinated Notes and the Trust Deed and any non-contractual obligations arising out of or in connection with the Subordinated Notes and the Trust Deed are governed by English law.

17. **Defined Terms**

In these Conditions:

"**Arrears of Interest**" has the meaning given in Condition 5(c) (*Arrears of Interest*);

"**Assets**" means the unconsolidated gross assets of the Issuer as shown in the latest published audited balance sheet of the Issuer, but adjusted for contingencies and subsequent events, all in such manner as the Directors of the Issuer may determine;

"**Authorised Denomination**" has the meaning given in Condition 1 (*Form and Denomination*);

"**Authorised Signatory**" means any Director, or any other person or persons notified to the Trustee by any Director as being an Authorised Signatory pursuant to clause 5.16 (*Authorised Signatories*) of the Trust Deed;

"**Business Day**" means: (i) except for the purposes of Conditions 3 (*Register, Title and Transfers*) and 7(d) (*Payments on business days*), a day (other than a Saturday, Sunday or public holiday) on which commercial banks and foreign exchange markets are open for general business in London; (ii) for the purposes of Condition 3, a day on which commercial banks are open for general business (including dealings in foreign currencies) in the city where the relevant Agent has its Specified Office; and (iii) for the purpose of Condition 7(d), any day on which banks are open for general business (including dealings in foreign currencies) in London and, in the case of surrender (or, in the case of part payment only, endorsement) of a Note Certificate, in the place in which the Note Certificate is surrendered (or, as the case may be, endorsed);

"**Calculation Amount**" has the meaning given in Condition 4(c) (*Calculation of Interest*);

"**Capital Disqualification Event**" is deemed to have occurred if, as a result of any replacement of or change to (or change to the interpretation by any court or authority entitled to do so of) Solvency II or the Relevant Rules or following the implementation of Solvency II, the Subordinated Notes are excluded from counting in full or in part as Tier 2 Capital for the purposes of the Issuer, the Insurance Group or any member of the Insurance Group whether on a solo, group or consolidated basis;

"**Directors**" means the directors of the Issuer from time to time;

**"Extraordinary Resolution"** has the meaning given in the Trust Deed;

**"FCA"** means the Financial Conduct Authority, acting in consultation with or with the consent of the PRA where required under the Relevant Rules, or such successor or other authority having primary supervisory authority with respect to conduct of business matters in relation to the Issuer and/or the Insurance Group and/or (as applicable) its capacity as the relevant authority under Part 6 of FSMA with respect to the Official List;

**"FSMA"** means the Financial Services and Markets Act 2000 (as amended or re-enacted from time to time including pursuant to the Financial Services Act 2012);

**"Holder"** has the meaning given in Condition 3(a) (*Register*);

**"Interest Payment Date"** has the meaning given in Condition 4(a) (*Interest*);

**"Interest Period"** means a period from (and including) one Interest Payment Date (or in the case of the first Interest Period only, the Issue Date) up to (but excluding) the next following Interest Payment Date;

**"Insurance Group"** means the Issuer (or its successor in business (as defined in the Trust Deed)) and its Subsidiaries;

**"Issue Date"** has the meaning given in Condition 4(a) (*Interest*);

**"Junior Creditors"** means creditors of the Issuer whose claims rank, or are expressed to rank junior to, the claims of the Noteholders, including holders of Junior Securities;

**"Junior Securities"** has the meaning given to it in Condition 2(b) (*Subordination*);

**"Liabilities"** means the unconsolidated gross liabilities of the Issuer as shown in the latest published audited balance sheet of the Issuer, but adjusted for contingent liabilities and for subsequent events, all in such manner as the Directors may determine;

**"London Stock Exchange"** means the London Stock Exchange plc;

**"Lower Tier 2 Capital"** has the meaning given by the PRA from time to time and shall, following the implementation of Solvency II or any other change in law or any Relevant Rules such that Lower Tier 2 Capital ceases to be a recognised tier of capital resources, be deemed to be a reference to any Tier 2 Capital;

**"Maturity Date"** means 25 July 2024;

**"Note Certificate"** has the meaning given in Condition 3(a) (*Register*);

**"Noteholder"** has the meaning given in Condition 3(a) (*Register*);

**"Official List"** means the official list of the UK Listing Authority maintained pursuant to Section 74 of FSMA;

**"Original Territory"** has the meaning given in Condition 14 (*Substitution of Issuer*);

**"Parity Creditors"** means creditors of the Issuer whose claims rank, or are expressed to rank, *pari passu* with the claims of the Noteholders, including holders of Parity Securities;

**"Parity Securities"** has the meaning given to it in Condition 2(b) (*Subordination*);

**"PRA"** means the Prudential Regulation Authority, acting in consultation with or with the consent of the FCA where required under the Relevant Rules, or such successor or other authority having primary supervisory authority with respect to prudential matters in relation to the Issuer and/or the Insurance Group;

**"Qualifying Dated Tier 2 Securities"** means securities issued directly or indirectly by the Issuer that:

- (a) have terms not materially less favourable to an investor than the terms of the Subordinated Notes (as reasonably determined by the Issuer in consultation with an independent investment bank of international standing, and *provided that* a certification to such effect (including as to the consultation with the independent investment bank and in respect of the matters specified in (1)-(5) and paragraph (b) below) signed by two Authorised Signatories shall have been delivered to the Trustee (upon which the Trustee shall be entitled to rely without liability to any person) prior to the issue of the relevant securities), *provided that* they shall (1) contain terms which comply with the current requirements of the PRA in relation to Tier 2 Capital (or, at any time prior to Solvency II Implementation, Lower Tier 2 Capital); (2) bear at least the same rate of interest from time to time applying to the Subordinated Notes and preserve the same Interest Payment Dates; (3) rank senior to, or *pari passu* with, the Subordinated Notes; (4) preserve the obligations of the Issuer as to redemption of the Subordinated Notes, including as to the timing of, and amounts payable upon redemption; and (5) preserve any existing rights under these Conditions to any accrued interest, any Arrears of Interest and any other amounts payable under the Subordinated Notes which, in each case, has accrued to Noteholders but not been paid; and
- (b) are listed or admitted to trading on the London Stock Exchange's main market (for the purposes of Directive 2004/39/EC) or such other stock exchange as is a Recognised Stock Exchange at that time as selected by the Issuer and approved by the Trustee;

**"Recognised Stock Exchange"** means a recognised stock exchange as defined in section 1005 of the Income Tax Act 2007 as amended or re-enacted from time to time, and any provision, statute or statutory instrument replacing the same from time to time;

**"Record Date"** has the meaning given in Condition 7(f) (*Record Date*);

**"Register"** has the meaning given in Condition 3(a) (*Register*);

**"Regulatory Clearance Condition"** means, in respect of any proposed act on the part of the Issuer, the PRA having consented to, or having been given due notification of and having not within any applicable time-frame objected to, such act (in any case only if and to the extent required by the PRA or any applicable rule of the PRA at the relevant time);

**"Regulatory Deficiency Interest Deferral Date"** means each Interest Payment Date in respect of which a Regulatory Deficiency Interest Deferral Event has occurred and is continuing or would occur if payment of interest was made on such Interest Payment Date;

**"Regulatory Deficiency Interest Deferral Event"** means (i) any event which (including, without limitation, any event which causes the Solvency Capital Requirement applicable to the Issuer, the Insurance Group or any member of the Insurance Group to be breached and such breach is an event which) under Solvency II and/or under the Relevant Rules would require the Issuer to defer a payment of interest in respect of the Subordinated Notes (on the basis that the Subordinated Notes are intended to qualify as Lower Tier 2 Capital of the Issuer, the Insurance Group or any member of the Insurance Group (prior to Solvency II Implementation) and as Tier 2 Capital of the Issuer, the Insurance Group or any member of the Insurance Group (following Solvency II Implementation and without the operation of any grandfathering provisions)) or (ii) the PRA has notified the Issuer in writing that it has determined in accordance with the Relevant Rules at such time that the Issuer must defer a payment of interest in respect of the Subordinated Notes;

**"Regulatory Deficiency Redemption Deferral Event"** means any event which (including without limitation, any event which causes the Solvency Capital Requirement applicable to the Issuer, the Insurance Group or any member of the Insurance Group to be breached and such breach is an event which) under Solvency II and/or under the Relevant Rules would require the Issuer to, defer or suspend a scheduled repayment or redemption of the Subordinated Notes (on the basis that the Subordinated Notes are intended to qualify as Lower Tier 2 Capital of the Issuer, the Insurance Group or any member of the Insurance Group (prior to Solvency II Implementation) and as Tier 2 Capital of the Issuer, the Insurance Group or any member of the Insurance Group (following Solvency II Implementation and without the operation of any

grandfathering provisions)) or (ii) the PRA has notified the Issuer in writing that it has determined in accordance with the Relevant Rules at such time that the Issuer must defer or suspend a scheduled repayment or redemption of the Subordinated Notes;

**"Related Undertaking"** means in relation to any person, (i) any subsidiary undertaking or parent undertaking of that person or (ii) any subsidiary undertaking of any such parent undertaking;

**"Relevant Date"** has the meaning given in Condition 8 (*Taxation*);

**"Relevant Jurisdiction"** means the United Kingdom or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and interest (including Arrears of Interest) on the Subordinated Notes;

**"Relevant Rules"** means any legislation, rules or regulations (whether having the force of law or otherwise) applicable in the United Kingdom from time to time and applying to the Issuer or any insurance or reinsurance undertaking within the Insurance Group from time to time relating to the characteristics, features or criteria of own funds or capital resources and the requirement to retain capital resources in excess of a prescribed capital resources requirement and, for the avoidance of doubt and without limitation to the foregoing, includes any legislation, rules or regulations relating to such matters which are supplementary or extraneous to the obligations imposed on Member States by Solvency I or the Solvency II Directive;

**"Reserved Matter"** has the meaning given in Condition 13(a) (*Meetings of Noteholders*);

**"Senior Creditors"** means:

- (a) any policyholders of the Issuer (and, for the avoidance of doubt, the claims of Senior Creditors who are policyholders shall include all amounts to which any such policyholder would be entitled in its capacity as policyholder under any applicable legislation or rules relating to a winding up of insurance companies to reflect any right to receive, or expectation of receiving, policyholder benefits which policyholders may have);
- (b) creditors of the Issuer (other than policyholders) who are unsubordinated creditors of the Issuer; and
- (c) other creditors of the Issuer whose claims are, or are expressed to be, subordinated to the claims of other creditors of the Issuer (other than those whose claims constitute (or relate to a guarantee or other like or similar undertaking or arrangement given by the Issuer in respect of any obligation of any other person which constitute), or would but for any applicable limitation on the amount of any such capital constitute, Tier 1 Capital, Upper Tier 2 Capital (issued prior to Solvency II Implementation), Lower Tier 2 Capital (issued prior to Solvency II Implementation), or Tier 2 Capital (issued on or after Solvency II Implementation) or whose claims otherwise rank, or are expressed to rank, *pari passu* with, or junior to, the claims of the Noteholders);

**"Solvency I"** means the directives adopted by the Parliament and Council of the European Union relating to the taking-up and pursuit of insurance business within the European Union (excluding the Solvency II Directive) and including, without limitation, Directive 73/239/EEC of the European Union (as amended) and Directive 98/78/EC of the European Union (as amended) on the supplementary supervision of insurance undertakings in an insurance group;

**"Solvency II"** means the Solvency II Directive and any implementing measures adopted pursuant to the Solvency II Directive (for the avoidance of doubt, whether implemented by way of regulation or by further directives or otherwise);

**"Solvency II Directive"** means Directive 2009/138/EC of the European Union (as amended) on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) and which must be transposed by Member States pursuant to Article 309 of Directive 2009/138/EC;

**"Solvency II Implementation"** means the implementation by the PRA of Solvency II or any other change in law or any Relevant Rules if such implementation or other change in law results in Upper Tier 2 Capital and Lower Tier 2 Capital ceasing to be recognised as distinct tiers of capital (or, if later, the coming into effect of the same with respect to the Insurance Group);

**"Solvency Capital Requirement"** means the solvency capital requirement or the group solvency capital requirement referred to in Solvency II (howsoever described or defined in Solvency II) or any solvency capital requirement, group solvency capital requirement or any other equivalent capital requirement howsoever described in the Relevant Rules;

**"Solvency Condition"** has the meaning given in Condition 2(c) (*Solvency Condition*);

**"Subsidiary"** means a subsidiary or subsidiary undertaking of the Issuer whose affairs are for the time being required to be fully consolidated in the consolidated accounts of the Issuer;

**"Substituted Obligor"** has the meaning given in Condition 14 (*Substitution of Issuer*);

**"Substituted Territory"** has the meaning given in Condition 14 (*Substitution of Issuer*);

**"Tier 1 Capital"** has the meaning given to it by the PRA from time to time;

**"Tier 2 Capital"** has the meaning given to it by the PRA from time to time;

**"Upper Tier 2 Capital"** has the meaning given to it by the PRA from time to time; and

**"Winding-Up"** has the meaning given in Condition 2(b) (*Subordination*).

## **SUMMARY OF PROVISIONS RELATING TO THE SUBORDINATED NOTES WHILE IN GLOBAL FORM**

### **1. Initial Issue of Certificates**

The Global Note Certificate will be registered in the name of a nominee for a common depository for Euroclear and Clearstream, Luxembourg (the "**Common Depository**") and may be delivered on or prior to the Issue Date.

Upon the registration of the Global Note Certificate in the name of any nominee for Euroclear and Clearstream, Luxembourg and delivery of the Global Note Certificate to the Common Depository, Euroclear or Clearstream, Luxembourg will credit each subscriber with a nominal amount of Subordinated Notes equal to the nominal amount thereof for which it has subscribed and paid.

### **2. Relationship of Accountholders with Clearing Systems**

Each of the persons shown in the records of Euroclear, Clearstream, Luxembourg or any other clearing system ("**Alternative Clearing System**") as the holder of a Subordinated Note represented by the Global Note Certificate must look solely to Euroclear, Clearstream, Luxembourg or any such Alternative Clearing System (as the case may be) for his share of each payment made by the Issuer to the holder of the Global Note Certificate and in relation to all other rights arising under the Global Note Certificate, subject to and in accordance with the respective rules and procedures of Euroclear, Clearstream, Luxembourg, or such Alternative Clearing System (as the case may be). Such persons shall have no claim directly against the Issuer in respect of payments due on the Subordinated Notes for so long as the Subordinated Notes are represented by the Global Note Certificate and such obligations of the Issuer will be discharged by payment to the registered holder of the Global Note Certificate in respect of each amount so paid.

### **3. Exchange**

The following will apply in respect of transfers of Subordinated Notes held in Euroclear or Clearstream, Luxembourg or an Alternative Clearing System. These provisions will not prevent the trading of interests in the Subordinated Notes within a clearing system whilst they are held on behalf of such clearing system, but will limit the circumstances in which the Subordinated Notes may be withdrawn from the relevant clearing system.

Transfers of the Subordinated Notes represented by the Global Note Certificate pursuant to Condition 3(c) (*Transfers*) may only be made in part:

- (i) if the relevant clearing system is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so; or
- (ii) upon or following any failure to pay principal in respect of any Subordinated Notes when it is due and payable; or
- (iii) with the consent of the Issuer,

**provided that**, in the case of the first transfer of part of a holding pursuant to paragraph (i) or (ii) above, the Holder has given the Registrar not less than 30 days' notice at its specified office of the Holder's intention to effect such transfer.

### **4. Amendment to Conditions**

The Global Note Certificate contains provisions that apply to the Subordinated Notes that it represents, some of which modify the effect of the terms and conditions of the Subordinated Notes set out in this Prospectus. The following is a summary of certain of those provisions:

#### **4.1 Payments**

All payments in respect of Subordinated Notes represented by a Global Note Certificate will be made to, or to the order of, the person whose name is entered on the Register at the close of

business on the Clearing System Business Day immediately prior to the date for payment, where Clearing System Business Day means Monday to Friday (inclusive) except 25 December and 1 January.

#### 4.2 ***Meetings***

For the purposes of any meeting of Noteholders, the holder of the Subordinated Notes represented by the Global Note Certificate shall (unless the Global Note Certificate represents only one Subordinated Note) be treated as two persons for the purposes of any quorum requirements of a meeting of Noteholders and as being entitled to one vote in respect of each integral currency unit of the currency of the Subordinated Notes.

#### 4.3 ***Trustee's Powers***

In considering the interests of Noteholders while the Global Note Certificate is held on behalf of, or registered in the name of any nominee for, a clearing system, the Trustee may have regard to any information provided to it by such clearing system or its operator as to the identity (either individually or by category) of its accountholders with entitlements to the Global Note Certificate and may consider such interests as if such accountholders were the holders of the Subordinated Notes represented by the Global Note Certificate.

### 5. **Electronic Consent and Written Resolution**

While any Global Note Certificate is registered in the name of any nominee for a clearing system, then:

- (i) approval of a resolution proposed by the Issuer or the Trustee (as the case may be) given by way of electronic consents communicated through the electronic communications systems of the relevant Clearing System(s) in accordance with their operating rules and procedures by or on behalf of the holders of not less than 90 per cent. in nominal amount of the Subordinated Notes outstanding (an "**Electronic Consent**" as defined in the Trust Deed) shall, for all purposes (including matters that would otherwise require an Extraordinary Resolution to be passed at a meeting for which the special quorum was satisfied), take effect as an Extraordinary Resolution passed at a meeting of Noteholders duly convened and held, and shall be binding on all Noteholders whether or not they participated in such Electronic Consent; and
- (ii) where Electronic Consent is not being sought, for the purpose of determining whether a Written Resolution (as defined in the Trust Deed) has been validly passed, the Issuer and the Trustee shall be entitled to rely on consent or instructions given in writing directly to the Issuer and/or the Trustee, as the case may be, by accountholders in the clearing system with entitlements to such Global Note Certificate or, where the accountholders hold any such entitlement on behalf of another person, on written consent from or written instruction by the person for whom such entitlement is ultimately beneficially held, whether such beneficiary holds directly with the accountholder or via one or more intermediaries and **provided that**, in each case, the Issuer and the Trustee have obtained commercially reasonable evidence to ascertain the validity of such holding and have taken reasonable steps to ensure that such holding does not alter following the giving of such consent or instruction and prior to the effecting of such amendment. Any resolution passed in such manner shall be binding on all Noteholders, even if the relevant consent or instruction proves to be defective. As used in this paragraph, "commercially reasonable evidence" includes any certificate or other document issued by Euroclear, Clearstream, Luxembourg or any other relevant clearing system, or issued by an accountholder of them or an intermediary in a holding chain, in relation to the holding of interests in the Subordinated Notes. Any such certificate or other document shall, in the absence of manifest error, be conclusive and binding for all purposes. Any such certificate or other document may comprise any form of statement or print out of electronic records provided by the relevant clearing system (including Euroclear's EUCLID or Clearstream, Luxembourg's CreationOnline system) in accordance with its usual procedures and in which the accountholder of a particular principal or nominal amount of the Subordinated Notes is clearly identified together with the amount of such holding. Neither the Issuer nor the Trustee shall be liable to any person by reason of having accepted as valid or not having rejected any certificate or other document to such effect purporting to be issued by any such person and subsequently found to be forged or not authentic.

## DESCRIPTION OF THE ISSUER

### 1. INTRODUCTION

The Issuer was incorporated and registered in England and Wales on 24 September 1999 under the Companies Act 1985 as a private company limited by shares with the name Admiral Group Limited and was registered under number 03849958. On 20 September 2004, the Issuer was re-registered as a public limited company and changed its name to Admiral Group plc.

The principal legislation under which the Issuer operates is the Companies Act 2006, FSMA and the rules, regulations and guidance made thereunder, including (but not limited to) the PRA and FCA Handbooks.

The head office and registered office of the Issuer is Capital Tower, Greyfriars Road, Cardiff CF10 3AZ. The telephone number is +44 (0)871 882 8282.

The Group is an innovative, growing personal lines insurance group with a long track record of profitability. The Group's core UK car insurance business launched in 1993 and has grown organically to service approximately 3.9 million insurance customers (as at 30 June 2014) in five countries and provide accurate comparison services to millions more.

The Group's main business is the sale and underwriting of private car insurance in the UK, where it has a market share of approximately 11% and insures 3.1 million vehicles (as at 30 June 2014). Since 2006, the Group has launched insurance businesses in Spain, Italy, France and the US which in aggregate, insure 0.6 million vehicles (as at 30 June 2014).

In the early 2000s, the Group pioneered price comparison for car insurance in the UK via its Confused.com business and has, more recently, established similar businesses in Spain, France and the US.

The Group employs 6,487 people across these countries as well as in Canada, India and Gibraltar (figure as at 30 June 2014). Underpinning the competitive strengths set out below is the Group's company culture, which is focused on motivating employees and aligning the interests of staff with those of the Group and its shareholders. Every employee of the Group, with the exception of Henry Engelhardt (CEO) and David Stevens (COO) who have declined to be included, is entitled to participate in and receive shares under the Group's share incentive plans. The Group's culture is built on the principle that people who like what they do, will do it better.

The table below provides certain information with respect to the Group as at and for each of the years ended 31 December 2013, 2012, and 2011:

	2013	2012	2011
Turnover (£m).....	2,030	2,215	2,190
Customers (m) .....	3.7	3.6	3.4
Profit before tax (£m) .....	370.2	344.6	299.1
Return on capital.....	58%	60%	59%
Earnings per share (pence) .....	104.6	95.1	81.9
Full year dividend per share (pence) .....	99.5	90.6	75.6

The Group's business is presented in three primary segments – UK car insurance, international car insurance and price comparison. At 31 December 2013, contributions to revenue from these segments were 84%, 9% and 6% respectively. An additional 1% of turnover was generated from "other group" activities (namely the sale of household and commercial van insurance in the UK).

The Issuer believes that retaining excess cash in a company can lead to poor decision-making. The Issuer is committed to returning surplus capital to shareholders.

#### A UK car insurance

The Group is one of the leading private car insurance groups in the United Kingdom in terms of total premiums and insured vehicles. The Group trades in the UK via four brands - Admiral, Bell, Diamond and elephant.co.uk and distributes direct to customers (via the phone or the internet) or via price comparison websites.

For the year ended 31 December 2013, pre-tax profit for the business segment was £393.9m (106% of Group pre-tax profit) and turnover was £1,699 million (84% of total revenue for the Group).

The Group underwrites a gross share of 60% of its UK car insurance business, with the remaining 40% underwritten outside the Group (by Great Lakes Reinsurance (UK) Plc, a member of the Munich Re Group). The Group also reinsures (via quota share reinsurance contracts) a further 35% of its total premium, to retain a net share of 25% for its own account. The UK car insurance business operates predominantly under the regulation of the FCA and PRA, and through a Gibraltar-based insurance company, under the FSC, in that territory. The FCA and PRA regulate the Group's UK registered subsidiaries including EUI Limited (an insurance intermediary) and Admiral Insurance Company Limited ("AICL") (an insurer), whilst the FSC regulates AIGL (also an insurer).

## **B International car insurance**

The Group also sells car insurance in Italy, Spain, France and the US, via the ConTe (Italy), Balumba.es and Qualitas Auto (Spain), L'olivier Assurances (France) and Elephant Auto (US) brands. The Group sells its car insurance to private customers using a multi-channel strategy similar to that used in the United Kingdom, and the combined international businesses insured approximately 515,000 customers as at 31 December 2013. For the year ended 31 December 2013, pre-tax losses for the business segment were £22.1m and turnover was £188 million (representing 9% of the Group's total turnover).

The Group underwrites a varying proportion of the total premiums across these businesses and, net of reinsurance, retains a share varying between 30% and 35% of the business for its own account.

The Group's insurance business in Spain, Italy and France is underwritten by AICL and AIGL. The Group's insurance business in the US is underwritten by Elephant Insurance Company, which is regulated by the Virginia State Corporation Commission's Bureau of Insurance.

## **C Price comparison**

The Group launched Confused.com, the first UK car insurance price comparison website, in 2002, and now operates similar websites in Spain, France and the US under the brands Rastreator, LeLynx and comparenow.com respectively.

Confused.com allows consumers to compare a range of general insurance and financial services products across price and policy benefits. The international businesses currently offer a more limited range of services than the UK, but the core service is consistently car insurance comparison.

For the year ended 31 December 2013, pre-tax profit was £20.4m and turnover was £113 million (6% of total turnover for the Group).

The Group's price comparison businesses generate revenue mainly via commissions from insurer partners which feature on the websites.

## **2. HISTORY**

The Group's core UK car insurance business was launched in 1993, with the current Chief Executive Officer (Henry Engelhardt) and Chief Operating Officer (David Stevens) being two of the founding managers. As of 31 May 2014, Henry Engelhardt and David Stevens (and their family members) own a total of 16% of the Issuer's shares.

Growth has been entirely organic and as at 30 June 2014 the Group had 3.9 million customers and 6,487 employees. The Group operates from its headquarters in Cardiff. In the UK, all of its offices are in South Wales, whilst the Group also operates from offices in: Seville and Madrid, Spain; Lille and Paris, France; Rome, Italy; Richmond, US; Halifax, Canada; Gibraltar; Bangalore and New Delhi, India.

A summary of the key milestones in the Group's history is set out below:

### **2 January 1993**

- The Group launches in Cardiff on time and under budget with one brand, no customers and 57 members of staff. The first policy is sold over the telephone at 9.10am.

- Admiral is a direct car insurance operation of Brockbank, a Lloyd's managing agent.

## **2 August 1993**

- The first Admiral TV commercial is broadcast.

## **1995**

- The Group's website goes live, making it one of the first UK direct insurers with an Internet presence.

## **1997**

- The Group embarks on its multi-brand sales strategy, launching Bell Direct and Diamond (the latter of which was created especially for women motorists).

## **1998**

- Gladiator launches as a commercial vehicle insurance intermediary business selling van insurance on behalf of a panel of insurers.

## **1999**

- Successful management buy-out of the Group from the Brockbank Group (which was then owned by XL Capita). Barclays Private Equity backs the MBO.
- The Group enters into co-insurance and reinsurance arrangements with Munich Re and Swiss Re. Both remain partners of the Group today.

## **2000**

- The Group launches its fifth brand, elephant.co.uk.

## **2002**

- Confused.com launches as the Group's sixth brand and the UK's first car insurance price comparison website.
- Munich Re acquires an 18.6% shareholding in the Issuer and the Group's debt is refinanced with Lloyds TSB and Bank of Scotland.

## **2004**

- On 23 September, the Issuer floats on the London Stock Exchange with a share price of £2.75 and market capitalisation of £711 million.

## **2005**

- The Group launches MultiCar, enabling UK customers to insure two or more cars on the same policy, with all cars eligible for a discount.

## **2006**

- Balumba.es, Admiral Group's first business in Continental Europe, launches in Seville, selling car insurance direct to customers in the Spanish market.

## **2007**

- AdmiralDirekt.de launches in Cologne, selling car insurance in Germany.
- On 12 December, the Issuer joins the FTSE 100 with a share price of £10.93 and market capitalisation of £2.9 billion.

**2008**

- Conte.it launches in Rome, selling car insurance in Italy.

**2009**

- Rastreator.com, a car insurance price comparison website, launches in Madrid, Spain.
- Elephant Auto Insurance launches in Richmond, Virginia selling car insurance in the United States of America. (Today it operates in Virginia, Maryland, Illinois and Texas.)
- Inspop Technologies launches in Gurgaon, India, to provide IT support to the Group's price comparison operations.

**2010**

- LeLynx, a car insurance price comparison website, launches in Paris, France.
- Chiarezza.it, a car insurance price comparison website, launches in Milan, Italy.
- L'olivier launches in Paris selling car insurance in France.

**2011**

- AdmiralDirekt.de is sold to Itzehoer Versicherung.

**2012**

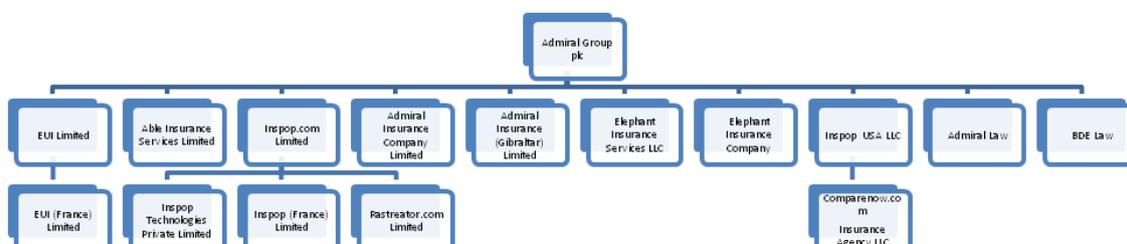
- Chiarezza, the Group's Italian price comparison website, is sold to BlackFin Assurance Courtage.
- Admiral Seguros, the Group's Spanish insurance company, launches a second brand, Qualitas Auto.
- Admiral Solutions opens in New Delhi, India.
- On 18 December, the Group launches UK household insurance.

**2013**

- Comparenow.com, a car insurance price comparison website, launches in Richmond, Virginia, US
- Admiral Law and BDE Law joint ventures are set up to bring the provision of legal services in-house for UK customers.

### 3. ORGANISATIONAL STRUCTURE OF THE GROUP

The Issuer is the holding company of the Group. Included within the Group's assets are its investments in Group companies. Its income and profits principally derive from subsidiary companies in the form of dividends. The following table shows the Group structure including all operating companies:



All companies are wholly owned (directly or indirectly) by the Issuer, except:

- Rastreator.com Limited which is 75% owned by Inspop.com Limited and 25% held by external shareholders.
- Inspop USA LLC, which is 67.8% owned by the Group, and 32.2% by external shareholders. Comparenow.com is a 100% wholly owned subsidiary of Inspop USA LLC.
- Admiral Law, which is 90% owned by the Group, and 10% by external shareholders.
- BDE Law, which is 90% owned by the Group, and 10% by external shareholders.

All companies are registered in England & Wales, except:

- AIGL, registered in Gibraltar.
- Inspop Technologies Private Limited, registered in India.
- Elephant Insurance Services LLC and Inspop USA LLC, registered in Delaware, USA.
- Elephant Insurance Company, registered in Virginia, US.

Further notes:

- EUI Limited has branches in Canada, Italy, Spain and India.
- Admiral Insurance Company Limited has a branch in Spain.
- Inspop.com Limited has a branch in India.
- Rastreator.com Limited has a branch in Spain.
- Inspop (France) Limited and EUI (France) Limited have branches in France.

## 4. OVERVIEW OF THE GROUP'S MARKETS

### A UK car insurance

Car insurance is the only compulsory form of personal insurance in the UK. Under the Road Traffic Act 1988, it is a criminal offence to use a car on public roads without having insurance to cover legal liabilities for injuries to others. Despite the relatively low statutory requirement of "third party personal injury" insurance, the vast majority of private drivers (approximately 90%) in the UK opt for fully comprehensive cover.

The UK private car insurance market is amongst the largest of the UK general insurance lines of business and is one of the largest general insurance markets in the world, with approximately 28.5 million private car policies at 31 December 2013 and £15.3 billion of gross written premiums in the year to 31 December 2013.

The UK car insurance market has historically been cyclical, categorised by periods of shortages of underwriting capacity and favourable premium levels as well as by periods of price competition due to excessive underwriting capacity. The most recent cyclical low point in terms of profitability (defined by the combined ratio) was reached in 2009. Beginning in that same year and continuing throughout 2010, car rates began to rise significantly, though the UK market subsequently entered a period of material rate reductions throughout 2012 and 2013.

The UK private car insurance market is highly competitive, with the five largest competitors accounting for approaching 50% of the overall market in terms of total written premiums.

Market participants can generally be split into three groups: direct insurers; insurance brokers and intermediaries; and distributors, including those who use "white labelling" arrangements with utilities, retailers and affinity groups to distribute products of insurance companies. Originally predominantly a broker market, the emergence of direct insurers in the mid 1980's started a swing from intermediated to direct business and direct insurers now account for nearly two thirds of the total market.

In terms of distribution there has been a shift from telephone to internet and most recently to price comparison delivery to consumers. Approximately 66% of the UK market's private car insurance new business sales were initiated through price comparison websites as at April 2014. There are four main price comparison websites in the UK that feature the products of over 100 car insurance brands. The cost of acquisition for insurers is materially lower via price comparison compared to other traditional means of acquisition (such as advertising on television). Price comparison websites increase price transparency and make the process of comparing prices and policy features and buying insurance more efficient for consumers.

The UK private car insurance industry and its market participants are closely monitored by various regulatory bodies (predominantly the FCA and the PRA in the UK) and in recent years have undergone a large number of regulatory changes. These changes include civil justice reforms aimed at curbing claims inflation and a thematic review into GI add-on products focussed on achieving positive customer outcomes. For further details on the regulatory environment, please refer to the section entitled "*Regulation of the Issuer*".

### B International car insurance

#### *Spain*

The Spanish private car insurance market comprises approximately 22 million vehicles and total premiums of around £8 billion.

The Spanish market has experienced challenging conditions associated with the financial crisis, with a material decrease in the level of total premium in the recent past, as prices have fallen. The market remains competitive.

The market remains dominated by the agent and broker channel, though the share of the direct insurers has grown in recent years, driven by increased media activity and also the emergence of the price comparison sector in Spain.

## ***Italy***

The Italian private car insurance market comprises 37 million vehicles and total premiums of around £17 billion.

Distribution of new business policies via the internet continues to grow steadily and price comparison websites are becoming a more material distribution channel.

## ***France***

The French private car insurance market comprises 32 million vehicles and total premium of around £13 billion.

Customer switching is an accelerating trend with the expansion of the price comparison market and ongoing investment by the operators of websites Les Furets and the Group's LeLynx. Additionally, there are regulatory changes in discussion that have the potential to substantially simplify switching insurers for consumers. The 'Hamon Law', passed by the Senate, is expected to come into effect later in 2014 and this should remove many of the barriers consumers currently face when trying to change car insurer.

## ***US***

The US private car insurance market is the largest in the world, comprising 200 million vehicles and total premiums of around £100 billion. Roughly a quarter of total new business premium in the US market is underwritten by direct insurers, and this continues to grow, with high levels of media spend encouraging consumers to shop around for their insurance. European-style price comparison has to date not been established in the US, and in the meantime direct insurers are engaged in high levels of competition for customers via television advertising.

In terms of pricing and claims inflation, the US car insurance market is less volatile than the UK. US car insurance claims costs are split approximately two thirds property damage and one third bodily injury, almost the opposite of the UK market (this is due to the existence of liability caps in the US motor market). Claims inflation is low and premiums in the market have also been broadly stable in the recent past.

## **C Price comparison**

### ***UK***

The UK car insurance price comparison market is the most mature in Europe, with approximately 66% of new business sales in the UK car insurance market originating via price comparison as at April 2014. Despite material rate reductions in the market for car insurance in 2013, which typically act as a brake on consumer switching, the volume of policies originated via price comparison as a whole grew by nearly 8% during the year.

The UK market is characterised by four main players (including Confused.com) and another five minor players. There is substantial competition within the market, as evidenced by the high levels of advertising spend.

During 2013 the price comparison sector has come under incremental scrutiny from the FCA and the CMA. The results of these reviews are expected later in 2014. Refer to the section entitled "*Regulation of the Issuer*" for further detail on the regulatory environment.

### ***Spain***

Price comparison continues to grow in Spain but the rate of growth slowed in 2013 compared to previous years because of lower advertising spend by the key market participants. The Group's Rastreator brand is the leading price comparison website in Spain (in terms of quotes), and also has brand recognition of 74% (Source: Millward Brown: Comparador de Seguros Rastreator.com, October 2013).

## *France*

Price comparison distribution of car insurance in France is growing quickly, with quote volumes up over 25% in 2013 compared to 2012. As noted above, the 'Hamon Law' is expected to simplify the current complicated process of changing insurer. The Group's LeLynx branded price comparison site has a market-leading position in France (in terms of car insurance quotes returned to customers).

## *US*

European-style price comparison has not been a feature of the US car insurance market to date. Comparenow.com, the Group's price comparison business which launched in 2013 is attempting to introduce European-style price comparison for car insurance into the US market.

## **5. COMPETITIVE STRENGTHS**

The Group has the following key competitive strengths that have enabled it to grow profitably, especially in the UK context, and to deliver loss and expense ratios that have been consistently lower than the market average.

### **A Group**

#### *Company culture*

Motivation of employees is achieved by several methods including encouraging communication and regular measurement and evaluation of staff satisfaction.

Employee share ownership is used to give staff a vested interest in the success of the business. Decision-making is fast and data driven; the culture of the Group embraces frequent tests and changes and enables the Group to adapt quickly.

The Group has received a series of awards in the UK and overseas, demonstrating an ability to export the company culture overseas. These include:

- Sunday Times: 100 Best Companies to Work for, 2001-2014. Ranking in 2014: 2<sup>nd</sup> place in large category;
- Great Place To Work: Best Workplaces in the UK, 2001-2014. Ranking in 2014: 3<sup>rd</sup> place; and
- Great Place To Work: Best Workplaces in Europe, 2009-2014. Ranking in 2014: 3<sup>rd</sup> place.

#### *Experienced management team with strong track record*

Two of the three Executive Directors were founding managers of the Group. The Senior Management team of 41 people has, in aggregate, worked at the Group for 487 years. The management team has substantial experience and a successful track record of delivering profitable, organic growth, introducing innovative business practices, and maintaining a cost-efficient business.

#### *Record of innovation*

The Group has demonstrated its ability to innovate through its products, its multi-brand strategy, and its risk sharing co-insurance and reinsurance arrangements. For example, in the UK, the Group was the first insurer to introduce a 10 month term insurance policy and multi-car insurance (which covers a number of cars on one insurance policy).

In addition, the Group pioneered car insurance price comparison with the launch of Confused.com, which was the first internet insurance price comparison website in the early 2000's. More recently the Group is investing in telematic products in the UK and Italy, which provide data on an existing or potential policyholder's driving abilities, including notification if an accident has occurred. Technology being investigated includes hard-install and self-install telematic devices and mobile applications.

### ***Customer focus***

Providing an excellent service for customers is essential to the future growth of the Group, both in the UK and overseas. All employee incentive schemes are designed in line with the Group's Incentive Policy, which ensures that appropriate emphasis is placed on the quality of service provided to customers. In 2013 the Issuer won two awards voted for by UK consumers:

- Direct Insurer of the Year at the Insurance Times Award; and
- Best Car Insurance Provider at the Personal Finance Awards.

### ***Strong, well capitalised balance sheet***

The Group maintains a level of capitalisation in line with its risk appetite, and manages its balance sheet in accordance with regulatory and other capital metrics. At 31 December 2013, the Group had an IGD surplus of £179 million after deduction of the final 2013 dividend of £138 million, and an IGD coverage ratio of 247% (also after deduction of the final dividend).

Before the proposed issue of the Subordinated Notes, the Group was unleveraged and maintains a cautious investment strategy (refer to the paragraph entitled "*Investment Strategy*" below for further detail on investments).

### ***Efficient use of capital***

The Group manages its capital efficiently by limiting the amount of net (of co-insurance and reinsurance) underwriting risk retained. The Group's business model is based on co-insurance and reinsurance relationships underpinned by strong underwriting results, with the Group itself only providing the capital backing for a minority of its business and therefore producing high returns on equity. The Group's combined ratio in 2013 was 89.1%. During 2013 and in early 2014 the Group announced extensions to its UK co-insurance and reinsurance arrangements with capacity being fully allocated until at least the end of 2016 and Munich Re committed to underwriting 40% of the UK car premium until at least the end of 2018. Similar long-term arrangements are in place in the Group's international insurance and UK household insurance operations.

The Group's business model tends to reduce the solvency requirements for the business retained on its account, allowing an efficient capital structure and leading to a return on equity of 58% in 2013. The reduced solvency requirements mean that less capital is required to fund the growth of the business, giving the Group the potential to deliver both growth and strong cash generation.

## **B UK car insurance**

### ***Low cost structure***

The Group's direct distribution model is cost effective, with the use of low cost distribution channels resulting in acquisition costs of only around 5.4% of the Group's gross written premiums in 2013. The lean management structure, cost conscious culture and geographic location in South Wales all contribute to an industry leading expense ratio. The Group's reported expense ratios for 2012 and 2013 were 13.6% and 15.0% respectively. These ratios compare favourably with the industry averages of 29% and 31% for the corresponding periods.

### ***Direct customer relationships provide cross-selling opportunities***

The Group's direct distribution model, combining telesales along with internet and price comparison channels, allows it to control the sales and distribution process whilst retaining customer ownership. The Group provides customers with opportunities to purchase policy upgrades and services associated with the core car insurance product and revenue from these activities, combined with other fees and commissions, materially contributed to the Group's UK business profit in 2013. In addition in 2012 the Group launched a household insurance product which will provide further cross-selling opportunities. In 2013, the Group set up a Customer Contact Strategy (CCS) team which is intended to create a consistently excellent experience for customers throughout their policy lifetime.

### ***Claims handling expertise***

Due to its direct contact with its customers, the Group has the ability to respond more quickly to a claim than would be possible in an intermediated relationship, increasing the chances of a quicker, less costly settlement and better customer service. The UK claims management processes are efficient and effective and provide strong levels of customer service with over 90% of customers who have experienced a claim feeding back that they would renew with the Group due to the excellent service they received.

The claims function is dynamic and quick to respond to the changing regulatory environment. During 2013 the Group brought the provision of legal services in-house to allow the Group to administer 'non-fault' claims on behalf of customers.

### ***Pricing expertise***

Possessing a high level of competence at pricing is particularly important in a market dominated by price comparison. The Group uses an extensive and detailed set of data to assist in pricing and underwriting decisions. These pricing techniques, together with the Group's flexibility in responding to changing market conditions, have contributed to the Group's superior underwriting performance and profitability with projected ultimate accident year loss ratios of 71% in 2013 and 2012 and 66% in 2011 compared with the industry averages of 78%, 81% and 78% respectively for 2013, 2012 and 2011.

The Group considers it essential to obtain and analyse comprehensive and up-to-date data from its customers to allow it to price its products accurately. The Group also makes extensive use of third party online databases to help provide such data.

Based on the data set, the Group seeks to identify and respond to attractive opportunities, and take steps to acquire customers in these target areas.

### ***Significant, high-quality profit commissions from co-insurance and reinsurance arrangements***

The Group receives profit commissions from its co-insurance and quota share reinsurance partners on a substantial proportion of its business, with the level of commission dependent on the combined ratio achieved on the business generated by the Group. The extensive use of co-insurance and reinsurance provides a degree of resilience to a downturn in the underwriting cycle in the form of risk mitigation as the Group only bears the risk of underwriting losses on its net share of the account.

### ***Limited exposure to underwriting cycle***

The Group tries to mitigate the effects of the UK car insurance underwriting cycle. During the period of premium inflation in 2009 to 2011, the Group's rate increases lagged the market and the Group continued to offer insurance to customers from higher risk segments. As prices have fallen, the Group has again lagged the market and reduced its share of new business volumes.

The Group's conservative approach to reserving means that profits earned are, to a large extent, not recognised immediately, but rather spread over a number of subsequent years, subject to the claims developing as expected. A large proportion of car insurance claims costs relate to large bodily injury claims whose final cost can be impossible to predict accurately in the year they occur. The Group believes it is appropriate to delay recognition of underwriting profit and profit commission until there is a higher degree of certainty in the outcomes for these claims.

This conservative policy means that reserve releases have been a recurring feature of the Group's financial results. In 2013 releases accounted for 14% of profits and equated to 13% of UK car insurance net earned premium. Underwriting profits derived from releases on older, more developed and less volatile years are, in the opinion of the Group, higher quality than underwriting profits reported on current, more immature years of account. The Group has reported reserve releases in its financial statements every year since flotation in 2004, at an average rate of 12% of net earned premium.

## **C International car insurance**

### ***Low cost structure***

In each market into which it has expanded, the Group has established lean and efficient operations with a keen focus on cost control. The Group has leveraged the knowledge, skills and resources attached to the Group's established UK businesses to promote cost-efficient expansion overseas in private car insurance.

### ***Marketing efficiency***

The Group takes care to ensure that its brands are advertised in a way which is as efficient as possible. Using a combination of television and other offline sources, the Group's international businesses make effective use of local understanding of the markets and cost efficiencies and lessons learnt by other Group businesses. A 'test and learn' approach is applied consistently across the Group. For example, in Europe, Admiral Seguros in Spain launched its second brand, Qualitas Auto, to broaden its market appeal.

### ***Direct to consumer distribution channels***

The Group's strategy is founded on a belief that, in the context of distribution of car insurance, the internet is an 'irresistible force'. The direct shopping and price comparison distribution channels are growing in each of the Group's overseas markets. Positioning the Group's overseas brands in these channels should enable the businesses to reach a wider customer base and meet consumer needs effectively.

### ***Focus on pricing***

The Group has made significant efforts to export its pricing expertise from the UK business to each of its overseas operations, adapting its approach according to the different conditions in each local market. The Group's businesses have flexible systems, direct access to data through direct access to the customer, use external databases, take a different perspective on rates, quote for a wider customer base and make more frequent changes. As is the case for the UK market, possessing a strong level of competence in pricing is particularly important in markets in which price comparison is an important distribution channel.

## **D Price comparison**

### ***Record of innovation***

The Group pioneered car insurance price comparison in the UK with the launch of Confused.com, which was the first internet car insurance comparison website. It has subsequently launched price comparison businesses in Spain, Italy (sold in April 2012), France and the US.

### ***Brand creation***

The Group has successfully established the Confused.com (UK), Rastreator (Spain), LeLynx (France) and comparenow.com (US) brands. Confused.com is one of the four main players in the UK market, whilst Rastreator and LeLynx are market leaders in their respective countries. With the 2013 launch of comparenow.com, the Group is attempting to bring the successful European model of insurance price comparison to the US.

### ***Low cost structure and marketing efficiency***

Consistent across the Group, the price comparison business have been established with cost-efficiency in mind. The strategy employed has been to progressively increase investment in the businesses as justified by marketing and sales performance. Price comparison businesses typically become profitable earlier than insurance businesses as they have materially lower fixed overheads. LeLynx, the Group's French price comparison business, returned a profit in its third full year of operation, whilst Rastreator in Spain has been profitable since its second full year.

### ***Deep product understanding of car insurance and strong partner management***

By exploiting expertise from the Group's insurance businesses in the UK and overseas, the price comparison operations have been able to provide a range of services reflective of knowledge already held

in the Group. Insurance expertise is evidenced in the understanding of, and service provided to, the panel partners.

### ***Proven and scalable IT systems***

The businesses were set up with growth in mind and thus are well-positioned from a strategic and systems perspective to take advantage of gaps in the comparison market and additional service offerings. The UK price comparison business, and, to a lesser extent (to date), the businesses in Spain and France, have been able to grow from purely offering car insurance comparison to allowing consumers to compare a range of general insurance and financial services products.

### ***Ownership structure***

25% of Rastreator and approximately 32% of comparenow.com are owned by third parties, to share the risk of starting new operations.

## **6. BUSINESS MODEL AND STRATEGY**

### **A Business Model**

The Group has a central business model that is core to each of the Group's businesses irrespective of product offering or geographical location. The objectives of the individual businesses are aligned with the model set out below.

The Group's strategy is intended to attract, keep, satisfy and ensure customers get value for money.

The Group makes significant efforts to make the Group and its offices an attractive place to work. There are four pillars to the Group's culture with regards to its employees: communication, equality, reward and fun.

The Group's employee share schemes are an important part of this culture, aligning the interests of staff with those of the Group and its shareholders. Every member of staff gets the same award in the Group's core share scheme, with a further share scheme providing additional awards to a large group of managers and star performers.

### ***Risk aversion***

A core part of the Group's strategy is to share risk and reward where possible, either to limit downside risk (especially in start-up situations) or to reduce the level of capital the Group is required to hold for a particular business.

This means the Group has a number of important, long-term strategic partners which are involved with the Group either through co- or reinsurance contracts, or minority ownership of subsidiaries. These partners include Munich Re, Swiss Re and Mapfre and others.

The reduced capital requirements that result from significant use of co-insurance and reinsurance coupled with high-levels of profitability in the UK car insurance business also lead to high return on capital ratios.

### ***Profit focus***

The Group is focused on bottom-line profitability in the short, medium and long term. Indicators such as total premium, turnover, growth and market share are by-products, not drivers, of decisions and strategy.

### ***Distribution***

As noted above, the Group's strategy is founded on the belief that in the context of distribution of car insurance, the internet is an 'irresistible force'.

## **B Strategy**

### ***UK car insurance***

The strategy for the Group's core UK car insurance business is:

- to grow profitably its share of the UK private car insurance market whilst maintaining a capital-efficient structure; and
- to always give excellent service to customers, whilst providing a positive environment in which staff can work and develop.

### *International Car Insurance*

An important element of Group strategy is to exploit the knowledge, skills and resources attached to the Group's established UK businesses to promote expansion overseas in private car insurance. The Group's objective is to create profitable, sustainable and growing businesses, aiming where possible to minimise any negative financial impact on the Group.

### *Price comparison*

The core objective of all the price comparison businesses is to provide consumers with a valuable service that saves them time and, where possible, money. This service is not limited to car insurance comparison or even insurance comparison. It also covers a range of financial services products.

In the UK, Confused.com's strategy is focused on car insurance comparison and is aimed at making Confused.com the most competitive car insurance price comparison website in the UK market.

In the Group's international price comparison businesses, a key part of the Group's overall strategy is to exploit its UK expertise in price comparison and export this overseas. To date the Group has targeted four markets (Spain, France, Italy and the US), with the Italian operation (Chiarezza.it) disposed of in April 2012.

## **7. THE BUSINESS**

### **A Overview – Products, Brands, Sales and Distribution**

The Group's business is presented in three segments:

#### *UK car insurance*

The Group is one of the largest and most profitable private car insurance groups in the UK, with 3.1 million in-force policies as at 30 June 2014. The table below provides some key metrics on the UK business as at, and for the years ended, 31 December 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Turnover (£m).....	1,698.9	1,936.2	1,966.0
Pre-tax profit (£m).....	393.9	372.8	313.6
Vehicles insured (m).....	3.02	3.02	2.97

#### *Products*

The Group's core business is selling and underwriting private car insurance in the UK through four brands – Admiral, Bell, Diamond and elephant.co.uk.

In addition to core car insurance, the Group offers additional covers including enhanced personal injury cover and breakdown cover.

#### *Distribution*

Policies are distributed through price comparison websites and direct channels (the Group's own websites and the telephone). The business has UK call centres in Cardiff, Newport and Swansea and also services customers from overseas centres in Halifax, Canada, Bangalore and New Delhi, India. Internet-originated sales represent the large majority of business for the Group.

The Group's ability to generate high volumes of quotes at low cost allows it to be selective in the risks it underwrites. This means the Group can operate at lower levels of conversion than other market participants and helps it achieve better than market average loss ratios.

The Group markets its products through various media channels, including television and other offline media and also online through price comparison and other internet marketing channels. The largest component of the Group's acquisition costs is price comparison fees paid to the websites for lead generation. The Group concentrates its relatively limited traditional marketing on direct response advertising, predominantly for its Admiral MultiCar product offering.

These low-cost methods of distribution have contributed to the Group achieving reported expense ratios significantly lower than the market average.

### ***International car insurance***

The Group is investing in building growing, profitable and sustainable car insurance businesses in Spain, Italy, US and France. These businesses currently represent less than 15% of the Group's revenue and customer base. The businesses are:

- Admiral Seguros (Seville, Spain): the most mature of the Group's international businesses, having traded since October 2006. The business currently operates through two brands – Balumba and Qualitas Auto;
- ConTe (Rome, Italy): launched in May 2008, ConTe is the largest of the non-UK insurers within the Group;
- Elephant Auto (Richmond, Virginia, US): launched in October 2009 and provides car insurance in four US states (Virginia, Maryland, Illinois and Texas) with a market size greater than the UK; and
- L'olivier Assurances (Paris, France): the Group's youngest (and smallest) international insurance business, launched in December 2010.

The table below provides some key metrics on the international businesses as at and for the years ended 31 December 2013, 2012 and 2011:

	<b>2013</b>	<b>2012</b>	<b>2011</b>
Turnover (£m).....	187.8	162.9	122.2
Pre-tax profit/(loss) (£m).....	(22.1)	(24.5)	(9.5)
Customers .....	515,000	436,000	306,000

### ***Products***

The product offerings of the international businesses are generally consistent with the UK, being private car insurance along with additional covers including personal injury cover and breakdown cover.

### ***Distribution***

The overseas businesses follow similar distribution channels to the UK with products sold directly to customers over the phone and through own-branded websites along with sales via price comparison websites. The use of price comparison is not as mature as in the UK market and as such this is a less established distribution method than for the UK brands.

The core product is marketed through television and other offline marketing channels and also online through price comparison and other internet marketing channels.

### ***Price comparison***

The Group operates price comparison businesses in the UK, Spain, France and the US:

- Confused.com (UK) is predominantly an insurance and financial services comparison website. Operating in the UK, the site allows consumers to compare a range of general insurance and financial services products across price and policy benefits. Confused.com's income is primarily generated from commissions paid by the product provider on the sale of an insurance policy or financial product;

- Rastreator (Spain) offers comparison on car, home, motorcycle and life insurance and also telephony products;
- LeLynx (France) offers comparison on car and health insurance and various other financial services products; and
- comparenow.com (US) offers comparison on car insurance.

The table below provides some key metrics on the businesses as at and for the years ended 31 December 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Turnover (£m).....	112.7	103.5	90.4
Pre-tax profit/(loss) (£m).....	20.4	18.0	10.5
Customer quotes (m) .....	18.7	17.5	14.9

#### *Products*

The Group has four price comparison businesses. In addition to core car insurance price comparison, the businesses offer comparison of a range of financial and non-financial products including home insurance, life insurance, credit cards, utilities and telephony (as noted above).

#### *Distribution*

The core product is marketed through television, other offline marketing channels and through internet marketing channels. If customers decide to complete a purchase the price comparison website receives a fee from the product provider.

#### *Other Group items*

Other Group items includes UK household insurance and UK commercial vehicle insurance broking and other central costs including the Group's staff share scheme costs.

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Turnover (£m).....	30.8	12.5	11.7
Pre-tax profit/(loss) (£m).....	(22.0)	(21.7)	(15.5)
Gladiator customers.....	118,000	95,000	88,000

#### *Products*

In addition to core household insurance and commercial vehicle insurance broking, the Group offers additional covers including home emergency cover and family legal protection.

#### *Distribution*

Products are sold directly to customers over the phone and through own-branded websites. The core products are marketed online through price comparison and other internet marketing channels.

#### *Other Revenues*

##### *UK car insurance*

The Group generates other revenue from a portfolio of insurance products that complement the core car insurance product, and also from fees generated over the life of the policy ("**Other Revenue**").

The most material contributors to Other Revenue within the financial statements are:

- profit earned from car policy upgrade products (some underwritten by the Group, including breakdown, car hire and personal injury covers, some underwritten outside the Group);
- vehicle Commission;
- fees – administration fees and referral income; and

- instalment income – interest charged to customers paying for cover in instalments.

*Car policy upgrade products underwritten by the Group, including breakdown, car hire and personal injury covers*

The Group offers a range of policy upgrades that complement the core car insurance product, such as breakdown cover, personal accident protection and car hire cover. Policy upgrades are available to purchase when policies are purchased online. The Group contact centre agents are also trained to offer appropriate products when customers complete their purchase on the telephone.

Part of the price paid by customers in respect of policy upgrade products is recognised as commission income at the point of sale by the Group's intermediary company, EUI Limited. The remainder is accounted for as underwriting premium by AIGL.

*Commission earned from car policy upgrade products not underwritten by the Group*

Certain policy upgrade products, including instalment payment protection and motor legal expenses insurance, are underwritten by third party underwriters.

Whilst motor legal expenses cover has been a standard benefit provided at no charge on all policies sold since April 2012, the Group has commenced a test to understand the impact of removing the standard cover from policies and offering an enhanced product to customers for an additional premium.

*Vehicle commission*

With effect from April 2012, the Group has charged its panel of co-insurance and reinsurance partners a vehicle commission, which is recognised at the point of sale and included within 'Other Revenue'.

*Fees – administration fees and referral income*

Administration fees constitute fees charged to customers for processing mid-term policy amendments and policy cancellations.

Referral fee income includes income derived from credit hire referrals and, until they were banned in April 2013, personal injury referral fees.

Please also see the section headed "*CMA - UK car insurance business and price comparison business*".

*Instalment income*

Instalment income is interest charged to customers paying for their insurance in instalments, and is calculated as a percentage of the premium payable by the customer.

*Admiral Law and BDE Law*

In 2013 the Group entered into two new joint ventures with law firms Lyons Davidson and Corder Lewis Solicitors to form Admiral Law Limited and BDE Law Limited, respectively (the Group owns 90% of both entities). Both ventures were granted ABS licences by the SRA effective from 1 May 2013. The Group is committed to providing its customers with the best possible service. Bringing the provision of legal services in-house has allowed the Group to administer 'non-fault' claims throughout the process. New and proposed reforms to the handling of bodily injury claims mean that the businesses are not expected to make a material contribution to Group profits in the foreseeable future.

*International car insurance*

The Group's businesses in Spain, Italy, US and France also generate Other Revenue from a portfolio of insurance products that complement the core car insurance product, and also fees generated over the life of the policy.

The most material contributors to net Other Revenue are:

- car policy upgrade products not underwritten by the Group, including breakdown, car hire and personal injury covers;

- fees – administration fees and referral income; and
- instalment income.

#### *Other Group Items*

##### *Gladiator*

Gladiator Commercial is a commercial vehicle insurance broker, offering car insurance and ancillary products from a panel of leading commercial vehicle insurers. It was launched in April 1998 and employs over 200 staff and, as at 30 June 2014, has 145,000 customers. As well as commercial van insurance, Gladiator Commercial arranges cover for public and employer's liability, shop retail and small business packages. Gladiator is a trading name of Able Insurance Services Ltd, which is part of the Group.

Gladiator Commercial operates under a collection of agency agreements with its panel of insurers. Gladiator Commercial receives commission on each policy sold. Gladiator Commercial made a contribution of £2.5 million to the Group profit the year ending 31 December 2013.

##### *Household*

UK household insurance was launched in December 2012 under the Admiral brand. The product is underwritten within the Group and in common with other businesses it is supported by proportional reinsurance covering 70% of the risk (shared between Munich Re, 40% and Swiss Re, 30%). In addition the Group has purchased excess of loss reinsurance to mitigate the impact of catastrophe event claims. At the end of the first 12 months of trading, Admiral Household's total loss before tax was £0.1 million.

#### **Underwriting income and profit commission**

Since the commencement of the 2003 underwriting year, the Group's underwriting activities have been carried on by AIGL and AICL. Each of AIGL and AICL has appointed EUI Limited as its agent for the purposes of effecting and carrying out contracts of insurance. AIGL, AICL and EUI Limited are all wholly-owned subsidiaries of the Issuer.

In 2009, upon commencement of writing business in the US, Elephant Insurance Company is the Group's active underwriter in the US. Elephant Insurance Services LLC is the US agent.

##### *Group Underwriting*

The Group's total premiums written in 2013 were £1,737.6 million, with underwriting profits from its net retained business amounting to £105.7 million and profit commissions from co-insurers and reinsurers amounting to £99.3 million.

##### *UK car insurance*

The Group earns underwriting income on core car product and additional products underwritten.

##### *Split of underwriting profit*

	<u>2013</u>	<u>2012</u>	<u>2011</u>
		<i>£m</i>	
Car.....	121.8	59.6	47.0
Additional products .....	12.3	4.8	—
<b>Underwriting profit .....</b>	<b><u>134.1</u></b>	<b><u>64.4</u></b>	<b><u>47.0</u></b>

In the UK the Group has outperformed the UK car insurance market average each year since 1998 in both loss and expense ratios.

### UK Profit commission

The Group is potentially able to earn material amounts of profit commission revenue from co-insurance and reinsurance partners, depending on the profitability of the business. Revenue is recognised in the income statement in line with the booked loss ratios on the Group's retained underwriting.

	<b>31 December 2013</b>	<b>31 December 2012</b>
	<i>£m</i>	
<b>Underwriting year:</b>		
2009 & prior .....	3.1	(2.3)
2010 .....	24.9	9.4
2011 .....	26.7	98.1
2012 .....	44.6	3.2
<b>Total profit commission .....</b>	<b>99.3</b>	<b>108.4</b>

When a quota share reinsurance contract is commuted (i.e. terminated early in return for an agreed payment, typically after two or three years from the start of an underwriting year), further improvement or deterioration in claims costs are reported within net claims. If the contracts were not commuted, the movement would be reported in profit commission.

### International car insurance

The Group's operations in Spain, Italy, US and France are currently loss making:

	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<i>£m</i>		
Underwriting result.....	(27.9)	(33.4)	(17.1)

### Other Group Items

UK household insurance was launched in December 2012 under the Admiral brand. The product is underwritten within the Group and in common with other businesses it is supported by proportional reinsurance covering 70% of the risk (shared between Munich Re, 40% and Swiss Re, 30%).

	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<i>£m</i>		
Underwriting result.....	(0.5)	—	—

### Proportional underwriting arrangements

Sharing a proportion of underwriting risk with co-insurance and quota share reinsurance partners has been an important component of the Group's underwriting model since the 2000 underwriting year. Through proportional underwriting arrangements, the Group limits the amount of underwriting risk retained, allowing it to increase capital efficiency, whilst benefiting from profit commission payments where the business written is profitable. Co- and reinsurers also bear their proportional shares of claims expenses and hence provide protection should results worsen substantially.

The Group seeks to develop strong relationships with its co-insurance and reinsurance partners, for example, through multi-year co-insurance and reinsurance contracts. As an example, the Group's relationship with Munich Re was initiated in 1999, with Munich Re's participation commencing at the start of the 2000 underwriting year. Under the current terms of the co-insurance agreement, this relationship extends until at least 2018.

### UK car insurance – co-insurance and reinsurance

#### Arrangements for 2013 to 2016

In early 2014 the Group announced extensions to its arrangements such that capacity is fully placed until the end of 2016. The underwriting splits can be summarised as follows:

	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
The Group .....	25.00%	25.00%	25.00%	25.00%
Great Lakes (Munich Re) .....	40.00%	40.00%	40.00%	40.00%
New Re .....	13.25%	13.25%	12.25%	12.25%
Hannover Re .....	8.75%	8.75%	8.75%	8.75%
Swiss Re .....	7.50%	9.00%	9.00%	9.00%
Mapfre Re .....	3.00%	4.00%	5.00%	5.00%
XL Re .....	2.50%	—	—	—
<b>Total .....</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

The proportion underwritten by Great Lakes (a UK subsidiary of Munich Re) is on a co-insurance basis, such that 40% of all car premium and claims for the 2013 year accrues directly to Great Lakes and does not appear in the Group's income statement. Similarly, Great Lakes reimburses the Group for its proportional share of expenses incurred in acquiring and administering the car business.

Great Lakes will underwrite 40% of the UK business until at least the end of 2018. The Group has agreed to retain at least 25% for the duration (any amendment to this is subject to agreement with Great Lakes), whilst the allocation of the balance is at the Group's discretion.

All other agreements are quota share reinsurance.

The Group has options to commute quota share reinsurance contracts and typically does so after two or three years of an underwriting year's development when there is a reasonably certain view on the year's outcome. There is little or no impact on profit or the timing of profit recognition from commutation.

After commutation, movements in booked loss ratios result in reduced or increased net claims costs (and not profit commission).

At 31 December 2013, all material UK quota share reinsurance contracts for underwriting years up to and including 2010 have been commuted. For the 2011 year, of the original 32.5% of the business that was reinsured, contracts covering 27.5% of the business have been commuted. All reinsurance for the 2012 and 2013 years remains in effect (as at 31 December 2013).

Co-insurance and reinsurance arrangements expose the Group to two key risks:

- the risk of reduced availability of co-insurance and reinsurance arrangements; and
- credit risk of significant counterparties through default of a reinsurer.

#### ***International car insurance co-insurance and reinsurance***

For the 2013 year the Group retained 35% (Italy), 30% (France and Spain) and 33% (US) of the underwriting risk respectively.

The arrangements for 2014 will remain the same, other than in Italy, where Munich Re will retain 40% of the risk, down from 65% in 2013, and Swiss Re will reinsure the remaining 25%.

All contracts are subject to certain caps on the reinsurers' exposures and all contracts have profit commission terms that allow the Group to receive a proportion of the profit earned on the underwriting once the business reaches cumulative profitability. The contracts include proportional sharing of Other Revenue.

#### ***UK household insurance reinsurance***

UK household insurance was launched in December 2012 under the Admiral brand. The policies are underwritten within the Group and in common with other businesses; it is supported by proportional reinsurance covering 70% of the risk (shared between Munich Re, 40% and Swiss Re, 30%).

#### ***Further detail***

The following table is relevant for the 2014 underwriting year.

	UK	UK	Italy	Spain	France	US
	Car Insurance	Household Insurance	Car Insurance	Car Insurance	Car Insurance	Car Insurance
<b>Primary Insurer &amp; Share:</b>						
Admiral Insurance (Gibraltar) Limited ....	52.50%	100.00%	45.00%	—	—	—
Admiral Insurance Company Limited .....	7.50%	—	45.00%	100.00%	—	—
Elephant Insurance Company .....	—	—	—	—	—	100.0%
Great Lakes Reinsurance (UK) Plc .....	40.00%	—	10.00%	—	—	—
<b>Totals</b> .....	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>—</b>	<b>100.0%</b>
<b>The Group gross share</b> .....	<b>60.00%</b>	<b>100.00%</b>	<b>90.00%</b>	<b>100.00%</b>	<b>—</b>	<b>100.00%</b>
<b>Quota Share Reinsurance: (%s of whole account)</b>						
New Re .....	13.25%	—	—	—	—	—
Hannover Re .....	8.75%	—	—	—	—	33.3%
Swiss Re .....	9.00%	30.00%	25.00%	35.00%	—	—
Mapfre Re .....	4.00%	—	—	—	—	—
Munich Re .....	—	40.00%	30.00%	35.00%	—	33.3%
<b>Total quota share</b> .....	<b>35.00%*<sup>1</sup></b>	<b>70.00%</b>	<b>55.00%*<sup>2</sup></b>	<b>70.00%</b>	<b>—</b>	<b>66.7%</b>
AIGL net share .....	17.50%	30.00%	17.50%	—	—	—
AICL net share .....	7.50%	—	17.50%	30.00%	—	—
EIC net share .....	—	—	—	—	—	33.3%
<b>The Group net retained share</b> .....	<b>25.00%</b>	<b>30.00%</b>	<b>35.00%</b>	<b>30.00%</b>	<b>—</b>	<b>33.3%</b>

Note: The Group reinsures 70% of the French car insurance premium to a panel of quota share reinsurers.

\*<sup>1</sup> Reinsured in respect of UK car = AIGL

\*<sup>2</sup> Quota share split equally between AIGL and AICL

## 8. FINANCIAL INFORMATION

### A Summary Financial Information

#### *Group results and dividend for the year ended 31 December 2013*

- Profit before tax increased by 7% to £370.2 million (2012: £344.6 million).
- UK car insurance profit increased by 6% to £393.9 million (2012: £372.8 million).
- International car insurance losses totalled £22.1 million (2012: £24.5 million).
- Price comparison profit increased by 13% to £20.4 million (2012: £18.0 million).
- Other Group items, including the employee share schemes, amounted to a cost of £22.0 million (2012: £21.7 million).

Further details by segment are set out below.

Earnings per share increased by 10% to 104.6 pence (2012: 95.1 pence). The increase is higher than the 7% increase in pre-tax profit due to the lower effective rate of corporation tax in 2013. Customer numbers were 4% higher at the end of 2013 at 3.70 million (2012: 3.55 million).

Total dividends paid and proposed for the financial year amounted to 99.5 pence per share (£272 million), an increase of 10% on the previous year (2012: 90.6 pence; £245 million). This was equal to 95% of earnings per share. The final dividend was 50.6 pence per share (11% higher than the final 2012 dividend of 45.5 pence).

The final dividend was made up of a 24.4 pence normal element, based on the stated dividend policy of distributing 45% of post-tax profits, and a further special element of 26.2 pence. The special dividend was calculated with reference to distributable reserves after taking into account required solvency and a margin for contingencies.

## B Divisional Performance Highlights – Year Ended 31 December 2013

The Group's UK car insurance business accounted for 84% of Group turnover (2012: 87%) and 82% of customers (2012: 85%). In 2013, in the face of very strong competition in the UK market, the business continued to focus on margin rather than growth and held the number of vehicles insured steady at just over three million. Supported by strong releases from prior year claims reserves on the back of continued positive development in projected claims costs, the combined ratio of the Group's UK car insurance business improved to 81.0% (2012: 89.1%) and profit before tax was £393.9 million – up 6% on 2012's result of £372.8 million.

A focus on lower premium, lower risk business, alongside a growing contribution to the total from renewal customers, contributed to a reduction in UK turnover of 12% to £1,698.9 million (2012: £1,936.2 million).

Outside of the UK, the Group's international car insurance businesses continued to develop, with combined turnover rising 15% to £187.8 million (2012: £162.9 million) and customer numbers surpassing 515,000 – an increase of 18% on a year earlier. The combined loss from the operations was lower at £22.1 million (2012: £24.5 million), primarily due to improved claims experience.

Confused.com, the Group's UK price comparison business, reported a pre-tax profit of £21.7 million – over £3 million higher than 2012's result. Outside the UK, the Group's other European price comparison businesses made a combined profit of £2.4 million (2012: loss of £0.2 million). During the year the Group invested £3.7 million in comparenow.com, a new car insurance comparison business being built in the US.

Other Group key performance indicators included:

- Group loss ratio 69.2% (2012: 79.2%) (an improved UK loss ratio resulting from higher reserve releases and an improved international loss ratio);
- Group expense ratio 19.9% (2012: 17.7%) (a slight increase in the UK ratio due to lower average premiums and an improved but high international ratio); and
- Group combined ratio 89.1% (2012: 96.9%).

## C Investments and cash

### *Investment strategy*

The Group maintained a low-risk investment strategy throughout 2012 and 2013, with a broadly consistent allocation of funds to the three main asset categories (cash at bank, cash deposits and money market funds) as in recent years.

The key focus of the Group's investment strategy is capital preservation, with additional priorities including low volatility of returns and high levels of liquidity. All objectives continue to be met.

The Group's Investment Committee continues to perform regular reviews of the strategy to ensure it remains appropriate.

### *Cash and Investments Analysis*

	2012	2013
	<i>£m</i>	
Money market funds and short-dated debt securities.....	1,225.8	1,608.5
Cash deposits .....	375.8	288.4
Cash .....	216.6	187.9
<b>Total .....</b>	<b>1,818.2</b>	<b>2,084.8</b>

The only notable change in asset allocation during 2013 was a higher proportion invested in money market funds and short-dated debt securities and a move away from cash deposits compared to 2012.

Money market funds and short-dated debt securities comprised the majority of the total; 77% at 31 December 2013, up from 67% at 31 December 2012.

Investment and interest income in 2013 was £14.3 million, down 10% on 2012 (£15.9 million). The reduction was due to the rate of return being slightly lower at 0.7% than in 2012 (0.9%).

The Group continues to generate substantial amounts of cash, and its capital-efficient business model enables the distribution of the majority of post-tax profits as dividends.

	<u>2011</u>	<u>2012</u>	<u>2013</u>
		<i>£m</i>	
Operating cash flow, before transfers to investments .....	779.1	742.0	616.8
Transfers to financial investments.....	(493.9)	(441.9)	(295.3)
Operating cash flow .....	285.2	300.1	321.5
Tax and interest payments .....	(95.3)	(79.7)	(88.5)
Investing cash flows (capital expenditure).....	(12.9)	(10.9)	(10.1)
Financing cash flows (largely dividends).....	(198.1)	(214.8)	(250.3)
Foreign currency translation impact.....	(1.0)	(2.7)	(1.3)
Net cash movement .....	(22.1)	(8.0)	(28.7)
<b>Net increase in cash and financial investments .....</b>	<b><u>473.8</u></b>	<b><u>434.5</u></b>	<b><u>266.6</u></b>

The main items contributing to the significant operating cash inflow were as follows:

	<u>2011</u>	<u>2012</u>	<u>2013</u>
		<i>£m</i>	
<b>Profit after tax .....</b>	<b>221.3</b>	<b>258.4</b>	<b>286.9</b>
Change in net insurance liabilities.....	244.3	200.0	186.2
Net change in trade receivables and liabilities .....	203.7	163.0	22.3
Non-cash income statement items .....	32.0	34.4	38.1
Tax and net interest expense.....	77.8	86.2	83.3
<b>Operating cash flow, before transfers to investments .....</b>	<b><u>779.1</u></b>	<b><u>742.0</u></b>	<b><u>616.8</u></b>

The key features to note were:

- Total cash plus investments increased by £267 million or 15% (2012: £435 million, 31%), the lower rate of growth resulted from lower growth in the UK business; somewhat offset by higher growth internationally.
- The net change in actual cash balances was small, as funds were transferred into investments.

## **D Capital Structure and Financial Position**

The Group's capital-efficient and profitable business model led to return on capital employed of 58% (2012: 60%). As noted earlier, a key feature of the business model is the extensive use of co-insurance and reinsurance across the Group. During 2013 and in early 2014 the Group announced extensions to its UK co-insurance and reinsurance arrangements with capacity fully allocated until at least the end of 2016 and Munich Re committed to underwriting 40% until at least the end of 2018. Similar long-term arrangements are in place in the Group's international insurance operations and UK Household business.

The Group continues to manage its capital to ensure that all entities within the Group are able to continue as going concerns and also to ensure that regulated entities comfortably meet regulatory capital requirements. Surplus capital within subsidiaries is paid up to the Issuer in the form of dividends on a regular basis.

The majority of the Group's capital requirement is derived from its European insurance operations, AIGL and AICL. The minimum capital requirement ("MCR") and surplus position at the end of 2013 for those companies, along with the overall Group position was as follows:

	<u>AIGL</u>	<u>AICL</u>	<u>Group</u>
		<i>£m</i>	
Net assets less goodwill.....	£165m	£73m	£453m
MCR.....	£77m	£27m	£122m
<b>Surplus over minimum requirement</b> .....	<b>£88m</b>	<b>£46m</b>	<b>£331m</b>
Total regulatory capital requirement.....			£283m <sup>†2</sup>
<b>Surplus over regulatory capital requirement<sup>†1</sup></b> .....			<b>£170m</b>

<sup>†1</sup> Before accounting for the 2013 Final Dividend of £139.6 million.

<sup>†2</sup> This being the aggregate of the individual capital requirements of each of AICL, AIGL and Elephant Auto.

The Group continues, and remains on track, with its Solvency II implementation plan to ensure compliance with the full requirements and guidelines. See the section headed "*Solvency II and Capital*".

## E Taxation

The tax charge reported in the income statement was £83.3 million (2012: £86.2 million), which equated to 22.5% (2012: 25.0%) of profit before tax. The lower effective rate of taxation compared to 2012 predominantly results from reductions in the rate of UK Corporation Tax in 2012 and 2013. The average rate of UK Corporation Tax in 2013 was 23.25% (2012: 24.5%). The average rate will fall to 21.5% in 2014 and 20.25% in 2015.

*The Group's results are presented in three segments – UK car insurance, international car insurance and price comparison. Other Group items are summarised in a fourth section.*

## F UK car insurance financial performance

### *Non-GAAP<sup>\*1</sup> format income statement*

	<u>2011</u>	<u>2012</u>	<u>2013</u>
		<i>£m</i>	
Turnover <sup>*2</sup> .....	1,966.0	1,936.2	1,698.9
Total premiums written <sup>*3</sup> .....	1,728.8	1,748.7	1,553.0
Net insurance premium revenue.....	418.6	455.6	425.1
Investment income.....	10.6	13.9	12.4
Net insurance claims.....	(335.5)	(355.1)	(251.3)
Net insurance expenses.....	(46.7)	(50.0)	(52.1)
<b>Underwriting profit</b> .....	<b>47.0</b>	<b>64.4</b>	<b>134.1</b>
Profit commission.....	61.8	108.4	99.3
<b>Underwriting profit plus profit commission</b> .....	<b>108.8</b>	<b>172.8</b>	<b>233.4</b>
Net other income.....	181.5	170.9	136.8
Instalment income.....	23.3	29.1	23.7
<b>UK car insurance profit before tax</b> .....	<b>313.6</b>	<b>372.8</b>	<b>393.9</b>

<sup>\*1</sup> GAAP = Generally Accepted Accounting Practice.

<sup>\*2</sup> Turnover (a non-GAAP measure) comprises total premiums written and Other Revenue.

<sup>\*3</sup> Total premiums written (non-GAAP) includes premium underwritten by co-insurers.

### *Split of underwriting profit*

	<u>2011</u>	<u>2012</u>	<u>2013</u>
		<i>£m</i>	
Car.....	47.0	59.6	121.8
Additional products.....	—	4.8	12.3
<b>Underwriting profit</b> .....	<b>47.0</b>	<b>64.4</b>	<b>134.1</b>

### *Key performance indicators*

	<u>2011</u>	<u>2012</u>	<u>2013</u>
Reported car loss ratio <sup>*1</sup> .....	77.9%	76.4%	68.0%

	2011	2012	2013
Reported car expense ratio <sup>*2</sup> .....	14.0%	13.6%	15.0%
Reported car combined ratio .....	91.9%	90.0%	83.0%
Written basis car expense ratio .....	13.2%	13.0%	14.5%
Reported total combined ratio <sup>*3</sup> .....	91.9%	89.1%	81.0%
Claims reserve releases – original net share <sup>*4</sup> .....	£7.8m	£16.3m	£53.3m
Claims reserve releases – commuted reinsurance <sup>*5</sup> .....	£2.5m	£1.3m	£40.9m
Total claims reserve releases .....	£10.3m	£17.6m	£94.2m
Vehicles insured at year end .....	2.97m	3.02m	3.02m
Other Revenue per vehicle .....	£84	£79	£67

<sup>[\*1]</sup> Car loss ratio adjusted to exclude impact of reserve releases on commuted reinsurance contracts.

<sup>[\*2]</sup> Car expense ratio is calculated by including claims handling expenses that are reported within claims costs.

<sup>[\*3]</sup> Reported total combined ratio includes additional products underwritten by the Group.

<sup>[\*4]</sup> Original net share shows reserve releases on the proportion of the portfolio that the Group wrote on a net basis at the start of the underwriting year in question.

<sup>[\*5]</sup> Commuted reinsurance shows releases on the proportion of the account that was originally ceded under quota share reinsurance contracts but has since been commuted and hence reported through underwriting and not profit commission.

### ***UK car insurance financial performance***

As noted in the Group's interim 2013 results, after significant rate increases in 2010 and 2011, the UK car insurance market is now in its second year of being more price competitive. The Group's UK business has maintained a stable vehicle count and has focused on margin rather than seeking to grow market share.

#### ***Profit***

Profit from UK car insurance increased 6% to £393.9 million (2012: £372.8 million). Profit from underwriting and profit commission increased 35% to £233.4 million (2012: £172.8 million), resulting largely from an improved combined ratio. The combined ratio improvement was largely due to higher reserve releases that resulted from positive claims development. The increase in profit from underwriting and profit commission was offset by a 20% reduction in net other income and instalment income to £160.5 million (2012: £200.0 million).

#### ***Turnover and premiums***

UK turnover of £1,698.9 million decreased by 12% (2012: £1,936.2 million) primarily due to reductions in average premiums which led to a 11% reduction in total premiums written to £1,553.0 million (2012: £1,748.7 million). The closing vehicle count was stable at 3.02 million (2012: 3.02 million). Average written premium for the year was around £505 down 13% on 2012 (2012: £580). The reduction in average premium was largely a result of rate cuts of around 10% (year-on-year) on average across new business and renewal business combined with portfolio mix changes.

#### ***Underwriting result and profit commission***

The UK car insurance combined ratio improved by around seven percentage points in 2013 as follows:

<b>UK car insurance combined ratio</b>	2012	2013
Loss ratio excluding reserve releases from original net share and commuted reinsurance .....	80.1%	81.2%
Reserve releases – original net share .....	3.7%	13.2%
<b>Loss ratio net of releases – original net share <sup>*1</sup> .....</b>	<b>76.4%</b>	<b>68.0%</b>
Expense ratio .....	13.6%	15.0%
<b>Combined ratio – original net share <sup>*1</sup> .....</b>	<b>90.0%</b>	<b>83.0%</b>

<sup>[\*1]</sup> Ratios calculated on original net share uses the proportion of the portfolio that the Group wrote on a net basis at the start of the underwriting year in question.

There was an improvement in the reported car combined ratio, which reduced to 83.0% (2012: 90.0%) (both figures exclude the impact of reserve releases from commuted reinsurance contracts). The improvement was driven by a reduction in the reported loss ratio to 68.0% (2012: 76.4%), which was due to materially higher reserve releases (£53.3 million v £16.3 million). These higher releases were possible

due to the positive claims experience during 2012 and 2013 which resulted in improvements in the projected ultimate loss ratios, especially for the 2010 to 2012 underwriting years.

Excluding reserve releases, the loss ratio increased slightly to 81.2% (2012: 80.1%), largely due to the impact of falling premiums.

The earned car expense ratio increased to 15.0% from 13.6% due to the reduction in average written premiums. The reduction in average written premiums was also the main reason the written basis expense ratio increased to 14.5% from 13.0%.

The projected ultimate loss ratio for the Group for the 2013 accident year is 71%, in line with 2012. During 2013, falling premiums were offset by a reduction in claims costs.

The projected ultimate combined ratio (ultimate loss ratio plus written expense ratio) for the Group for the 2013 accident year is 85%, compared to 84% for 2012, resulting from an increased expense ratio.

### ***Profit commission***

The Group is potentially able to earn material amounts of profit commission revenue from co-insurance and reinsurance partners, depending on the profitability of the business. Revenue is recognised in the income statement in line with the booked loss ratios on the Group's retained underwriting.

In 2013 the Group recognised profit commission revenue of £99.3 million (2012: £108.4 million) and reserve releases from business that was originally ceded under quota share reinsurance contracts that have since been commuted of £40.9 million (2012: £1.3 million). Total income from both of the above therefore increased by 28% to £140.2 million (2012: £109.7 million) due to improvements in prior year claims costs and the earning of the 2012 underwriting year.

When a quota share reinsurance contract is commuted (typically after two or three years from the start of an underwriting year), further improvement or deterioration in claims costs are reported within net claims. If the contracts were not commuted, the movement would be reported in profit commission.

Total profit from car insurance underwriting of £121.8 million and profit commission of £99.3 million increased significantly, by 32% to £221.1 million from £168.0 million in 2012.

### ***Other Revenue***

The Group generates other revenue from a portfolio of insurance products that complement the core car insurance product, and also fees generated over the life of the policy.

Other Revenue (net of costs and including contribution from additional products underwritten by the Group) decreased by 16% to £172.8 million (2012: £204.8 million). This was equivalent to £67 per vehicle (gross of costs) – down from £79 at the end of 2012.

The £12 reduction in other revenue per vehicle from full year 2012 to full year 2013 was due to changing accounting recognition and treatment (-£6) and true economic changes (-£6) as follows:

#### *Changing accounting recognition and treatment*

- Change to accounting recognition and treatment of MLEI and vehicle commission (-£6), where profit has been reallocated from Other Revenue to Underwriting.

#### *True economic changes*

- Reduction in income earned from personal injury referral fees (-£4).
- Reduction in instalment income reflecting lower average premiums (-£2).

### **UK car insurance Other Revenue – analysis of contribution:**

	<b>2011</b>	<b>2012</b>	<b>2013</b>
		<i>£m</i>	
Contribution from additional products and fees.....	213.9	205.2	170.4
Contribution from additional products underwritten by the Group <sup>*1</sup> .....	—	4.8	12.3
Instalment income.....	23.3	29.1	23.7
<b>Other Revenue</b> .....	<b>237.2</b>	<b>239.1</b>	<b>206.4</b>
Internal costs .....	(32.4)	(34.3)	(33.6)
Net Other Revenue .....	204.8	204.8	172.8
<b>Other Revenue per vehicle</b> <sup>*2</sup> .....	<b>£84</b>	<b>£79</b>	<b>£67</b>

<sup>[\*1]</sup> Included in underwriting profit in income statement but re-allocated to Other Revenue for purpose of KPIs.

<sup>[\*2]</sup> Other Revenue (before internal costs) divided by average active vehicles, rolling 12 month basis.

### **MLEI and vehicle commission**

With effect from 1 April 2012, the Group no longer earns other revenue from the sale of MLEI. In addition, the Group began recognising revenue from co-insurer and reinsurer vehicle commissions. The Group's car insurance policies continue to include MLEI as an integral feature and there has been no impact on customers in the level of cover or cost of policies as a result of this change. The overall net economic impact of these two changes is not significant although there are differences in the timing of revenue recognition.

During 2013 the intra-group element of vehicle commission totalling £18.4 million was eliminated (from the insurance expenses and Other Revenue lines in the income statement). This reduced Other Revenue per vehicle by approximately £6 during 2013. There is no profit impact of the elimination as profit is reallocated from Other Revenue to Underwriting.

### **Referral fees**

Personal injury referral fees were banned with effect from 1 April 2013. The ban reduced the Group's Other Revenue per vehicle by £4 per vehicle during 2013. The Group expects this reduction in revenue will be offset by reductions in claims costs.

The Group notes that in June 2014 the CMA released its provisional decisions on its review of the car insurance market. A potential outcome of the review is regulatory change resulting in a reduction of credit hire claims costs. The Group expects any such reduction in claims costs will be associated with a reduction in revenue from credit hire referral fees. In 2013, the Group earned £14 million in credit hire referral fees.

### **Additional products underwritten by the Group**

There are a number of products which are core to providing car insurance to customers (including personal injury insurance, breakdown cover and car hire cover). During the second half of 2012 the Group began to underwrite the majority of these within the Group (they were previously underwritten by external insurers). The advantages of doing this include improved products for customers and increased control and flexibility with regards to their features and terms.

Contribution from these products underwritten by the Group during 2013 was £12.3 million and this is included in underwriting profit in the income statement, but reallocated to Other Revenue for the purpose of management key performance indicators.

### **Instalment income**

Instalment income is interest charged to customers paying for their insurance in instalments. During 2013 the Group earned £23.7 million from instalment income, down 19% on the prior period (2012: £29.1 million). This reduced the Group's Other Revenue per vehicle by around £2 compared to the end of 2012. Instalment charges are calculated as a percentage of premium and therefore a reduction in average premium leads to a reduction in instalment income.

## G International car insurance financial performance

### Non-GAAP format income statement<sup>\*1</sup>

	2011	2012	2013
	<i>£m</i>		
Turnover.....	122.1	162.9	187.8
Total premiums written .....	112.5	148.5	168.3
Net insurance premium revenue.....	27.2	43.3	54.1
Investment income.....	0.2	0.1	—
Net insurance claims.....	(28.3)	(49.4)	(49.1)
Net insurance expenses.....	(16.2)	(27.4)	(32.9)
Underwriting result.....	(17.1)	(33.4)	(27.9)
Net other income .....	8.0	8.9	5.8
Other Revenue and charges .....	(0.4)	—	—
<b>International Car Insurance result.....</b>	<b>(9.5)</b>	<b>(24.5)</b>	<b>(22.1)</b>

<sup>[\*1]</sup> Excludes pre-launch costs.

### Key performance indicators

	2011	2012	2013
Reported loss ratio.....	104%	114%	91%
Reported expense ratio .....	60%	63%	61%
Reported combined ratio <sup>*1</sup> .....	164%	177%	152%
Reported combined ratio, net of Other Revenue <sup>*2</sup> .....	134%	157%	141%
Vehicles insured at period-end .....	306,000	436,000	515,300

<sup>[\*1]</sup> Reported combined ratio is calculated on the Group's net share of premiums and excludes Other Revenue.

<sup>[\*2]</sup> Reported combined ratio, net of Other Revenue is calculated on the Group's net share of premiums and includes Other Revenue.

### Geographical analysis

<b>2013</b>	<b>Spain</b>	<b>Italy</b>	<b>France</b>	<b>US</b>	<b>Total</b>
Vehicles insured at period end .....	136,500	279,900	28,600	70,300	515,300
Turnover (£m) <sup>*1</sup> .....	40.6	93.4	13.0	40.8	187.8
<b>2012</b>	<b>Spain</b>	<b>Italy</b>	<b>France</b>	<b>US</b>	<b>Total</b>
Vehicles insured at period end .....	104,300	265,800	13,450	52,450	436,000
Turnover (£m) <sup>*1</sup> .....	32.8	89.6	6.4	30.4	159.2

<sup>[\*1]</sup> Turnover includes total premium written and income generated by the sale of additional products and services and fees. In 2012 £3.7 million of turnover from AdmiralDirekt.de is included to bring the total to £162.9 million.

### International car insurance financial performance

The Group's international insurance businesses (in aggregate and individually) continued to grow, adding over 79,000 customers and ending 2013 18% larger than a year earlier. Turnover grew 15% to £187.8 million (2012: £162.9 million). Vehicles and turnover from these businesses represent 14% and 9% of the Group totals respectively in 2013, up from 12% and 7% in 2012.

Improved prior year claims development in the more mature operations led to a lower combined ratio, which decreased from 177% in 2012 to 152% in 2013. This improvement, in conjunction with higher net insurance premium revenue led to a lower loss, of £22.1 million in 2013, down from £24.5 million in 2012. The lower combined ratio was a result of a 23 percentage point improvement in the loss ratio to 91% in 2013 (2012: 114%) whilst in the same year the expense ratio improved by 2 percentage points to 61% (2012: 63%). The expense ratio is high in comparison to the Group's UK business because all of the international operations need to grow to achieve economies of scale. In addition, there are market specific reasons why the expense ratios are higher, for example high acquisition costs in the US.

As the Group's international insurance operations grow, it is expected that they will make losses until appropriate scale has been achieved. The Group is satisfied with the progress each business continues to make towards the goal of becoming a sustainable, growing, profitable operation.

Admiral Seguros (Spain) was launched in 2006 and is the oldest of the Group's international operations. During the first half of the year, Admiral Seguros launched a second brand (Qualitas Auto) to complement its original Balumba brand. The business insured 136,500 customers at the end of 2013, 31% more than a year earlier.

The Group's largest international operation is ConTe in Italy which had 279,900 vehicles at the end of 2013, up 5% year-on-year. ConTe was launched in 2008 and has benefited from a period of generally favourable market conditions which has recently come to an end. ConTe is focused on improving underwriting margin and during 2013 ConTe's claims experience was significantly better than in prior years.

The Group's youngest and smallest international insurance business is L'olivier Assurances, launched in 2010 in France. L'olivier insured 28,600 vehicles at the end of 2013, up over 125% on a year earlier. L'olivier was initially established with a different start-up model to the Group's other operations, with certain functions outsourced to keep expenses low in the initial phases of development. During 2014 L'olivier will bring a number of these functions in-house, therefore, management focus on vehicle count growth is expected to be lower.

The consolidated result of the Group's insurance operations in Spain, Italy and France was a loss of £11.7 million in 2013, the same as 2012. The combined ratio<sup>1</sup> improved to 138% from 155% primarily due to improved claims experience.

In the US, the Group operates in four states (Virginia, Maryland, Illinois and Texas) through its Elephant Auto business, which launched in 2009. At the end of 2013, Elephant Auto insured over 70,000 vehicles, up around 34% year-on-year. Elephant Auto's expense ratio is currently high as the business is spending significant amounts on advertising to develop the Elephant Auto brand and grow the portfolio. Elephant Auto's written combined ratio improved from 176% in 2012 to 153% in 2013 primarily resulting from an improved expense ratio due to vehicle count growth.

## H Price comparison financial performance

### *Non-GAAP format income statement*

	<u>2011</u>	<u>2012</u>	<u>2013</u>
	<i>£m</i>		
Revenue:			
Car insurance price comparison .....	72.2	82.5	87.2
Other .....	18.2	21.0	25.5
Total Revenue .....	<u>90.4</u>	<u>103.5</u>	<u>112.7</u>
Operating expenses .....	(79.9)	(85.5)	(92.3)
<b>Operating profit</b> .....	<b><u>10.5</u></b>	<b><u>18.0</u></b>	<b><u>20.4</u></b>
Confused.com profit .....	16.1	18.2	21.7
International Price Comparison result <sup>*1</sup> .....	<u>(5.6)</u>	<u>(0.2)</u>	<u>(1.3)</u>
	<b><u>10.5</u></b>	<b><u>18.0</u></b>	<b><u>20.4</u></b>

<sup>[\*1]</sup> Excludes pre-launch costs. Figures include results of Chiarezza it, which was sold in April 2012. The disposal did not have material impact on the income statement.

<sup>1</sup> European combined ratio is calculated on the earned basis, and Elephant Auto combined ratio is calculated on the written basis due to market claims patterns. Both combined ratios are calculated on 100% of underwritten premium (including co-insurer's and reinsurer's share) and include the results from the sale of additional products and services and fees.

### ***UK price comparison – Confused.com***

Confused.com produced an improved result in the 2013 financial year, with revenue 6% higher at £87.7 million (2012: £82.7 million) and profit up 19% to £21.7 million (2012: £18.2 million).

Revenue from non-car insurance comparison sources increased in actual terms, and now represents nearly one quarter of total revenue. Confused.com's operating margin improved to 25% in 2013 (2012: 22%).

### ***International price comparison***

Following the sale of the Italian price comparison operation (Chiarezza) during H1 2012 and the launch in Q1 2013 of a new operation in the US, the Group now operates three price comparison businesses outside the UK: in Spain (Rastreator), France (LeLynx) and the US (comparenow.com).

The combined revenue from the European operations in 2013 increased by 20% to £25.0 million, with 19% more quotes provided. Both Rastreator and LeLynx have strong positions and brands in their respective markets. The combined result for Rastreator and LeLynx was a profit of £2.4 million in 2013 (2012: £0.2 million loss) reflecting increased quote volumes and improved conversion rates. The Issuer owns 75% of Rastreator, whilst the remaining 25% is owned by Mapfre.

In March 2013, the Group launched a new price comparison operation in the US (based in Virginia), trading as comparenow.com. During the year the operation has incurred staff and IT costs and some initial marketing expenses totalling £3.7 million. The Issuer owns 67.8% of comparenow.com, White Mountains Insurance Group Ltd owns 21.1% and Mapfre USA owns 11.1%.

The combined result for International price comparison was therefore a loss of £1.3 million – the profit from Rastreator and LeLynx offset by investment in comparenow.com.

## **I Other Group Items**

	<u>2011</u>	<u>2012</u>	<u>2013</u>
		<i>£m</i>	
UK household insurance underwriting result.....	—	—	(0.1)
UK commercial vehicle operating profit.....	2.8	2.5	2.5
Group net interest income .....	2.9	1.9	1.9
Share scheme charges .....	(18.6)	(20.6)	(22.5)
Business development costs .....	(0.8)	(2.1)	(0.3)
Other central overhead.....	(1.8)	(3.4)	(3.5)

### ***UK household insurance***

UK household insurance was launched in December 2012 under the Admiral brand. The product is underwritten within the Group and in common with other businesses it is supported by proportional reinsurance covering 70% of the risk (shared between Munich Re, 40% and Swiss Re, 30%). In addition the Group has purchased excess of loss reinsurance to mitigate the impact of catastrophe event claims. At the end of the first 12 months of trading, Admiral Household total loss before tax was £0.1 million.

### ***UK commercial vehicle***

The Group operates a commercial vehicle insurance broker (Gladiator) offering Van Insurance and associated products, typically to small businesses. Distribution is via telephone and internet (including price comparison websites).

UK commercial vehicle operating profit in the 2013 financial year remained in line with 2012 at £2.5 million, and customer numbers increased from 94,800 at the end of 2012 to 117,900 at the end of 2013.

### ***Interest income***

Interest income in 2013 was £1.9 million, in line with 2012.

### *Share scheme charges*

These costs relate to the Group's two employee share schemes. The increase in the charge is due to a combination of a higher share price at the end of 2013 compared to 2012 and an increase in the number of awards across the Group resulting from headcount growth.

### *Other central overhead*

Other central overheads include Group Directors' remuneration and other Group central costs.

## **9. CURRENT TRADING AND FUTURE PROSPECTS**

The Group's business strategy has continued unchanged since 31 December 2013.

A trading update for the Group for the six-month period ended 30 June 2014 is below. Unless otherwise stated, figures quoted are for the six months ended 30 June 2014, with comparatives reflecting the position against the same period in 2013.

- Group customers increased to 3.9 million (H1 2013: 3.6 million)
- Group turnover decreased to £1.0 billion (H1 2013: £1.1 billion)
- UK car insurance vehicle count up to 3.1 million (H1 2013: 3.0 million)
- UK car insurance turnover decreased to £0.85 billion (H1 2013: £0.92 billion)
- International car insurance vehicle count increased to 0.6 million (H1 2013: 0.5 million)
- International car insurance turnover £0.1 billion (H1 2013: £0.1 billion)

In the UK there are some indications that premiums are no longer falling but the Group has yet to see firm evidence of an inflection point and a return to premium growth. The Group's premium rates have been relatively unchanged over the first half of 2014, though as a result of the premium rate cuts in 2013, total premiums are down around 9% compared to the first half of 2013. Due to increases in retention levels, the Group's UK customer numbers have increased by over 4% during from 30 June 2013 to 30 June 2014.

UK claims development in respect of the 2012 and prior accident years has been positive and the Group continues to anticipate good levels of reserve releases from those accident years. The Issuer's expectations for the Group's UK business in 2014 therefore remain unchanged. However, the Group's margin expectations for business earned during 2014 are lower than during recent years, in the main as a consequence of the decline in premiums. Much of the impact of the reduced margin will be reflected in the Group's earnings during financial years after 2014.

Outside the UK, the Group's international insurance operations continue to grow and make positive progress. The Group's European price comparison businesses have had a good, profitable first half of 2014 and the Group is encouraged by the very early indicators from comparenow.com in the US, which would suggest meriting an increase in marketing investment in the second half of 2014.

## **10. PRICING AND CLAIMS MANAGEMENT**

The Group's data-driven pricing processes and effective claims management impact on both the profit commission derived from the co-insurance / reinsurance agreements that the Group has in place and also the underwriting profit from the share of the risk that the Group retains itself.

The Group's underwriting philosophy, which is broadly consistent across geographies, is focused on a sophisticated data-driven approach to pricing and underwriting. The Group retains a competitive advantage in this area by:

- collating and analysing comprehensive data from customers;
- maintaining tight control over the pricing guidelines in order to target profitable business sectors; and

- responding fast and flexibly to data analysis and market trends.

The Group is committed to establishing premium rates that appropriately price the underwriting risk and exposure. It sets policy rates utilising a number of factors including vehicle type, driver age, driver record, type of coverage, geographical location, miles driven and risk scores based on data from external data suppliers.

Premium rates are continually monitored and the Group has rating software which facilitates fast changes to both premium rates and structures of multi-dimensional rating tables.

The Group reviews and implements different rate structures for new business and renewals. This provides significant flexibility in its pricing and underwriting regimes. The Group also seeks to enhance this versatility by constantly analysing claims experience and amending rates accordingly.

### **Data Analysis**

The Issuer considers that accurate pricing of insurance products is significantly dependent upon obtaining and analysing accurate, comprehensive and up-to-date data from its customers. The Group maintains an extensive proprietary database containing statistical records with respect to customers. The Group has gained increasing depth of data as its customer base has grown. Using this expanding database, the Group's pricing managers are able to produce a wide range of analytical reports and analyses enabling the Group to identify opportunities in the market through better risk selection and pricing.

The Issuer believes that there is a strong link between the increase in depth of data which the Group has been able to collate over time and the historic reported earned loss ratios enjoyed by the Group, which are significantly better than the industry average.

### **Claims Management**

The Group adopts various claims management strategies designed to ensure that claims are paid at an appropriate level, to minimise the expenses associated with claims management and to provide high levels of customer service.

The Group developed an effective workflow system that reduces the scope for human error in the claims handling process and enables technical claims handlers to focus more on areas of added value and less on simple claim processing. A feature of the system is an ability to provide key suppliers with access to the system and to individual claim files, offering the potential to increase both service and process efficiency.

An outbound telephone team attempts to contact third parties as soon as a claim is reported. The aim is to minimise the potential claims costs and to ensure that more third parties utilise the Group approved repairers, in order to maximise control over damage repair costs.

The combination of an effective system and appropriate resourcing mean that the Group has avoided the process backlogs that sometimes occur in car claims operations and that both reduce service levels and increase settlement costs.

The Group also utilises sophisticated and innovative methods to check for fraudulent claims.

## **11. RESERVING**

### **Overview**

The Group is required by applicable insurance laws and regulations and UK GAAP to establish reserves for payment of claims and claims handling costs and expenses that arise from its underwriting activities. These reserves are balance sheet liabilities representing estimates of future amounts required to pay claims (losses) and claims handling expenses for insured claims which have occurred at or before the balance sheet date, whether already known to the Group or not yet reported. The key reserve categories are:

- claims reserves to cover the future cost of claims that have occurred prior to the balance sheet date to ultimate settlement (case outstanding plus Incurred but Not Reported), net of reinsurance;

- unearned premium reserves, net of reinsurance; and
- claims expense reserves, to cover the administration cost of all existing claims (including those not yet reported).

The majority of the Group's technical reserves are held to pay bodily injury claims in both the United Kingdom and overseas.

### **Claims reserving**

The Group's reserving policy (both within the claims function and in the financial statements) is initially to reserve conservatively, above internal and independent projections of ultimate loss ratios. This is designed to create a margin held in reserves to allow for unforeseen adverse development in open claims and typically results in the Group making above industry average reserve releases. The Group's booked claims reserves continue to include a significant margin above projected best estimates of ultimate claims costs.

As profit commission income is recognised in the income statement in line with loss ratios accounted for on the Group's own claims reserves, the reserving policy also results in profit commission income being deferred and released over time.

For the UK car insurance business, which accounts for over 90% of net claims reserves, the reserve process undertaken involves the following:

- regular management and internal review using standard actuarial techniques of individual and aggregate case claim reserves, including regular reporting of management information and exception reporting of significant movements. The actuarial review includes consideration of:
  - wider economic trends;
  - expected changes to legislation;
  - propensity of bodily injury claims to result in a periodic payment order;
  - changes to the Ogden discount rate; and
  - changes of relevant inflation factors,
- regular management and internal actuarial review of large claims, including claims settled or potentially settled by PPOs for which the uncertainty is increased by factors such as the lifetime of the claimant and movements in the indexation for the cost of future care of the claimant;
- bi-annual external actuarial review of best estimate claims reserves using a variety of recognised actuarial techniques, including reviews of the potential ranges around best estimates; and
- use of a reserving policy which informs management's reserving decisions for the purposes of the Group's financial statements. In respect of critical accounting judgements and estimates, the policy determines that reserves should be set within a pre-determined range above best estimate assumptions to allow for unforeseen adverse claims development.

## **12. EXCESS OF LOSS REINSURANCE**

The Group purchases reinsurance to protect its capital position as well as the results of individual business lines. The primary objectives of the Group's reinsurance programmes are to reduce the volatility of the Group's overall underwriting result and improve the stability of earnings for relevant business lines.

Reducing volatility in the Group's underwriting results and supporting its capital base is sought to be achieved by purchasing reinsurance for catastrophes and other major individual or accumulation losses. The retained portions of insurance risk are managed at levels that the Group expects it can absorb in accordance with loss models and regulatory capital requirements. The Group seeks to purchase reinsurance at cost effective rates from secure reinsurers within credit risk levels acceptable to management.

The Group has arranged layers of non-proportional excess of loss reinsurance protection covering all underwriting years with varying levels of protection and participation.

These variations result from changes in the car excess of loss pricing cycle and also the Group's attitude to the minimum level of large claim exposure it is prepared to accept.

In the future, the level of excess of loss cover purchased will depend on the attractiveness of market rates and the Group's appetite for individual claims exposure. This in turn will depend upon, *inter alia*, solvency limits, the financial strength of the Group and its evolving large claim experience.

The layers are effected with a number of reinsurers, all rated at least "A-" by S&P (with equivalent ratings from Fitch and Moody's) when the cover is purchased, unless agreed otherwise at the GRC. The ratings of the excess of loss reinsurers are continually monitored.

### 13. RISK MANAGEMENT

#### Risk Management

The Board of the Issuer has delegated the task of supervision of risk management to the GRC and of internal control to the Audit Committee.

There are several key elements to the risk management environment throughout the Group including: the setting of the Group's risk management strategy, risk appetite and risk policy by the GRC; dissemination of that policy by the Chief Executive; delivery of the policy by the UK Risk Management Committee ("**UK RMC**") and the Group's other UK and overseas entities through the application of the Group's systems of internal control and risk management; and the overall assurance provided to the Audit Committee by Internal Audit that the systems operate effectively. The Board recognises that the day-to-day responsibility for implementing these policies must lie with the senior management whose operational decisions must take into account risk and how this can be controlled effectively.

The GRC reports on its activities to the Audit Committee in support of the overall assurance provided by the Audit Committee that the Group's risk management and compliance systems operate effectively. Every six months, the GRC Chairman also reports on the activities of the GRC in a formal comprehensive written report to the Board on the Group's risk appetite, risk strategy and risk management policy with focus on a consideration of the principal assessed exposures and the effectiveness of the mitigation strategies adopted.

The responsibilities of the GRC are set out in its terms of reference and are summarised below:

- agreeing the Group's risk management framework, including the remits of Risk Management Committees that are established within each of the Group's operational entities and overseeing the risk management functions;
- monitoring the Group's prudential risk exposure, which includes ensuring that the Group's capital resources and liquidity profile are appropriate to its needs whilst meeting minimum regulatory requirements, including overseeing and challenging the design and execution of the Group's stress and scenario testing;
- ensuring the adequacy and effectiveness of the Group's systems and controls for the prevention of financial crime, including prevention of bribery and adequacy of anti-money laundering and data protection systems and controls;
- monitoring the adequacy and effectiveness of the Group's compliance functions;
- reviewing the Group's progress towards achieving Solvency II compliance;
- reviewing compliance with Group policies, including the established Reserving Policy and process; and
- considering and recommending to the Board for approval the Group's risk appetite, including any changes to the appetite for each material type of risk faced by the Group.

The work of the GRC is supported by more detailed work undertaken by executive Risk Management Committees in each of the Group's operational entities. The membership of the UK RMC includes the Group Chief Operating Officer (CEO of the UK car insurance business). Membership of the other UK and overseas Committees includes the Managing Director of the operation. At each meeting, the Risk Management Committees consider significant movements in the operation's risk profile, any risks that have arisen and any emerging risks. Risk Management Committees also assess and monitor any regulatory issues, ensuring that their resolution and the action taken are appropriately recorded. In the UK, the Risk Management Committee receives regular information on Conduct Risk, such as complaint handling reports and other management information.

The Risk Department defines and prescribes the financial and operational risk assessment processes for the business; maintains the risk registers; undertakes regular reviews of these risks in conjunction with line management; and records any actual losses or near misses that occur as a consequence of the realisation of risk. The Director of Risk has responsibility for ensuring that managers are aware of their risk management obligations, providing them with support and advice, and ensuring that the risk management strategy is properly communicated. Reports are produced showing the most significant risks identified and the controls in place. Internal Audit uses the risk registers to plan and inform their programme of audits around the most significant risks to the Group to ensure that the prescribed controls are in place and are operating effectively.

The GRC, UK RMC and other UK and overseas committees receive reports setting out key performance and risk indicators and consider possible control issues brought to their attention by early warning mechanisms that are embedded within the operational units. They, together with the Audit Committee, also receive regular reports from the relevant Internal Audit functions, which include recommendations for improvement of the control and operational environment. Twice a year the Chairman of the GRC provides a comprehensive written report to the Board on the Group's risk appetite, risk strategy and risk management policy with focus on a consideration of the principal assessed exposures and the effectiveness of the mitigation strategies adopted. In addition, the Board receives reports from the Chairman of the Audit Committee as to its activities, together with copies of the minutes of the UK RMC and the GRC and Audit Committees.

The Audit Committee's ability to provide the appropriate assurance to the Board depends on the provision of periodic and independent confirmation, primarily by Internal Audit, that the controls established by management are operating effectively and where appropriate provides a high-level challenge to the steps being taken by the GRC to implement the risk management strategy. The Internal Audit functions undertake regular reviews of internal control systems and business processes, identifying control weaknesses and making recommendations to management on improvements where necessary.

#### **14. CREDIT RATINGS**

The rating of the Subordinated Notes has been issued by Fitch and is BBB-. The Issuer itself has been given a rating of A- by Fitch. A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. The credit ratings included or referred to in this Prospectus have been issued by the Fitch Rating Group of Companies (UK – Fitch Ratings Limited) which was registered on 31 October 2011 in accordance with Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, as amended by Regulation (EU) No. 513/2011 of the European Parliament and of the Council of May 11, 2011, and by Regulation (EU) No. 462/2013 of the European Parliament and of the Council of May 21, 2013.

#### **15. SOLVENCY II AND CAPITAL**

##### **Solvency II**

The Group, including its insurance companies, has been preparing for the implementation of Solvency II for a number of years, both increasing the resourcing of internal teams and working with external technical and assurance partners (typically large accounting and actuarial consulting firms). The Group has participated in both Quantitative Impact Studies (QIS 4 and QIS 5) and is in regular dialogue with the PRA and FSC regarding Solvency II and capital. The Group's Solvency II implementation plan is in place and the Group remains confident that it will be ready for the implementation on 1 January 2016.

## The Group Capital Policy

The Group's strategy is to operate a capital-efficient business model, transferring a significant proportion of underwriting risk to co-insurance and reinsurance partners. This in turn allows the Group to distribute a significant proportion of earnings as dividends.

Consistent with this strategy, the Board will review the capital adequacy of the Group on a continuous basis and, amongst other things, will ensure that the Group will hold sufficient capital, at all times plus an appropriate buffer, to meet the Group's aggregate regulatory capital requirement, which (effective from 31 December 2014) will be assessed using a Group individual capital assessment ("ICA") approach and, as such, subject to any Individual Capital Guidance imposed by the PRA from time to time. The ICA will run in parallel with Solvency II Standard Formula assessment during 2015.

In addition, the GRC will review, at least annually, any risks associated with the operation of a capital-efficient strategy, and the adequacy of its capital contingency plans. The capital analysis gives assurance to the boards of the companies in the Group that management strategies are appropriate.

## 16. EMPLOYEES

### Staff numbers:

	Average for the year		
	2013	2012	2011
	<i>Number</i>		
Direct customer contact staff.....	5,145	4,991	4,264
Support staff.....	1,420	1,231	1,060
<b>Total</b> .....	<b>6,565</b>	<b>6,222</b>	<b>5,324</b>

### Staff numbers at 31 December 2013 by country:

	Number	Proportion
UK (Cardiff, Newport and Swansea).....	5,187	74%
Canada (Halifax).....	524	7%
Italy (Rome).....	484	7%
US (Richmond).....	292	4%
Spain (Madrid and Seville).....	287	4%
India (New Delhi).....	153	2%
France (Paris).....	58	1%
Gibraltar.....	2	<1%
<b>Total at 31 December 2013</b> .....	<b>6,987</b>	<b>100%</b>

The Group's management team has extensive experience in the direct insurance industry, with two of the Executive Directors having worked for the Group's business since it was launched in 1993. The skills, experience and motivational powers of the Senior Management play a vital role in implementing the Group's business model.

The philosophy underpinning the Group's culture is that "if people like what they do, they'll do it better". In a 2013 anonymous staff survey 88% of staff responded that they are happy working at the Group.

The Group seeks to improve the working skills and knowledge of its employees and to develop their individual capabilities as far as possible, by identifying and developing employees with the ability and desire to be promoted to more responsible positions and each call centre department has one or more trainers assigned specifically.

The Group offers, where appropriate, country based retirement savings based on local labour practices and laws. Where the Group operates a pension scheme in addition to the state provision, contributions are made by both the Group and the employee.

Trade Unions are recognised by the Group businesses in Spain, Italy and France. They are not currently recognised in other countries.

## 17. **INFORMATION TECHNOLOGY INFRASTRUCTURE**

The Group's IT capability is led by an IT director in each business, who reports directly to either the entity's Chief Executive or Chief Operating Officer. The IT systems and underlying technologies that support the Group's business have evolved since the launch of the business in 1993. IT capabilities are continuously reviewed and invested in to ensure that they are fit for the needs of the business to ensure continued sustainability, profitability and growth in the markets that support business operations.

The maturity and complexity of the IT capability required by the business has grown as customer needs and demands have changed. Given that price comparison is a key channel for business operations, the Group has started to transition its customer contact strategy from a web / telephony centric strategy to a more mobile digital multi-channel contract strategy. Appropriate investments continue to be made to aid this transition and support the modernisation of the IT capability.

Business continuity and disaster recovery play a key role in assuring sustainability of the business operations, these are tested on a regular basis in each Group entity at a system and data-centre level. Planned and unplanned tests are reported to the Group's Business Continuity and Disaster Recovery Committees and when appropriate to the GRC. The Group continues to enhance and develop its business continuity plan to ensure excellence in execution when needed.

Data security and data protection from both a customer and corporate perspective continues to be a focus for business operations. Work continues with internal teams and third parties to ensure that appropriate controls are in place to mitigate confidentiality, integrity and availability concerns that affect the business.

## 18. **INTELLECTUAL PROPERTY**

### **Trade Marks**

The Group is the owner of, amongst others, trade marks for Admiral, Bell, Diamond, elephant.co.uk, EUI, Admiral Law, BDE Law, Confused.com (including for Brian, Confused.com's main advertising platform) and Gladiator in the UK and in the European Community. These trade marks are all established, registered and well known in the United Kingdom through their extensive use. The Group also has registered trade mark for Confused.com in Ireland and pending trade mark applications for Admiral, Bell, Diamond and Elephant in India.

The Group has trade mark registrations in each of the overseas territories in which it operates including for Comparenow.com and Elephant (in the US), for ConTe (in Italy), for L'Olivier and LeLynx (in France) and for Balumba, Qualitas and Rastreator (in Spain). The Group also has European Community trade mark registrations for ConTe and Rastreator.

### **Registered Designs**

The Group is the owner of UK registered design for "elephant" and a European Community registered design for "Brian the Robot", Confused.com's main advertising platform.

### **Patent Protection**

The Group is the owner of a UK registered patent relating to certain telematics technology which is currently sold under the Bell brand.

### **Domain Names**

The Group is the owner of approximately 1,600 domain names. These domain names are either used by the Group's businesses to deliver services and information to customers or held to protect trading names and brands developed by the Group. These domain names include all of the Group's trading operations including for Admiral, Bell, Diamond, elephant.co.uk, EUI, Admiral Law, BDE Law, Confused.com, Gladiator, Comparenow.com, Elephant (in the US), ConTe, L'olivier, LeLynx, Balumba, Qualitas Auto and Rastreator.

## 19. INVESTMENTS

### Investment Strategy

The investments of the Group are managed within the confines of the Investment Policy as agreed at Group Board level. The core objective of the investment is to preserve capital to ensure that the appropriate funds are available to meet the Group's liabilities.

The operational management of the investments is delegated to the Group Investment Committee (Senior Management, Investment Function and Non Exec director). This committee reports directly to the boards of the Group insurance companies, in addition to the board of the Issuer.

The strategy is achieved by adhering to the following criteria:

- material allocation to "AAA" rated Prime Money Market Funds;
- no equity investments;
- all other investments are as a minimum Investment Grade rated; and
- maximum allocation to "BBB" rated assets of 10% of the total portfolio.

20% of the Group's investments during the 2013 financial year were "AAA" rated (compared to 30% in the 2012 financial year). The day to day management of cash and deposits are kept in-house, aside from these classes the funds are outsourced to appropriate external managers. The performance of all managers is monitored through monthly reporting.

### Portfolio Holdings

The table below summarises the Group's investment portfolio position as at 31 December 2013:

	<b>31 December 2013</b>
	<i>£m</i>
<b>Financial assets:</b>	
Investments held at fair value .....	1,406.1
Short dated debt securities held at fair value.....	202.4
Term deposits with credit institutions .....	288.4
Total financial assets per consolidated statement of financial position .....	1,896.9
Cash and cash equivalents .....	187.9
	<b>2,084.8</b>

The target asset class allocation for the portfolio at the end of 2014 is:

- Money Market Funds – 35%
- Short-dated Fixed Income Securities – 20%
- Asset Backed Securities – 10%
- Other Short Term Securities – 25%
- Cash Deposits – 10%

### Investment Controls

There is a clear segmentation of the treasury functions and the accounting teams. This ensures that there are control processes in place at each point in the investment process. Monitoring of investments is also undertaken by the Group Risk Team on a monthly basis.

## 20. MANAGEMENT

### Directors of the Issuer

The following is a list of the Directors of the Issuer and their principal directorships, if any (other than the positions with the Issuer), which are or may be significant with respect to the Issuer as at the date of this Prospectus. The business address of each of the directors is: Capital Tower, Greyfriars Road, Cardiff, CF10 3AZ.

<u>Name</u>	<u>Responsibilities in relation to the Issuer</u>	<u>Other significant directorships</u>
Alastair Lyons, CBE	Non-Executive Chairman	Serco Group plc (Non-Executive Chairman)  Towergate Insurance Group (Non-Executive Chairman) Bovis Homes Group plc (Group Deputy Chairman) Moondance Foundation (Trustee)
Henry Engelhardt, CBE	Chief Executive Officer	Wales Millennium Centre (Trustee)
David Stevens, CBE	Chief Operating Officer	Waterloo Foundation (Trustee)
Kevin Chidwick Roger Abravanel	Chief Financial Officer Non-Executive Director	Luxottica Group S.p.A (Non-Executive Director)  Teva Pharmaceutical Industries Ltd (Non-Executive Director) Banca Nazionale del Lavoro S.p.A. (Non-Executive Director) COFIDE S.p.A. (Non-Executive Director) Italian Institute of Technology (Board member) INSEAD Advisory Group of Italy (Chairman)
Manfred Aldag	Non-Executive Director	
Annette Court	Non-Executive Director	Jardine Lloyd Thompson Group plc (Non-Executive Director) Foxtons plc (Non-Executive Director) Workshare (Non-Executive Director) GO Outdoors Ltd (Chairman)
Colin Holmes	Non-Executive Director	
Margaret Johnson, OBE	Non-Executive Director	Leagas Delaney (Group Chief Executive Officer)
Lucy Kellaway	Non-Executive Director	
Jean Park	Non-Executive Director	Murray Income Trust plc (Non-Executive Director)  National House Building Council (Non-Executive Director)

Set out below is a brief description of the business experience and qualifications of the individuals who serve as members of the board of directors of the Issuer.

#### **Alastair Lyons (CBE)**

Alastair was appointed Non-Executive Chairman in July 2000. In his executive career Alastair has been Chief Executive Officer (CEO) of the National Provident Institution and of the National & Provincial Building Society, Managing Director of the Insurance Division of Abbey National plc and Director of Corporate Projects at National Westminster Bank plc. He has held numerous non-executive roles, having most recently stepped down as Senior Independent Non-Executive Director at the Phoenix Group. He has also been a Non-Executive Director of both the Department for Transport (DfT) and the Department for Work and Pensions (DWP), as well as of its predecessor, the Department of Health and Social Security

(DHSS). Alastair is a Fellow of the Institute of Chartered Accountants. He was awarded a CBE in the 2001 Birthday Honours for services to social security.

#### **Henry Engelhardt (CBE)**

Henry was appointed Chief Executive Officer (CEO) in October 1999. Henry is a founder Director of the Group and was recruited by the Brockbank Group in 1991 to set up the Group business. Prior to joining the Group, Henry was the original Marketing and Sales Manager for Churchill Insurance. Henry has an MBA from INSEAD, a BA from the University of Michigan and was awarded an honorary CBE in 2008 for services to business in Wales.

#### **David Stevens (CBE)**

David was appointed Chief Operating Officer (COO) in October 1999. David is a founder Director of the Group and was recruited in 1991 to set up the Group business. Prior to joining the Group David worked at McKinsey & Co, in the Financial Interest Group, and Cadbury Schweppes in the UK and the US. David has an MBA from INSEAD and he was awarded a CBE in 2010 for services to business and the community in Wales.

#### **Kevin Chidwick**

Kevin was appointed Chief Financial Officer (CFO) in September 2006. Kevin is responsible for finance, compliance and investments, as well as the subsidiary Elephant Auto. Kevin joined the Group in 2005, becoming Chief Financial Officer in September 2006. Prior to Admiral, Kevin worked in UK financial services for over 25 years and he held a number of senior roles in other insurance organisations, including being the Finance Director of Engage Mutual Assurance and Cigna UK. Kevin is a Fellow of the Chartered Institute of Certified Accountants and has an MBA from London Business School.

#### **Roger Abravanel**

Roger was appointed Non-Executive Director in March 2012. Roger has significant international consulting experience having been with McKinsey and Co. from 1972 until his retirement as Director Emeritus in 2006. Roger holds an MBA from INSEAD. Roger is a Non-Executive Director serving on, amongst others, the Boards of: Luxottica Group S.p.A; Teva Pharmaceutical Industries Ltd; Banca Nazionale del Lavoro S.p.A and COFIDE S.p.A. Roger is a Board member of the Italian Institute of Technology and Chairman of the INSEAD Advisory Group in Italy. Roger has authored several books and currently writes for an Italian daily newspaper.

#### **Manfred Aldag**

Manfred was appointed Non-Executive Director in March 2003. Manfred is Chief Executive Manager of Munich Re, responsible for UK and Ireland. Manfred graduated from University of Essen with a degree in Economics and Business Management. Since 1981, Manfred has been working for Munich Re.

#### **Annette Court**

Annette was appointed Non-Executive Director in March 2012. Annette is Non-Executive Director of Jardine Lloyd Thompson Group plc, Foxtons plc and Workshare. Between 2007 and 2010 Annette was CEO of Europe General Insurance for Zurich Financial Services and a member of the Group Executive Committee. Annette is former CEO of the Direct Line Group (formerly known as RBS Insurance). In this role Annette was also a member of the RBS Group Executive Management Committee. Annette has previously served as a member on the ABI.

#### **Colin Holmes**

Colin was appointed Non-Executive Director in December 2010. Colin is Chairman of GO Outdoors Ltd. Colin was formerly a member of the Executive Committee of Tesco plc and during his 22 year career at Tesco he held a wide range of positions, including UK Finance Director and CEO of Tesco Express. Colin is a Chartered Management Accountant.

**Margaret Johnson (OBE)**

Margaret was appointed Non-Executive Director in September 2006. Margaret is currently Group CEO the international advertising agency Leagas Delaney and has worked there for the past 15 years. Margaret was awarded an OBE in 2013 in recognition of her services to the creative industries and her voluntary work for charities.

**Lucy Kellaway**

Lucy was appointed Non-Executive Director in September 2006. Lucy is a management columnist on the Financial Times. In her 20 years at the Financial Times, Lucy has been an oil correspondent, a Lex columnist and Brussels correspondent. Lucy has authored various books.

**Jean Park**

Jean was appointed Non-Executive Director in January 2014. Jean is Non-Executive Director of Murray Income Trust plc and National House Building Council. Jean was Group Chief Risk Officer at the Phoenix Group from 2009 until June 2013, during which time she held responsibility for the Group's relationship with the regulator and founded the Board Risk Committee. Previously, she was Risk Management Director of the Insurance and Investments division of Lloyds TSB and, before that, Head of Compliance and Audit at Scottish Widows. Jean is a Member of the Institute of Chartered Accountants of Scotland.

**Conflicts of Interest**

There are no conflicts of interest between the duties of the directors listed above to the Issuer and their private interests or other duties.

## REGULATION OF THE ISSUER

### Introduction

The Group operates primarily through seven countries (the UK, Canada, Italy, the US, Spain, India and France), with regulated entities in three jurisdictions (England & Wales, Gibraltar and the US). The Group's business is structured into four segments: UK car insurance, international car insurance, price comparison and other Group items (comprised of UK household insurance, commercial vehicle insurance broking and other central costs).

In terms of the UK car insurance business, the Group sells and underwrites private car insurance in the UK through four brands – Admiral, Bell, Diamond and elephant.co.uk (all trading names of EUI Limited). The FCA and PRA regulate AICL, as an insurer, and the FCA regulates EUI Limited, as an insurance intermediary. The FSC of Gibraltar regulates AIGL, also an insurer. By virtue of its FSC permissions, AIGL is authorised to provide services in the UK, France, Germany and Italy.

The Group's international car insurance businesses are: Admiral Seguros (a Spanish entity, trading through two brands - Balumba and Qualitas Auto), ConTe (an Italian entity), L'olivier Assurances (a French entity) and Elephant Auto (a US entity). The Group's European operations are subject to the same regulation as the UK car insurance business by virtue of AICL's outward branch passporting rights into Spain and outward service passporting rights into Italy and France. The Group's US insurer, Elephant Insurance Company, is regulated by the Virginia State Corporation Commission's Bureau of Insurance.

The Group's price comparison business is similarly international. Inspop.com Ltd (trading as Confused.com) is a UK entity regulated by the FCA as a general insurance intermediary. Rastreator.com (Spanish comparison business) and LeLynx.fr (French comparison business) are structured as branches of Rastreator.com Limited and Inspop.com (France) Limited (and appointed representatives of) the UK incorporated Inspop.com Ltd. This structure allows for the UK insurance intermediary permissions to be passported into Spain and France, respectively. Comparenow.com (the US comparison business) is a regulated insurance agency in Virginia, US.

The UK household insurance and commercial vehicle insurance broking forms only a small proportion of the Group's turnover. The UK household insurance is underwritten by AIGL and intermediated by EUI Limited. Able, trading as Gladiator, is the Group's commercial vehicle insurance broker and is authorised by the FCA to carry out insurance intermediation business.

### UK Regulation

#### *Regulatory powers*

The Financial Services Act 2012 introduced a new regulatory framework for financial services in the UK. Following the abolishment of the Financial Services Authority, the UK system now has two regulators, the PRA and FCA, designed to offer a strengthened system of financial supervision.

The focus of the FCA, in its capacity as business conduct regulator for the UK financial services industry, is to protect consumers, ensure that the financial industry remains stable and promote competition between financial services providers. In order to regulate the financial services market, the FCA has rule-making, investigative and enforcement powers.

The focus of the PRA, in its capacity as the micro-prudential regulator, is to promote the safety and soundness of banks, building societies, credit unions, insurers and large investment firms and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders. In promoting the safety and soundness of such firms, the PRA is primarily concerned with the harm that firms can cause to the stability of the UK financial system.

In the UK, the Group's business is subject to regulation by both the PRA and FCA, both of which have broad powers under FSMA, including, among others, the authority to: grant and, in specific circumstances, vary or cancel permissions; ensure regulated firms treat customers fairly; investigate marketing, sales, claims and complaint handling practices; and require the maintenance of adequate financial resources. One of the principal regulatory objectives in the context of the regulation of insurance companies is the protection of policyholders, as opposed to protection of shareholders or general creditors.

The PRA and FCA have powers to impose requirements on an insurance company (such as a requirement not to take on new business) if they consider that the company has not met its capital adequacy requirement or does not meet the necessary Threshold Conditions (see section below: *Permission to carry on insurance business*). The FCA may make enquiries or conduct inspections of the companies which it regulates regarding compliance with regulations governing the conduct and operation of business. Issues and disputes may arise from time to time in relation to the way an insurance product has been constructed, sold or administered, or in the way in which policyholders or customers have been treated, either at an individual firm level or across the insurance industry. In the UK, individual policyholder disputes of this nature are typically resolved by the Financial Ombudsman Service or, failing this, through litigation. However, the FCA may intervene directly where larger groups or matters of public policy are involved. There have been several industry-wide issues in recent years where the FCA has intervened directly, such as the widespread mis-selling of payment protection insurance.

The PRA and FCA have extensive powers to supervise and intervene in the affairs of an insurance company in certain circumstances, for example: if they consider that it is appropriate in order to protect policyholders or potential policyholders against the risk that the company may be unable to meet its liabilities as they fall due; that the Threshold Conditions may not be met; that the company or its parent has failed to comply with its obligations under the relevant legislation; that the company has furnished misleading or inaccurate information; or that there has been a substantial departure from any proposal or forecast submitted to the regulators. The PRA and FCA also have the power to take a range of informal and formal disciplinary or enforcement actions in relation to a breach by a firm of FSMA or the PRA Handbook or FCA Handbook rules, including private censure, public censure, restitution, fines or sanctions and the award of compensation.

#### ***Permission to carry on insurance business***

Under section 19 of FSMA, it is unlawful to carry on insurance business in the UK unless permitted to do so by the PRA (acting with the consent of the FCA) under Part IV of the FSMA (a "**Part IV Permission**"). In deciding whether to grant permission, the PRA and FCA are required to determine whether the applicant satisfies, and will continue to satisfy, the Threshold Conditions set out in Schedule 6 to FSMA (the "**Threshold Conditions**") to be engaged in insurance business and, in particular, whether the applicant has and will continue to have appropriate resources and that it is and will continue to be a fit and proper person having regard to the objectives of the PRA and the FCA; in both cases this includes whether those who manage the applicant's affairs have adequate skills and experience and that such affairs are conducted soundly and with integrity. A permission to carry on insurance business may be subject to such requirements as the PRA (with consent of the FCA) considers appropriate.

In specific circumstances, the PRA and / or FCA may vary or cancel an insurer's Part IV Permission to carry on a particular class or classes of business of insurance business generally. The circumstances in which the PRA and / or FCA can vary or cancel a Part IV Permission include a failure to meet the Threshold Conditions or where such action is desirable in order to protect the interests of consumers or potential consumers.

#### ***Approval of controllers***

Under section 178 of FSMA, if a person intends to acquire or increase its "control" of an authorised firm, it must first obtain approval from the appropriate regulator (the PRA for dual-authorised firms such as insurance companies and the FCA for firms such as insurance intermediaries, only authorised by the FCA). It is a criminal offence under section 191F of FSMA to acquire or increase control of an insurance company or an insurance intermediary without obtaining approval from the appropriate regulator first.

The appropriate regulator has up to 60 working days (without taking into account any interruption period) in which to assess a change of control case. Acquiring control for the purposes of FSMA includes where a person holds 10% or more of the shares or voting power in an authorised firm or its parent undertaking. A person will be treated as increasing its control over an authorised firm, and will therefore require further approval from the appropriate regulator, if the level of its shareholding or entitlement to voting power increases from a holding below certain thresholds to a holding above those thresholds. The relevant thresholds for insurance companies are 10% or more but less than 20%, 20% or more but less than 30%, 30% or more but less than 50% and 50% or more of the shares or voting power in an authorised firm or its parent undertaking. The relevant threshold for insurance intermediaries is 20% or

more of the shares or voting power in an authorised firm or its parent undertaking. SUP 11 in the PRA Handbook and FCA Handbook give details of the thresholds and requirements.

When determining a person's level of control, that person's holding of shares or entitlement to voting power will be aggregated with the holdings or entitlements of any person with whom it is "acting in concert".

#### ***Approval of controlled function holders***

Certain key, controlled functions in the operation of an insurance business may only be carried out by persons who are approved for such tasks by the PRA and FCA under FSMA ("**Approved Persons**"). Under FSMA, the PRA and FCA have powers to regulate three types of such individuals: those whose functions have a significant influence on the conduct of an authorised company's affairs and functions, those who have contact with customers (or the property of customers) and those who have contact with Libor functions.

Approved Persons must comply with the PRA's and FCA's fit and proper test and the Statements of Principle and Code of Practice for Approved Persons in the FCA Handbook. The following are primarily the matters for consideration in determining an individual's suitability for an Approved Person position: (i) honesty, integrity and reputation; (ii) competence and capability; and (iii) financial soundness.

#### ***Prudential requirements***

The PRA's rules which govern the prudential regulation of insurers are found primarily in GENPRU and INSPRU. The capital requirements are set out in "Pillar 1" rules (based on EC and PRA requirements) and "Pillar 2" rules (a risk-sensitive approach prescribed by the PRA).

The Pillar 1 rules essentially require insurance companies to maintain capital resources equal to or in excess of their capital resources requirement. The CRR for an insurance company carrying on general (and not long-term) insurance business is equal to the MCR. The MCR for an insurance company only carrying on general insurance business (such as those entities in the Group) is the higher of:

- (a) the base capital resources requirement; and
- (b) the general insurance capital requirement.

The Pillar 2 rules require insurance companies carrying on general insurance business to calculate an enhanced capital requirement under INSPRU 1.1.72B and carry out an ICA under INSPRU 7. Pursuant to this ICA, insurance companies are required to conduct stress and scenario testing to determine the overall adequacy of their financial resources and make a reasonable assessment of the capital needs for their business overall in line with the overall financial adequacy rule in GENPRU 1.2.26R.

The PRA, if it disagrees with the ICA, may provide Individual Capital Guidance to insurance companies on a confidential basis. This regulatory guidance is tailored to the specific business and control risks faced by each entity and takes account of the company's ICA. The PRA has indicated that it would expect to be notified of a failure to maintain capital at levels advised in the ICA (or Individual Capital Guidance, if applicable) and there is a subsequent expectation from the PRA for firms to establish the necessary plans to restore adequate capital.

#### ***Admissible Assets and Capital Adequacy Rules***

PRA rules govern the types of assets that can be used by an insurer to meet its regulatory capital requirements in addition to the maximum permitted exposure levels to certain assets and counterparties. The capital that comprises an insurer's capital resources is classified into tiers based on the quality of capital in terms of factors such as its persistency and loss-absorbency.

"Tier 1" capital is typically comprised of permanent share capital and certain perpetual preference shares issued by the firm. "Tier 2" capital is broadly other types of preference shares and subordinated debt issued by the firm, with a split between upper Tier 2 for perpetual instruments and lower Tier 2 for fixed term instruments. GENPRU provides several requirements for capital instruments to qualify as upper or lower Tier 2 and it is intended that the Subordinated Notes qualify as lower Tier 2 capital for the Issuer. PRA rules require that the Issuer must ensure that at least 50% of the MCR is constituted by total Tier 1

capital after any deductions and 75% of the MCR is constituted by Tier 1 and upper Tier 2 capital. One third of the long-term insurance capital requirement of the Issuer must be met by Tier 1 and Tier 2 capital.

### ***The IGD***

The IGD (as amended by the Financial Groups Directive and the Reinsurance Directive) sets out supervisory arrangements for insurance companies falling within a group. This legislation is implemented in the UK via INSPRU. The IGD contains further provisions for monitoring intra-group transactions, group risk management processes, internal control processes and reporting and accounting procedures. Insurers are also required to have appropriate internal control mechanisms to allow the production of data/information relevant to supervision under the IGD.

### ***Conduct of business requirements***

The FCA's conduct of business requirements are set out in its Conduct of Business Sourcebook ("**COBS**") and, in relation to the distribution and sale of insurance products, its Insurance Conduct of Business Sourcebook ("**ICOBS**"). These sourcebooks also implement the Insurance Mediation Directive (Directive 2002/92/EC) and extend this legislation to direct sales by insurers themselves.

Many of the provisions of COBS and ICOBS only apply to insurers or intermediaries who deal directly with retail customers, or are confined in their application to transactions with retail customers. Further, the conduct rules require the product documentation to be fully compliant for retail sales.

In general, COBS and ICOBS govern the sale of new policies. They also include rules applicable in the course of administration of insurance by the Group relating to: information to be provided to existing policyholders; cancellation rights; and the handling of claims, which may apply regardless of whether or not the insurer is actively selling its products.

### ***Road Traffic Act***

Any insurance company underwriting compulsory car insurance in the UK is obliged, by virtue of the Road Traffic Act 1988, to be a member of the Motor Insurer's Bureau (the "**MIB**") and to contribute to its funding. The aim of the MIB is to compensate the victims of negligent, uninsured and untraced motorists. AICL and AIGL are both members of the MIB and pay the related levy annually in arrears.

### ***Data Protection***

The Data Protection Act 1998 regulates the use of data from policyholders and other third parties, and, as such, the Group will be subject to this legislation. There are particular requirements that the Group must adhere to, including restrictions as to the gathering and holding of personal data and restrictions on disclosure. The UK Information Commissioner's Office ("**ICO**") oversees and enforces this legislation along with the FCA in relation to certain data security matters; as such, the Group is subject to the regulatory oversight of the ICO and FCA in its compliance.

### ***The FSCS***

Insurance companies are subject to the FSCS, which is an independent and impartial body established by FSMA in order to protect policyholders when a UK authorised firm is unable or is likely to be unable to meet its financial obligations. Most claims made in respect of insurance business will also be protected if the business was carried out from the UK or, in another EEA State, from a branch of an insurer authorised by the PRA. The FSCS is funded by levies on authorised UK firms and generally companies subject to the FSCS make provisions for their share of the levies. Such provisions are often based on estimates of a company's market participation in the relevant charging periods and the interest the FSCS will pay on the facilities provided by the UK Treasury in support of its obligations.

### ***Legal Services***

During 2013, the Issuer entered into two joint ventures with law firms Lyons Davidson and Corder Lewis to form Admiral Law and BDE Law (in each case, the Group owns 90% of the shares in each law firm). Both ventures were granted ABS licences by the SRA pursuant to their powers under Part 5 of the Legal Services Act 2007. These law firms are regulated by the SRA and, as such, are subject to the SRA Principles, the Code of Conduct and other SRA Handbook provisions.

### ***Price comparison websites***

As mentioned in the "*Description of the Issuer*" section, Inspop.com Ltd (trading as Confused.com) is a UK entity regulated by the FCA as a general insurance intermediary. Rastreator.com (Spanish comparison business) and LeLynx.fr (French comparison business) are structured as branches and appointed representatives of the UK incorporated Inspop.com Ltd. This structure allows for the UK insurance intermediary permissions to be passported into Spain and France, respectively. Pursuant to this, the price comparison operations will need to comply with FCA regulations, including COBs (outlined in the above "*Conduct of business requirements*" section). Inspop.com Ltd is the only price comparison business of the Group directly authorised by the FCA and as such Inspop.com Ltd has a responsibility to ensure that the Spanish and French appointed representative firms also comply with the FCA Handbook.

Further, the FCA has, as part of its primary objectives, been tasked with promoting effective competition in the interests of consumers. The FCA will also have a statutory basis for the conduct of market studies and rights to refer markets to the CMA under the Enterprise Act 2002, when the concurrent powers come into effect, which is anticipated to be in April 2015. Further details as to price comparison websites and competition are provided in the "*CMA - UK car insurance business and price comparison business*" and "*FCA - price comparison business*" sections of the "*Risk Factors*".

## **EU Legislation**

### ***Solvency II***

Solvency II is an insurance and reinsurance industry directive adopted by the EU in November 2009. The aim of Solvency II is to strengthen the prudential regime for insurance and reinsurance undertakings throughout the EU. Solvency II is intended to protect policyholders' interests more effectively by making failure of insurance and reinsurance entities less likely, and by reducing the probability of consumer loss or market disruption. Solvency II should also enable firms to do business across the EU more easily, as the current system of varying local standards will be replaced by more consistent requirements. The implementation is based on the concept of three pillars; minimum capital requirements, supervisory review of firms' assessment of risk and enhanced reporting and disclosure requirements. Matters covered include valuations, the treatment of insurance groups, the definition of capital and the overall level of capital requirements. Solvency II is intended to align the assessment of risks and capital requirements more closely with capital requirements, and permits insurance entities to make use of their own internal capital models if approved by the PRA. It is anticipated that Solvency II will be implemented on 1 January 2016.

Solvency II provides for the supervision of insurance groups and imposes a group-level capital requirement in relation to certain insurance groups. Where entities in any insurance group are located in different Member States, the national supervisors of those entities will participate in a college of supervisors in order to supervise the group, with the PRA and FCA acting as lead regulators for the Group.

### ***IMD2***

In July 2012, the EC published IMD2; a proposal for the revision of the Insurance Mediation Directive (2002/92/EC) which established an EU-wide supervisory regime for intermediaries involved in the promotion, sale and administration of certain insurance products which would be implemented by additional rules in the UK. IMD2 is expected to introduce further conduct of business rules in the sale of insurance products by the Group including the extension of rules currently only applicable to intermediaries to direct sales of insurance and the requirement to consider the suitability of insurance products even in non-advised sales to ensure that it does not remunerate or assess staff in a way which conflicts with its duty to act in the best interests of customers.

Whilst there remains uncertainty over exact timing, it is currently anticipated that the directive will be adopted in 2015 and implemented into national law in 2017. Once IMD2 has been adopted, the EC and EIOPA are expected to work on technical measures prior to the implementation date.

### ***EIOPA***

EIOPA was established in 2011 as an independent advisory body to the European Parliament, the EU Council and the EC, responsible for the insurance and occupational pensions sector. The aims of EIOPA

are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.

Under the Omnibus II Directive, EIOPA was granted extended powers to develop the detailed aspects of the Solvency II regime, to provide guidelines and recommendations to national supervisors and to resolve differences between national supervisors in the supervision of international insurance groups.

### **EU passporting regime**

The EU Life and Non-Life Insurance Directives ("**EU Insurance Directives**") establish a framework for the regulation of insurance companies in the EU which is extended to the EEA. For insurance intermediaries and other firms solely regulated by the FCA, the Insurance Mediation Directive is the equivalent framework legislation.

An insurance firm or intermediary that is entitled to carry on certain insurance activity granted by the relevant regulator in an EEA member state where the insurance firm or intermediary is incorporated or has its head office (a "**home state regulator**") has a right to either establish a physical presence or provide freedom of services into another EEA State (a "**host state**"), subject to the fulfilment of the conditions under the relevant directive; its "**passporting right**". Generally, the EU Insurance Directives and Insurance Mediation Directive reserve the regulation of an insurance firm or intermediary for its home state regulator, but the host state determines the local conduct of business and marketing requirements applicable. The insurance firm or intermediary must comply with any stipulated conditions under which, in the interests of the general good, the activity must be carried on in the host State.

### **Anti-money laundering, anti-terrorism and sanctions laws and regulations**

In addition to the aforementioned financial and insurance regulation, the Group must comply with anti-money laundering, anti-terrorism and sanctions laws and regulations. A specific responsibility of the Group's Risk Committee is to ensure the adequacy and effectiveness of the Group's systems and controls for the prevention of financial crime, including prevention of bribery and adequacy of anti-money laundering and data protection systems and controls.

Sanctions rules require the Group to ensure that it neither breaches legal and/or regulatory requirements nor suffers reputational damage by providing services to, or dealing directly or indirectly with persons, entities or countries which have been identified by the United Kingdom, United States, United Nations, European Union or other governmental, national and international bodies as subject to any form of restriction including financial sanctions or asset freezing orders. The FCA generally requires firms to establish and maintain effective systems and controls to minimise the risk of being used in connection with financial crime. There is no one piece of legislation that sets out the UK financial sanctions regime. Instead, the regime reflects the requirements of various UN resolutions that are applicable to the UK, and is implemented by way of various EU regulations and UK statutory instruments.

Regulatory investigations and/or enforcement actions against the Group in relation to anti-money laundering, anti-terrorism and sanctions laws or regulations could result in fines, immediate reputational and regulatory risks, and materially adverse effects to its business and financial position.

### **International Regulatory Initiatives**

Certain regulatory initiatives are also taking place at a global level. The International Association of Insurance Supervisors (the "**IAIS**"), a voluntary membership organisation of insurance supervisors and regulators from more than 140 countries, established its Insurance Core Principles ("**ICPs**") in October 2011 (last updated on 19 October 2013). These ICPs act as a benchmark for insurance supervisors and encourage adaptation of national regulatory frameworks to comply with global standards. The IAIS also announced in October 2013 that it has committed to developing the first risk-based global insurance capital standard by the end of 2016, followed by two years of testing by supervisors and internationally active insurance groups.

Further to the ICPs, the IAIS is involved in the Common Framework for the Supervision of Internationally Active Insurance Groups ("**ComFrame**"); a set of international supervisory requirements focusing on the effective group-wide supervision of internationally active insurance groups ("**IAIGs**"). These provisions will serve as a framework for national regulators, assisting co-operation by providing a basis of comparison of IAIG regulation and supervision. ComFrame is built and expands upon the high

level requirements and guidance currently set out in the ICPs, which generally apply on both a legal entity and group-wide level. The IAIS is currently scheduled to formally adopt ComFrame in 2018, with its Members to begin implementing ComFrame thereafter.

## **Regulation in the US**

### ***Regulation of Insurance Companies***

US insurance companies are generally subject to regulation and supervision by insurance departments of the jurisdictions in which they are domiciled or licensed to transact business. The nature and extent of such regulation and supervision varies from jurisdiction to jurisdiction. Generally, an insurance company is subject to a higher degree of regulation and supervision in its state of domicile. As outlined in the "Description of the Issuer" section, the Group operates in four states within the US (Virginia, Maryland, Illinois and Texas) through its Elephant Auto business, which launched in 2009. The Group's US insurer, Elephant Insurance Company, is domiciled in Virginia and regulated by the Virginia State Corporation Commission's Bureau of Insurance.

State insurance laws impose numerous requirements, conditions, and limitations on the operations of insurance companies. Insurance departments have broad regulatory powers relating to those operations. Regulated areas include, among others:

- licensing and examination of insurers;
- capital and surplus requirements;
- statutory accounting principles specific to insurance companies and the content of required financial and other reports;
- requirements for establishing insurance reserves;
- investments;
- acquisitions of insurers and transactions between insurers and affiliates;
- limitations on rates of return or profitability;
- rating criteria, rate levels, and rate changes;
- insolvencies of insurance companies;
- assigned risk programs;
- authority to exit a business;
- corporate governance; and
- numerous requirements relating to other areas of insurance operations, including: required coverages, involuntary coverages, policy forms, underwriting standards, and claims handling.

Insurance departments are authorised to conduct periodic and other examinations of regulated insurers' financial condition and operations to monitor the financial stability of the insurers and to ensure adherence to statutory accounting principles and compliance with state insurance laws and regulations. In addition, in some states, the attorney general's office may exercise certain supervisory authority over insurance companies and, from time to time, may investigate certain insurance company practices. Insurance companies are generally required to file detailed annual and other reports with the insurance department of each jurisdiction in which they conduct business. State insurance laws and insurance departments also regulate investments that insurers are permitted to make. Limitations are placed on the amounts an insurer may invest in a particular issuer, as well as the aggregate amount an insurer may invest in certain types of investments. Certain investments are prohibited.

Insurance holding company laws enacted in many jurisdictions authorise insurance departments to regulate acquisitions of insurers and certain other transactions and to require periodic disclosure of

specified information. These laws impose prior approval requirements for certain transactions between insurers and their affiliates and generally regulate dividend and other distributions, including loans and cash advances, between insurers and their affiliates.

Under state insolvency and guaranty laws, insurers can be assessed or required to contribute to state guaranty funds to cover policyholder losses resulting from the insolvency of other insurers.

Many states have laws and regulations that limit an insurer's ability to exit a market. For example, certain states limit an automobile insurer's ability to cancel or non-renew policies. Certain states also prohibit an insurer from withdrawing one or more lines of business from the state, except pursuant to a plan that is approved by the state insurance department.

In recent years, the state insurance regulatory framework has come under increased federal scrutiny. As part of an effort to strengthen the regulation of the financial services market, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") was enacted in 2010. Many regulations required pursuant to this law must still be finalised, and the Group cannot predict what the final regulations will require. Dodd-Frank also created the Federal Insurance Office ("**FIO**") within the US Treasury Department. The FIO monitors the insurance industry, provides advice to the Financial Stability Oversight Council, represents the US on international insurance matters, and studies the current regulatory system. FIO submitted a report to Congress in December 2013 addressing how to improve and modernise the system of insurance regulation. In addition, state legislators and insurance departments continue to examine the appropriate nature and scope of state insurance regulation.

Federal law and the laws of many states require financial institutions to protect the security and confidentiality of customer information and to notify customers about their policies and practices relating to collection and disclosure of customer information and their policies relating to protecting the security and confidentiality of that information. Federal law and the laws of many states also regulate disclosures and disposal of customer information. Congress, state legislatures, and regulatory authorities are expected to consider additional regulation relating to privacy and other aspects of customer information.

### ***Regulation of Insurance Providers***

Comparenow.com provides online car insurance comparison throughout the US and is a regulated insurance agency with Virginia as its home state. While laws and regulations vary from jurisdiction to jurisdiction, every state of the US requires insurance market intermediaries and related service providers (such as insurance brokers, agents and consultants, reinsurance brokers, managing general agents and third party administrators) to hold an individual and/or company license from a governmental agency or self-regulatory organization.

In recent years, several states considered new legislation or regulations regarding the compensation of agents and brokers by insurance companies. The proposals ranged in nature from new disclosure requirements to new duties on insurance agents and brokers in dealing with customers.

In addition, Comparenow.com is affected by laws and regulations that apply to businesses in general, as well as to businesses operating on the Internet. This includes a continually expanding and evolving range of laws, regulations and standards that address information security, data protection, privacy, consent and advertising, among other things. Advertising and promotional information presented to visitors to Comparenow.com's online services, and its other marketing activities, are subject to federal and state consumer protection laws that regulate unfair and deceptive practices. Federal, state, local and foreign governments are also considering other legislative and regulatory proposals that would regulate the Internet more rigorously than at present.

### **Regulation in Gibraltar**

In Gibraltar, the regulatory and supervisory function for financial services business is vested with the Gibraltar FSC. The FSC is a statutory body corporate established by virtue of the Financial Services Commission Act 2007 (the "**FSC Act**").

Under the FSC Act, generally, the function of the FSC is to consider and determine applications, supervise and monitor compliance and financial services business in accordance with any Act of the Gibraltar Parliament which the Minister with responsibility for financial services may by order in the Gibraltar Gazette specify "Supervisory Acts".

The FSC's regulatory objectives are: (a) the promotion of market confidence; (b) the reduction of systematic risk; (c) the promotion of public awareness; (d) the protection of the good reputation of Gibraltar; (e) the protection of consumers; and (f) the reduction of financial crime. Thus, in order to regulate the financial services market in Gibraltar, the FSC has investigative powers, enforcement powers, rule-making powers (with the consent of the Minister with responsibility for financial services) and the power to issue guidance notes (also with the consent of the Minister with responsibility for financial services).

In Gibraltar, AIGL is subject to regulation by the FSC which has broad powers under the Financial Services (Insurance Companies) Act (the "**IC Act**"), including, among others, the authority to: grant and, in specific circumstances, vary, suspend or withdraw authorisations; ensure regulated firms treat customers fairly; investigate marketing, sales, complaints and claims; and require the maintenance of adequate financial resources.

#### ***Permission in Gibraltar to carry on insurance business***

Under section 17 of the IC Act, it is unlawful to carry on insurance business in or from within Gibraltar unless permitted to do so by the FSC under Part IV of the IC Act. In deciding whether to grant permission, the FSC is required to determine whether the applicant satisfies, and will continue to satisfy, the margins of solvency prescribed by the IC Act and the Insurance Companies (Solvency Margins and Guarantee Funds) Regulations 2004. The FSC will usually require a margin above the minimum solvency margin, which can vary according to the nature of the business, and is discussed openly with the licensee.

When considering an application, the FSC will determine whether the applicant has, and will continue to have appropriate resources and that it is and will continue to be a fit and proper person having regard to the regulatory objectives of the FSC. Licensed entities must have at least two individuals who must effectively direct the business of the entity (commonly known as the 'four eyes business principle'). This is designed to ensure that at least two perspectives are applied both to the formulation and implementation of the policy of the licensed entity. Both persons must demonstrate the qualities and application necessary to influence strategy, day-to-day policies and their implementation, and both must actually do so in practice. Both persons must have sufficient experience and knowledge of the business and the necessary authority to detect and deal with any imprudence, dishonesty or other irregularities in the licensed entity.

#### ***Approval of controllers and controlled functions***

Under Part V and Schedule 11 of the IC Act, if a person intends to acquire or increase its "control" of an insurance company, it must first obtain the consent of the FSC. It is a criminal offence under the IC Act to acquire or increase control of an insurance company or to appoint an individual to undertake a "controller" function without first obtaining the consent of the FSC. Generally the FSC will have up to 3 months to determine a change of "control" without taking into account any interruption period.

#### ***European Directives***

Gibraltar is a British Overseas Territory. It is part of the EU, having joined the European Economic Community with the United Kingdom in 1973 by virtue of Article 355(3) (ex Article 299(4)) which applies the treaty to "the European territories for whose external relations a Member State is responsible", a provision which in practice only applies to Gibraltar. Gibraltar has implemented all EU Directives, including the IGD, the Insurance Mediation Directive (Directive 2002/92/EC), the Data Protection Directive (Directive 95/46/EC) and the EU Insurance Directives. Please see the applicable sections under "*UK Regulation*" and "*EU Legislation*" for further details.

Firms authorised by the FSC have the right to passport their insurance services throughout the EU and EEA. Firms authorised to provide insurance services in one jurisdiction are therefore able to provide insurance services in another jurisdiction without the need for authorisation (by means of either a branch in the other jurisdiction or through the provision of cross-border services).

***Anti-money laundering, anti-terrorism laws and sanction laws and regulations***

In addition to the aforementioned financial and insurance regulation in Gibraltar, AIGL must comply with Gibraltar anti-money laundering, anti-terrorism and sanction laws and regulations. As is the case in the UK, regulated firms are required to implement systems of controls.

## **USE OF PROCEEDS**

The net proceeds of the issue of the Subordinated Notes will be used by the Issuer to fund the general business and commercial activities of the Group and to strengthen further its capital base at group level.

The expenses in connection with the transaction are expected to amount to £1.3 million.

## TAXATION

### United Kingdom Taxation

The following is a summary of the United Kingdom withholding taxation treatment as at the date of this Prospectus in relation to payments of principal and interest in respect of the Subordinated Notes. It is based on current United Kingdom law as applied in England and Wales, and the published practice of Her Majesty's Revenue and Customs ("**HMRC**") (which may not be binding on HMRC), which may be subject to change, sometimes with retrospective effect. The comments do not deal with other United Kingdom tax aspects of acquiring, holding or disposing of the Subordinated Notes. The comments relate only to the position of persons who are absolute beneficial owners of the Subordinated Notes, hold such Subordinated Notes as investments and are not connected to the Issuer. Noteholders holding their notes via a depositary receipt system or clearance service should note that they may not always be the beneficial owners thereof. The following is a general guide for information purposes and should be treated with appropriate caution. It is not intended as tax advice and it does not purport to describe all of the tax considerations that may be relevant to a prospective purchaser. Prospective Noteholders who are in any doubt as to their tax position should consult their professional advisers. Prospective Noteholders who may be liable to taxation in jurisdictions other than the United Kingdom in respect of their acquisition, holding or disposal of the Subordinated Notes are particularly advised to consult their professional advisers as to whether they are so liable (and if so under the laws of which jurisdictions), since the following comments relate only to certain United Kingdom withholding taxation aspects of payments in respect of the Subordinated Notes and information sharing requirements. In particular, prospective Noteholders should be aware that they may be liable to taxation under the laws of other jurisdictions in relation to payments in respect of the Subordinated Notes even if such payments may be made without withholding or deduction for or on account of taxation under the laws of the United Kingdom.

The summary of the United Kingdom withholding tax position below assumes that there will be no substitution of the Issuer as Issuer pursuant to Condition 14 (*Substitution of Issuer*) of the Subordinated Notes or otherwise and does not consider the tax consequences of any such substitution(s).

#### ***UK Withholding Tax on UK Source Interest***

The Subordinated Notes issued by the Issuer, which carry a right to interest, will constitute "quoted Eurobonds" provided they are and continue to be listed on a recognised stock exchange within the meaning of section 1005 of the Income Tax Act 2007. Whilst the Subordinated Notes are and continue to be quoted Eurobonds, payments of interest on the Subordinated Notes may be made without withholding or deduction for or on account of United Kingdom income tax.

Securities will be "listed on a recognised stock exchange" for this purpose if they are admitted to trading on an exchange designated as a recognised stock exchange by an order made by the Commissioners for HMRC and either they are included in the United Kingdom official list (within the meaning of Part 6 of the Financial Services and Markets Act 2000) or they are officially listed, in accordance with provisions corresponding to those generally applicable in European Economic Area states, in a country outside the United Kingdom in which there is a recognised stock exchange.

The London Stock Exchange is a recognised stock exchange, and accordingly the Subordinated Notes will constitute quoted Eurobonds provided they are and continue to be included in the United Kingdom official list and admitted to trading on the Main Market of that Exchange.

In all cases falling outside the exemption described above, interest on the Subordinated Notes may fall to be paid under deduction of United Kingdom income tax at the basic rate (currently 20%) subject to such relief as may be available following a direction from HMRC pursuant to the provisions of any applicable double taxation treaty, or to any other exemption which may apply.

#### ***Provision of Information***

HMRC have powers to obtain information, including in relation to interest or payments treated as interest and payments derived from securities. This may include details of the beneficial owners of the Subordinated Notes (or the persons for whom the Subordinated Notes are held), details of the persons to whom payments derived from the Subordinated Notes are or may be paid and information in connection

with transactions relating to the Subordinated Notes. Information obtained by HMRC may be provided to tax authorities in other countries.

Information may also be required to be reported in accordance with regulations made pursuant to the EU Savings Directive (see "*EU Savings Directive*" below).

#### ***Other Rules Relating to United Kingdom Withholding Tax***

Where interest has been paid under deduction of United Kingdom income tax, Noteholders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in any applicable double taxation treaty.

The references to "interest" in this section "*Taxation*" mean "interest" as understood in United Kingdom tax law. The statements in this section "*Taxation*" do not take any account of any different definitions of "interest" which may prevail under any other law or which may be created by the terms and conditions of the Subordinated Notes or any related documentation. Prospective Noteholders should seek their own professional advice as regards the withholding tax treatment of any payment on the Subordinated Notes which does not constitute "interest" or "principal" as those terms are understood in United Kingdom tax law.

#### ***FATCA***

Whilst the Subordinated Notes are in global form and held within Euroclear or Clearstream, Luxembourg (together, the "**ICSDs**"), it is expected that FATCA will not affect the amount of any payments made under, or in respect of, the Subordinated Notes by the Issuer, any paying agent and the Common Depositary, given that each of the entities in the payment chain between the Issuer and the participants in the ICSDs is a major financial institution whose business is dependent on compliance with FATCA and that any alternative approach introduced under an intergovernmental agreement will be unlikely to affect the securities. The documentation expressly contemplates the possibility that the securities may go into definitive form and therefore that they may be taken out of the ICSDs. If this were to happen, then a non-FATCA compliant holder could be subject to withholding. However, definitive notes will only be printed in remote circumstances.

#### **Other Tax Considerations**

##### ***EU Savings Directive***

Under EC Council Directive 2003/48/EC on the taxation of savings income, each EU Member State is required to provide to the tax authorities of another EU Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for the benefit of, an individual resident or certain limited types of entity established in that other EU Member State; however, for a transitional period, Austria and Luxembourg will instead apply a withholding system in relation to such payments, deducting tax at a rate of 35%. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

Luxembourg has announced that it will no longer apply the withholding tax system as from 1 January 2015 and will provide details of payments of interest (or similar income) as from this date.

The Council of the European Union formally adopted a Council Directive amending the Directive on 24 March 2014 (the "**Amending Directive**"). The Amending Directive broadens the scope of the requirements described in the first paragraph above. Member States have until 1 January 2016 to adopt the national legislation necessary to comply with the Amending Directive and are required to apply these new requirements from 1 January 2017. The changes made under the Amending Directive include extending the scope of the Directive to payments made to, or collected for, certain other entities and legal arrangements. They also broaden the definition of "interest payment" to cover additional types of income payable on securities.

Investors who are in any doubt as to their position should consult their professional advisers.

***The proposed financial transactions tax ("FTT")***

On 14 February 2013, the European Commission published a proposal (the "**Commission's Proposal**") for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "**participating Member States**").

The Commission's Proposal has very broad scope and could, if introduced, apply to certain dealings in the Subordinated Notes (including secondary market transactions) in certain circumstances.

Under the Commission's Proposal the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Subordinated Notes where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State.

A joint statement issued in May 2014 by ten of the eleven participating Member States indicated an intention to implement the FTT progressively, such that it would initially apply to shares and certain derivatives, with this initial implementation occurring by 1 January 2016. The FTT, as initially implemented on this basis, may not apply to dealings in the Subordinated Notes.

The FTT proposal remains subject to negotiation between the participating Member States. It may therefore be altered prior to any implementation. Additional EU Member States may decide to participate.

Prospective holders of the Subordinated Notes are advised to seek their own professional advice in relation to the FTT.

## SUBSCRIPTION AND SALE

Merrill Lynch International (the "**Manager**") has, pursuant to a Subscription Agreement dated 23 July 2014, agreed with the Issuer, subject to the satisfaction of certain conditions, to subscribe the Subordinated Notes at 100 per cent. of their principal amount, less an amount which the Issuer has agreed to pay to the Manager in respect of a combined management and underwriting commission. In addition, the Issuer has agreed to reimburse the Manager for certain of its expenses in connection with the issue of the Subordinated Notes. The Subscription Agreement entitles the Manager to terminate it in certain circumstances prior to payment being made to the Issuer.

The yield of the Subordinated Notes is 5.576 per cent. on an annual basis. The yield is calculated as at the date of this Prospectus on the basis of the issue price. It is not an indication of future yield.

### **General**

Neither the Issuer nor the Manager has made any representation that any action will be taken in any jurisdiction by the Manager or the Issuer that would permit a public offering of the Subordinated Notes, or possession or distribution of this Prospectus (in preliminary, proof or final form) or any other offering or publicity material relating to the Subordinated Notes (including roadshow materials and investor presentations), in any country or jurisdiction where action for that purpose is required. The Manager has agreed that it will comply to the best of its knowledge and belief in all material respects with all applicable laws and regulations in each jurisdiction in which it acquires, offers, sells or delivers Subordinated Notes or has in its possession or distributes this Prospectus (in preliminary, proof or final form) or any such other material, in all cases at its own expense. It will also ensure that no obligations are imposed on the Issuer in any such jurisdiction as a result of any of the foregoing actions.

### **United States**

The Subordinated Notes have not been and will not be registered under the Securities Act and the Subordinated Notes are subject to US tax law requirements. Subject to certain exceptions, the Subordinated Notes may not be offered, sold or delivered within the United States or to US persons. The Manager has represented and agreed that it has not offered, sold or delivered and will not offer, sell or deliver any Subordinated Notes within the United States or to US persons, except as permitted by the Subscription Agreement.

In addition, until 40 days after the commencement of the offering, an offer or sale of the Subordinated Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

### **United Kingdom**

The Manager has represented and agreed that:

- (a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of the Subordinated Notes in circumstances in which Section 21(1) of the FSMA would not, if the Issuer was not an authorised person, apply to the Issuer; and
- (b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Subordinated Notes in, from or otherwise involving the United Kingdom.

## GENERAL INFORMATION

1. The listing of the Subordinated Notes on the Official List will be expressed as a percentage of their nominal amount (exclusive of accrued interest). It is expected that listing of the Subordinated Notes on the Official List and admission of the Subordinated Notes to trading on the Market will be granted on or around 28 July 2014, subject only to the issue of the Global Note Certificate. Prior to official listing and admission to trading, however, dealings will be permitted by the London Stock Exchange in accordance with its rules. Transactions will normally be effected for delivery on the third working day after the day of the transaction.
2. The Issuer has obtained all necessary consents, approvals and authorisations in the United Kingdom in connection with the issue and performance of the Subordinated Notes. The issue of the Subordinated Notes was authorised by a resolution of the Board of Directors of the Issuer passed on 26 June 2014 and resolutions of a committee of the Board of Directors of the Issuer passed on 3 July 2014 and 18 July 2014.
3. There has been no material adverse change in the financial position or prospects of the Issuer or the Group since 31 December 2013 and there has been no significant change in the financial or trading position of the Issuer or of the Group since 31 December 2013.
4. There are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) with respect to any member of the Group during the 12 months preceding the date of this Prospectus which may have or has had in the recent past significant effects on the financial position or profitability of the Issuer and/or the Group.
5. The Subordinated Notes have been accepted for clearance through the Euroclear and Clearstream, Luxembourg systems (which are the entities in charge of keeping the records) with a Common Code of 109033405. The International Securities Identification Number (ISIN) for the Subordinated Notes is XS1090334050.

The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy L-1855 Luxembourg.

6. There are no material contracts (not being contracts entered into in the ordinary course of business which could result in the Issuer being under an obligation or entitlement that is material to the Issuer's ability to meet its obligations to Noteholders in respect of the Subordinated Notes being issued) that have been entered into by the Group.
7. Where information in this Prospectus has been sourced from third parties, this information has been accurately reproduced and, as far as the Issuer is aware and is able to ascertain from the information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third-party information is identified where used.
8. For the period of 12 months starting on the date on which this Prospectus is made available to the public, copies of the following documents will be available, during usual business hours on any weekday (Saturdays and public holidays excepted), for inspection at the office of the Issuer, Admiral Group plc, Capital Tower, Greyfriars Road, Cardiff CF10 3AZ:
  - (a) the Trust Deed (which includes the form of the Global Note Certificate and the Certificates);
  - (b) the Agency Agreement;
  - (c) the articles of association of the Issuer;
  - (d) the published annual report and audited consolidated annual accounts of the Issuer for the years ended 31 December 2012 and 31 December 2013; and
  - (e) a copy of this Prospectus together with any Supplement to this Prospectus or further Prospectus. This Prospectus will be published on the website of the Regulatory News

Service operated by the London Stock Exchange at <http://www.londonstockexchange.com/exchange/prices-and-news/news/market-news/market-news-home.html>.

9. KPMG Audit Plc of 3 Assembly Square, Britannia Quay, Cardiff, CF10 4AX audited without qualification the financial statements contained in the Annual Report and Accounts of the Issuer for the financial years ended 31 December 2012 and 2013.
10. The Manager and its affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services to the Issuer and/or its affiliates in the ordinary course of business. In addition, in the ordinary course of their business activities, the Manager and its affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of the Issuer or the Issuer's affiliates. Certain of the Manager or its affiliates that have a lending relationship with the Issuer routinely hedge their credit exposure to the Issuer consistent with their customary risk management policies. Typically, the Manager and such affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in securities, including potentially the Subordinated Notes. Any such short positions could adversely affect future trading prices of Subordinated Notes. The Manager and its affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

**FINANCIAL STATEMENTS AND AUDITORS' REPORTS**

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# Independent auditor's report to the members of Admiral Group plc

We have audited the financial statements of Admiral Group plc for the year ended 31 December 2012 set out on pages 58 to 93. The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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

## Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 46, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

## Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at [www.frc.org.uk/auditscopeukprivate](http://www.frc.org.uk/auditscopeukprivate)

## Opinion on financial statements

### 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 2012 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the Parent Company financial statements have been properly prepared in accordance with UK Generally Accepted Accounting Practice;
- 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 IAS Regulation.

## 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;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the Corporate Governance Statement set out on pages 29 to 43 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following:

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

- 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 and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- a Corporate Governance Statement has not been prepared by the Company.

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 46 in relation to going concern;
- the part of the Corporate Governance Statement on pages 32 to 37 relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.



## Salim Tharani

(Senior Statutory Auditor)  
for and on behalf of KPMG Audit Plc, Statutory Auditor  
Chartered Accountants  
3 Assembly Square  
Britannia Quay  
Cardiff Bay  
Cardiff  
CF10 4AX

5 March 2013

# Consolidated Income Statement

	Note	Year ended	
		31 December 2012 £m	31 December 2011 £m
Insurance premium revenue		1,156.5	959.7
Insurance premium ceded to reinsurers		(657.6)	(513.9)
<b>Net insurance premium revenue</b>	4	<b>498.9</b>	<b>445.8</b>
Other revenue	6	361.1	349.0
Profit commission	4	108.4	61.8
Investment and interest income	5	15.9	13.7
<b>Net revenue</b>		<b>984.3</b>	<b>870.3</b>
Insurance claims and claims handling expenses		(929.1)	(785.9)
Insurance claims and claims handling expenses recoverable from reinsurers		524.6	422.1
<b>Net insurance claims</b>		<b>(404.5)</b>	<b>(363.8)</b>
Operating expenses	7	(214.6)	(188.8)
Share scheme charges	7	(20.6)	(18.6)
<b>Total expenses</b>		<b>(639.7)</b>	<b>(571.2)</b>
<b>Profit before tax</b>		<b>344.6</b>	<b>299.1</b>
Taxation expense	8	(86.2)	(77.8)
<b>Profit after tax</b>		<b>258.4</b>	<b>221.3</b>
Profit after tax attributable to:			
Equity holders of the parent		258.4	221.2
Non-controlling interests		–	0.1
		<b>258.4</b>	<b>221.3</b>
<b>Earnings per share:</b>			
Basic	10	95.1p	81.9p
Diluted	10	94.9p	81.7p
Dividends declared and paid (total)	10	219.3	198.8
Dividends declared and paid (per share)	10	81.6p	74.6p

# Consolidated Statement of Comprehensive Income

	Year ended	
	31 December 2012 £m	31 December 2011 £m
<b>Profit for the period</b>	<b>258.4</b>	<b>221.3</b>
<b>Other comprehensive income</b>		
Exchange differences on translation of foreign operations	(2.7)	(1.0)
Other comprehensive income for the period, net of income tax	<b>(2.7)</b>	<b>(1.0)</b>
<b>Total comprehensive income for the period</b>	<b>255.7</b>	<b>220.3</b>
Total comprehensive income for the period attributable to:		
Equity holders of the parent	255.9	220.2
Non-controlling interests	(0.2)	0.1
	<b>255.7</b>	<b>220.3</b>

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# Consolidated Statement of Financial Position

	Note	As at	
		31 December 2012 £m	31 December 2011 £m
<b>ASSETS</b>			
Property and equipment	9	16.5	17.6
Intangible assets	9	92.5	87.5
Deferred income tax	8	15.2	10.3
Reinsurance assets	4	803.0	639.8
Trade and other receivables	5, 9	55.3	52.1
Financial assets	5	2,005.1	1,583.0
Cash and cash equivalents	5	216.6	224.6
<b>Total assets</b>		<b>3,204.2</b>	<b>2,614.9</b>
<b>EQUITY</b>			
Share capital	10	0.3	0.3
Share premium account		13.1	13.1
Other reserves		0.7	3.2
Retained earnings		443.0	377.3
<b>Total equity attributable to equity holders of the parent</b>		<b>457.1</b>	<b>393.9</b>
Non-controlling interests		3.6	0.5
<b>Total equity</b>		<b>460.7</b>	<b>394.4</b>
<b>LIABILITIES</b>			
Insurance contracts	4	1,696.9	1,333.7
Trade and other payables	5, 9	1,006.5	856.6
Current tax liabilities		40.1	30.2
<b>Total liabilities</b>		<b>2,743.5</b>	<b>2,220.5</b>
<b>Total equity and total liabilities</b>		<b>3,204.2</b>	<b>2,614.9</b>

These financial statements were approved by the Board of Directors on 5 March 2013 and were signed on its behalf by:



**Kevin Chidwick**

Director  
Admiral Group plc  
Company Number: 03849958

# Consolidated Cash Flow Statement

	Note	31 December 2012 £m	31 December 2011 £m
<b>Profit after tax</b>		<b>258.4</b>	<b>221.3</b>
Adjustments for non-cash items:			
– Depreciation		6.6	6.1
– Amortisation of software		4.1	3.3
– Change in unrealised gains on investments		(0.6)	(1.9)
– Other gains and losses		0.6	0.9
– Share scheme charge	7	23.7	23.6
Change in gross insurance contract liabilities		363.2	527.1
Change in reinsurance assets		(163.2)	(282.8)
Change in trade and other receivables, including from policyholders		13.1	(88.4)
Change in trade and other payables, including tax and social security		149.9	292.1
Taxation expense		86.2	77.8
<b>Cash flows from operating activities, before movements in investments</b>		<b>742.0</b>	<b>779.1</b>
Net cash flow into investments		(441.9)	(493.9)
Cash flows from operating activities, net of movements in investments		300.1	285.2
Taxation payments		(79.7)	(95.3)
<b>Net cash flow from operating activities</b>		<b>220.4</b>	<b>189.9</b>
<b>Cash flows from investing activities:</b>			
Proceeds from investing activities		–	3.9
Purchases of property, equipment and software		(10.9)	(16.8)
<b>Net cash used in investing activities</b>		<b>(10.9)</b>	<b>(12.9)</b>
<b>Cash flows from financing activities:</b>			
Non controlling interest capital contribution		4.6	–
Capital element of new finance leases		–	1.0
Repayment of finance lease liabilities		(0.1)	(0.3)
Equity dividends paid	10	(219.3)	(198.8)
<b>Net cash used in financing activities</b>		<b>(214.8)</b>	<b>(198.1)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(5.3)</b>	<b>(21.1)</b>
Cash and cash equivalents at 1 January		224.6	246.7
Effects of changes in foreign exchange rates		(2.7)	(1.0)
<b>Cash and cash equivalents at end of period</b>	5	<b>216.6</b>	<b>224.6</b>

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# Consolidated Statement of Changes in Equity

	Share capital £m	Share premium account £m	Foreign exchange reserve £m	Retained profit and loss £m	Non- controlling interests £m	Total equity £m
At 1 January 2011	0.3	13.1	4.2	332.7	0.4	350.7
Profit for the period	–	–	–	221.2	0.1	221.3
<b>Other comprehensive income</b>						
Currency translation differences	–	–	(1.0)	–	–	(1.0)
<b>Total comprehensive income for the period</b>	<b>–</b>	<b>–</b>	<b>(1.0)</b>	<b>221.2</b>	<b>0.1</b>	<b>220.3</b>
<b>Transactions with equity-holders</b>						
Dividends	–	–	–	(198.8)	–	(198.8)
Share scheme credit	–	–	–	23.6	–	23.6
Deferred tax charge on share scheme credit	–	–	–	(1.4)	–	(1.4)
<b>Total transactions with equity-holders</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>(176.6)</b>	<b>–</b>	<b>(176.6)</b>
As at 31 December 2011	0.3	13.1	3.2	377.3	0.5	394.4
At 1 January 2012	0.3	13.1	3.2	377.3	0.5	394.4
Profit for the period	–	–	–	258.4	–	258.4
<b>Other comprehensive income</b>						
Currency translation differences	–	–	(2.5)	–	(0.2)	(2.7)
<b>Total comprehensive income for the period</b>	<b>–</b>	<b>–</b>	<b>(2.5)</b>	<b>258.4</b>	<b>(0.2)</b>	<b>255.7</b>
<b>Transactions with equity-holders</b>						
Dividends	–	–	–	(219.3)	–	(219.3)
Share scheme credit	–	–	–	23.7	–	23.7
Deferred tax credit on share scheme credit	–	–	–	1.5	–	1.5
Transactions with non-controlling interests	–	–	–	1.4	3.3	4.7
<b>Total transactions with equity-holders</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>(192.7)</b>	<b>3.3</b>	<b>(189.4)</b>
As at 31 December 2012	0.3	13.1	0.7	443.0	3.6	460.7

# Notes to the Financial Statements

## 1. General information and basis of preparation

### General information

Admiral Group plc is a Company incorporated in England and Wales. Its registered office is at Capital Tower, Greyfriars Road, Cardiff CF10 3AZ and its shares are listed on the London Stock Exchange.

The consolidated financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The Company has elected to prepare its Parent Company financial statements in accordance with UK Generally Accepted Accounting Practice (GAAP).

### Adoption of new and revised standards

The Group has applied all adopted IFRS and interpretations endorsed by the EU at 31 December 2012, including all amendments to extant standards that are not effective until later accounting periods.

There are a number of standards, amendments to standards and interpretations that were issued by 31 December 2012 but have either yet to be endorsed by the EU, or were endorsed shortly after the year end. These are as follows:

- IFRS 9 Financial Instruments
- Government Loans (Amendments to IFRS 1)
- Improvements to IFRSs 2009-2011
- Transition guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)
- Investment entities (Amendments to IFRS 10, IFRS 12 and IAS 27).

None of these standards, amendments to standards or interpretations of current standards above will have a material impact on the Group's financial statements in future periods.

In addition, none of the standards or interpretations adopted for the first time in the year have had a material impact on the consolidated financial results or position of the Group for the year ended 31 December 2012.

### Basis of preparation

The accounts have been prepared on a going concern basis. In considering the appropriateness of this assumption, the Board have reviewed the Group's projections for the next twelve months and beyond, including cash flow forecasts and regulatory capital surpluses. The Group has no debt.

The Directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis in preparing the annual financial statements.

Further information regarding the company's business activities, together with the factors likely to affect its future development, performance and position, is set out in the Business Review on pages 11 to 21. Further information regarding the financial position of the company, its cash flows, liquidity position and borrowing facilities are described in the Business Review on pages 20 to 21. In addition notes 5 and 10 to the financial statements include the company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk and liquidity risk.

The accounting policies set out in the notes to the financial statements have, unless otherwise stated, been applied consistently to all periods presented in these Group financial statements.

The financial statements are prepared on the historical cost basis, except for the revaluation of financial assets classified as at fair value through profit or loss.

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The preparation of financial statements in conformity with adopted IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is reviewed if this revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years. To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, it is recognised by adjusting the carrying amount of the related asset or liability in the period of the change.

## Notes to the Financial Statements continued

### 2. Critical accounting judgements and estimates

#### Judgements:

In applying the Group's accounting policies as described in the notes to the financial statements, management has primarily applied judgement in the classification of the Group's contracts with reinsurers as reinsurance contracts. A contract is required to transfer significant insurance risk in order to be classified as such. Management reviews all terms and conditions of each such contract, and if necessary obtains the opinion of an independent expert at the negotiation stage in order to be able to make this judgement.

#### Estimation techniques used in calculation of claims provisions:

Estimation techniques are used in the calculation of the provisions for claims outstanding, which represent a projection of the ultimate cost of settling claims that have occurred prior to the balance sheet date and remain unsettled at the balance sheet date.

The key area where these techniques are used relates to the ultimate cost of reported claims. A secondary area relates to the emergence of claims that occurred prior to the balance sheet date, but had not been reported at that date.

The estimates of the ultimate cost of reported claims are based on the setting of claim provisions on a case-by-case basis, for all but the simplest of claims.

The sum of these provisions are compared with projected ultimate costs using a variety of different projection techniques (including incurred and paid chain ladder and an average cost of claim approach) to allow an actuarial assessment of their likely accuracy. They include allowance for unreported claims.

The most significant sensitivity in the use of the projection techniques arises from any future step change in claims costs, which would cause future claim cost inflation to deviate from historic trends. This is most likely to arise from a change in the regulatory or judicial regime that leads to an increase in awards or legal costs for bodily injury claims that is significantly above or below the historical trend.

The claims reserves are subject to independent review by the Group's actuarial advisors. Management's reserving policy is to reserve at a level above best estimate assumptions to allow for unforeseen adverse claims development. For further detail on objectives, policies and procedures for managing insurance risk, refer to note 4 of the financial statements.

Future changes in claims reserves also impact profit commission income, as the recognition of this income is dependent on the loss ratio booked in the financial statements, and cash receivable is dependent on actuarial projections of ultimate loss ratios.

### 3. Group consolidation and operating segments

#### 3a Accounting policies

##### (i) Group consolidation

The consolidated financial statements comprise the results and balances of the Company and its subsidiaries (together referred to as the Group) for the year ended 31 December 2012 and comparative figures for the year ended 31 December 2011. The financial statements of the Company's subsidiaries are consolidated in the Group financial statements. The Company controls 100% of the voting share capital of all its principal subsidiaries, except Rastreator.com Limited and Inspop USA LLC. The Parent Company financial statements present information about the Company as a separate entity and not about its Group. In accordance with International Accounting Standard (IAS) 24, transactions or balances between Group companies that have been eliminated on consolidation are not reported as related party transactions in the consolidated financial statements.

##### (ii) Foreign currency translation:

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in millions of pounds sterling, which is the Group's presentation currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss.

The financial statements of foreign operations whose functional currency is not pounds sterling are translated into the Group presentation currency (sterling) as follows:

- Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- Income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the date of the transaction); and
- All resulting exchange differences are recognised in other comprehensive income and in a separate component of equity.

On disposal of a foreign operation, the cumulative amount recognised in equity relating to that particular operation is recognised in the income statement.

### 3b Segment reporting

The Group has four reportable segments, as described below. These segments represent the principal split of business that is regularly reported to the Group's Board of Directors, which is considered to be the Group's chief operating decision maker in line with IFRS 8, Operating Segments.

#### UK Car Insurance:

The segment consists of the underwriting of car insurance and other products that supplement the car insurance policy. It also includes the generation of ancillary income from underwriting car insurance in the UK. The Directors consider the results of these activities to be reportable as one segment as the activities carried out in generating the income are not independent of each other and are performed as one business. This mirrors the approach taken in management reporting.

#### International Car Insurance:

The segment consists of the underwriting of car insurance and the generation of ancillary income from underwriting car insurance outside of the UK. It specifically covers the Group operations Admiral Seguros in Spain, ConTe in Italy, L'olivier Assurances in France and Elephant Auto in the USA. None of these operations are reportable on an individual basis, based on the threshold requirements in IFRS 8.

#### Price Comparison:

The segment relates to the Group's price comparison websites Confused in the UK, Rastreator in Spain and LeLynx in France. The Group's price comparison operation in Italy, Chiarezza was sold in 2012. Each of the Price Comparison businesses are operating in individual geographical segments but are grouped into one reporting segment as LeLynx and Rastreator do not individually meet the threshold requirements in IFRS 8.

#### Other:

The 'other' segment is designed to be comprised of all other operating segments that do not meet the threshold requirements for individual reporting. Currently there is only one such segment, the Gladiator commercial van insurance broking operation, and so it is the results and balances of this operation comprises the 'other' segment.

The Group launched a UK Household insurance product at the end of 2012. There are no transactions relating to household insurance within any of the segments reported below.

Taxes are not allocated across the segments and, as with the corporate activities, are included in the reconciliation to the Consolidated Income Statement and Consolidated Statement of Financial Position.

An analysis of the Group's revenue and results for the year ended 31 December 2012, by reportable segment are shown below. The accounting policies of the reportable segments are consistent with those presented in the notes to the financial statements for the Group.

	31 December 2012					
	UK Car Insurance £m	International Car Insurance £m	Price Comparison £m	Other £m	Eliminations £m	Segment total £m
Turnover*	1,936.2	162.9	103.5	12.5	–	2,215.1
Net insurance premium revenue	455.6	43.3	–	–	–	498.9
Other revenue and profit commission	342.7	10.8	103.5	12.5	–	469.5
Investment and interest income	13.9	0.1	–	–	–	14.0
Net revenue	812.2	54.2	103.5	12.5	–	<b>982.4</b>
Net insurance claims	(355.1)	(49.4)	–	–	–	(404.5)
Expenses	(84.3)	(29.3)	(85.5)	(10.0)	–	(209.1)
<b>Segment profit/(loss) before tax</b>	<b>372.8</b>	<b>(24.5)</b>	<b>18.0</b>	<b>2.5</b>	<b>–</b>	<b>368.8</b>
Other central revenue and expenses, including share scheme charges						(26.1)
Interest income						1.9
<b>Consolidated profit before tax</b>						<b>344.6</b>
Taxation expense						(86.2)
<b>Consolidated profit after tax</b>						<b>258.4</b>
Other segment items:						
Capital expenditure	6.1	3.1	0.9	0.1	–	10.2
Depreciation and Amortisation	28.8	26.2	1.0	0.3	–	56.3

\*Turnover is a non-GAAP measure and consists of total premiums written (including co-insurers share) and other revenue.

## Notes to the Financial Statements continued

Revenue and results for the corresponding reportable segments for the year ended 31 December 2011 are shown below.

	31 December 2011					
	UK Car Insurance £m	International Car Insurance £m	Price Comparison £m	Other £m	Eliminations £m	Segment total £m
Turnover*	1,966.0	122.2	90.4	11.7	–	2,190.3
Net insurance premium revenue	418.6	27.2	–	–	–	445.8
Other revenue and profit commission	299.0	9.7	90.4	11.7	–	410.8
Investment and interest income	10.6	0.2	–	–	–	10.8
Net revenue	728.2	37.1	90.4	11.7	–	867.4
Net insurance claims	(335.5)	(28.3)	–	–	–	(363.8)
Expenses	(79.1)	(18.3)	(79.9)	(8.9)	–	(186.2)
<b>Segment profit/(loss) before tax</b>	<b>313.6</b>	<b>(9.5)</b>	<b>10.5</b>	<b>2.8</b>	<b>–</b>	<b>317.4</b>
Other central revenue and expenses, including share scheme charges						(21.2)
Interest income						2.9
<b>Consolidated profit before tax</b>						<b>299.1</b>
Taxation expense						(77.8)
<b>Consolidated profit after tax</b>						<b>221.3</b>
Other segment items:						
Capital expenditure	12.4	2.9	1.1	0.4	–	16.8
Depreciation and amortisation	37.8	11.8	1.2	0.3	–	51.1

\*Turnover is a non-GAAP measure and consists of total premiums written (including co-insurers share) and other revenue.

### Segment revenues

The UK and International Car Insurance reportable segments derive all insurance premium income from external policyholders. Revenue within these segments is not derived from an individual policyholder that represents 10% or more of the Group's total revenue.

The total of Price Comparison revenues from transactions with other reportable segments is £13.0m (2011: £14.9m). These amounts have not been eliminated on consolidation as the Directors consider that not doing so results in a better overall presentation of the financial statements. The impact on the financial statements in the current and prior period is not material. There are no other transactions between reportable segments.

Within the UK Car Insurance segment, transactions between the Group's intermediary and the Group's insurance companies relating to vehicle commission totalling £7.0m have not been eliminated (from the insurance expenses and other revenue lines in the income statement) in order to ensure consistency between the financial statements and key performance indicators quoted in the business review. There is no profit impact of the non-elimination.

Revenues from external customers for products and services is consistent with the split of reportable segment revenues as shown above.

### Information about geographical locations

All material revenues from external customers, and net assets attributed to a foreign country are shown within the International Car Insurance reportable segment shown above. The revenue and results of the two International Price Comparison businesses, Rastreator and LeLynx are not yet material enough to be presented as a separate segment.

## Segment assets and liabilities

The identifiable segment assets and liabilities at 31 December 2012 are as follows.

	31 December 2012					
	UK Car Insurance £m	International Car Insurance £m	Price Comparison £m	Other £m	Eliminations £m	Segment total £m
Property and equipment	11.6	2.8	1.7	0.4	–	16.5
Intangible assets	77.6	13.8	1.0	0.1	–	92.5
Reinsurance assets	717.1	85.9	–	–	–	803.0
Trade and other receivables	98.7	(20.6)	9.1	9.5	(41.4)	55.3
Financial assets	1833.2	97.3	–	–	–	1,930.5
Cash and cash equivalents	125.0	50.2	25.4	5.6	–	206.2
Reportable segment assets	2,863.2	229.4	37.2	15.6	(41.4)	3,104.0
Insurance contract liabilities	1,543.0	153.9	–	–	–	1,696.9
Trade and other payables	961.8	31.9	6.5	6.3	–	1,006.5
Reportable segment liabilities	2,504.8	185.8	6.5	6.3	–	2,703.4
Reportable segment net assets	358.4	43.6	30.7	9.3	(41.4)	400.6
Unallocated assets and liabilities						60.1
Consolidated net assets						460.7

Unallocated assets and liabilities consist of other central assets and liabilities, plus deferred and current corporation tax balances. These assets and liabilities are not regularly reviewed by the Board of Directors in the reportable segment format.

There is an asymmetrical allocation of assets and income to the reportable segments, in that the interest earned on cash and cash equivalent assets deployed in the UK Car Insurance, Price Comparison and International Car Insurance segments is not allocated in arriving at segment profits. This is consistent with regular management reporting.

Eliminations represent inter-segment funding and balances included in trade and other receivables.

The segment assets and liabilities at 31 December 2011 are as follows.

	31 December 2011					
	UK Car Insurance £m	International Car Insurance £m	Price Comparison £m	Other £m	Eliminations £m	Segment total £m
Property and equipment	12.1	3.1	1.8	0.6	–	17.6
Intangible assets	78.4	8.5	0.5	0.1	–	87.5
Reinsurance assets	570.3	69.5	–	–	–	639.8
Trade and other receivables	118.7	(5.5)	(0.2)	9.0	(69.9)	52.1
Financial assets	1,464.8	83.2	–	–	–	1,548.0
Cash and cash equivalents	117.8	38.9	8.8	4.4	–	169.9
Reportable segment assets	2,362.1	197.7	10.8	14.1	(69.9)	2,514.8
Insurance contract liabilities	1,215.4	118.3	–	–	–	1,333.7
Trade and other payables	816.1	28.3	6.6	5.6	–	856.6
Reportable segment liabilities	2,031.5	146.5	6.6	5.6	–	2,190.2
Reportable segment net assets	330.6	51.2	4.2	8.5	(69.9)	324.6
Unallocated assets and liabilities						69.8
Consolidated net assets						394.4

## Notes to the Financial Statements continued

### 4. Premium, Claims and Profit Commissions

#### 4a Accounting policies

##### (i) Revenue recognition – premiums:

Premiums relating to insurance contracts are recognised as revenue proportionally over the period of cover. Premiums with an inception date after the end of the period are held in the statement of financial position as deferred revenue. Outstanding collections from policyholders are recognised within policyholder receivables.

##### (ii) Revenue recognition – profit commission:

Under some of the co-insurance and reinsurance contracts under which motor premiums are shared or ceded, profit commission may be earned on a particular year of account, which is usually subject to performance criteria such as loss ratios and expense ratios. The commission is dependent on the ultimate outcome of any year, with revenue being recognised when loss and expense ratios used in the preparation of the financial statements, move below an agreed threshold.

##### (iii) Insurance contracts and reinsurance assets:

###### • Premiums

The proportion of premium receivable on in-force policies relating to unexpired risks is reported in insurance contract liabilities and reinsurance assets as the unearned premium provision – gross and reinsurers' share respectively.

###### • Claims

Claims and claims handling expenses are charged as incurred, based on the estimated direct and indirect costs of settling all liabilities arising on events occurring up to the balance sheet date.

The provision for claims outstanding comprises provisions for the estimated cost of settling all claims incurred but unpaid at the balance sheet date, whether reported or not. Anticipated reinsurance recoveries are disclosed separately as assets.

Whilst the Directors consider that the gross provisions for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided.

Adjustments to the amounts of claims provisions established in prior years are reflected in the income statement for the period in which the adjustments are made and disclosed separately if material. The methods used, and the estimates made, are reviewed regularly.

Provision for unexpired risks is made where necessary for the estimated amount required over and above unearned premiums (net of deferred acquisition costs) to meet future claims and related expenses.

###### • Co-insurance

The Group has entered into certain co-insurance contracts under which insurance risks are shared on a proportional basis, with the co-insurer taking a specific percentage of premium written and being responsible for the same proportion of each claim. As the contractual liability is several and not joint, neither the premiums nor claims relating to the co-insurance are included in the income statement. Under the terms of these agreements the co-insurers reimburse the Group for the same proportionate share of the costs of acquiring and administering the business.

###### • Reinsurance assets

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on the insurance contracts issued by the Group are classified as reinsurance contracts. A contract is only accounted for as a reinsurance contract where there is significant insurance risk transfer between the insured and the insurer.

The benefits to which the Group is entitled under these contracts are held as reinsurance assets.

The Group assesses its reinsurance assets for impairment on a regular basis, and in detail every six months. If there is objective evidence that the asset is impaired, then the carrying value will be written down to its recoverable amount.

#### 4b Net insurance premium revenue

	31 December 2012 £m	31 December 2011 £m
Total motor insurance premiums written before co-insurance	1,897.2	1,841.3
Group gross premiums written after co-insurance	1,167.2	1,128.4
Outwards reinsurance premiums	(679.1)	(622.0)
Net insurance premiums written	488.1	506.4
Change in gross unearned premium provision	(10.7)	(168.7)
Change in reinsurers' share of unearned premium provision	21.5	108.1
Net insurance premium revenue	498.9	445.8

The Group's share of the car insurance business was underwritten by Admiral Insurance (Gibraltar) Limited, Admiral Insurance Company Limited and Elephant Insurance Company. All contracts are short-term in duration, lasting for 10 or 12 months.

#### 4c Profit commission

	31 December 2012 £m	31 December 2011 £m
Underwriting year:		
2009 and prior	(2.3)	2.3
2010	9.4	46.8
2011	98.1	12.7
2012	3.2	–
Total profit commission	108.4	61.8

#### 4d Reinsurance assets and insurance contract liabilities

##### (i) Objectives, policies and procedures for the management of insurance risk:

The Group is involved in issuing motor insurance contracts that transfer risk from policyholders to the Group and its underwriting partners.

Insurance risk primarily involves uncertainty over the occurrence, amount or timing of claims arising on insurance contracts issued.

The key reserving risk is that the frequency and/or value of the claims arising exceeds expectation and the value of insurance liabilities established.

The Board of Directors is responsible for the management of insurance risk, although as mentioned in note 5, it has delegated the task of supervising risk management to the Group Risk Committee.

The Board implements certain policies in order to mitigate and control the level of insurance risk accepted by the Group. These include underwriting partnership arrangements, pricing policies and claims management and administration policies.

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## Notes to the Financial Statements continued

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A number of the key elements of these policies and procedures are detailed below:

- **Co-insurance and reinsurance:**

As noted in the business review, the Group cedes a significant amount of the motor insurance business generated to external underwriters. In 2012, 40% of the UK risk was shared under a co-insurance contract, under which the primary risk is borne by the co-insurer. A further 35% of the UK risk was ceded under quota share reinsurance contracts. Co-insurance and reinsurance contracts are also used in the International car insurance businesses. Further detail can be found in the business review on page 13 and 17.

As well as these proportional arrangements, an excess of loss reinsurance programme is also purchased to protect the Group against very large individual claims and catastrophe losses.

- **Data driven pricing:**

The Group's underwriting philosophy is focused on a sophisticated data-driven approach to pricing and underwriting and on exploiting the competitive advantages direct insurers enjoy over traditional insurers through:

- Collating and analysing more comprehensive data from customers;
- Tight control over the pricing guidelines in order to target profitable business sectors; and
- Fast and flexible responsiveness to data analysis and market trends.

The Group is committed to establishing premium rates that appropriately price the underwriting risk and exposure. Rates are set utilising a larger than average number of underwriting criteria.

The Directors believe that there is a strong link between the increase in depth of data that the Group has been able to collate over time and the lower than average historic reported loss ratios enjoyed by the Group.

- **Effective claims management:**

The Group adopts various claims management strategies designed to ensure that claims are paid at an appropriate level and to minimise the expenses associated with claims management. These include:

- An effective, computerised workflow system (which along with the appropriate level of resources employed helps reduce the scope for error and avoids significant backlogs);
- Use of an outbound telephone team to contact third parties aiming to minimise the potential claims costs and to ensure that more third parties utilise the Group approved repairers; and
- Use of sophisticated and innovative methods to check for fraudulent claims.

**Concentration of insurance risk:**

The Directors do not believe there are significant concentrations of insurance risk. This is because, although the Group has historically written only one line of insurance business, the risks are spread across a large number of people and a wide regional base.

**(ii) Sensitivity of recognised amounts to changes in assumptions:**

The following table sets out the impact on equity and profit or loss at 31 December 2012 that would result from a 1 per cent movement in the UK loss ratios used for each underwriting year for which material amounts remain outstanding.

	Underwriting year			
	2009	2010	2011	2012
Booked loss ratio	77%	75%	76%	84%
Impact of 1% change (£m)	5.3	8.3	12.0	6.0

The impact is stated net of reinsurance and includes the change in net insurance claims along with the associated profit commission movements that result from changes in loss ratios. The figures are stated net of tax at the current rate.

**(iii) Analysis of recognised amounts:**

	31 December 2012 £m	31 December 2011 £m
<b>Gross:</b>		
Claims outstanding	1,147.7	781.1
Unearned premium provision	549.2	552.6
Total gross insurance liabilities	1,696.9	1,333.7
<b>Recoverable from reinsurers:</b>		
Claims outstanding	487.3	334.2
Unearned premium provision	315.7	305.6
Total reinsurers' share of insurance liabilities	803.0	639.8
<b>Net:</b>		
Claims outstanding	660.4	446.9
Unearned premium provision	233.5	247.0
Total insurance liabilities – net	893.3	693.9

The maturity profile of gross insurance liabilities at the end of 2012 is as follows:

	< 1 Year £m	1 – 3 years £m	> 3 years £m
Claims outstanding	344.1	391.7	411.9
Unearned premium provision	549.2	–	–
Total gross insurance liabilities	893.3	391.7	411.9

The maturity profile of gross insurance liabilities at the end of 2011 was as follows:

	< 1 Year £m	1 – 3 years £m	> 3 years £m
Claims outstanding	234.3	266.6	280.2
Unearned premium provision	552.6	–	–
Total gross insurance liabilities	786.9	266.6	280.2

## Notes to the Financial Statements continued

**(iv) Analysis of UK claims incurred:**

The following tables illustrate the development of net UK Car Insurance claims incurred for the past four financial periods, including the impact of re-estimation of claims provisions at the end of each financial year. The first table shows actual net claims incurred, and the second shows the development of UK loss ratios. Figures are shown net of reinsurance and are on an underwriting year basis.

Analysis of claims incurred (Net amounts):	Financial year ended 31 December				Total £m
	2009 £m	2010 £m	2011 £m	2012 £m	
<b>Underwriting year (UK only):</b>					
2009 and earlier	(132.4)	(53.9)	8.7	(5.5)	
2010	–	(130.2)	(128.6)	8.4	(250.3)
2011	–	–	(203.7)	(151.1)	(354.8)
2012	–	–	–	(191.3)	(191.3)
UK net claims incurred (excluding claims handling costs)	(132.4)	(184.1)	(323.6)	(339.5)	
International net claims incurred	(13.6)	(15.9)	(28.3)	(54.2)	
Claims handling costs and other amounts	(5.7)	(8.5)	(11.9)	(10.8)	
<b>Total net claims incurred</b>	<b>(151.7)</b>	<b>(208.5)</b>	<b>(363.8)</b>	<b>(404.5)</b>	

UK loss ratio development:	Financial year ended 31 December				
	2009 £m	2010 £m	2011 £m	2012 £m	
<b>Underwriting year (UK only):</b>					
2007		72%	70%	69%	69%
2008		79%	74%	72%	73%
2009		84%	75%	77%	77%
2010			78%	77%	75%
2011				82%	76%
2012					84%

**(v) Analysis of net claims provision releases (UK business only):**

The following table analyses the impact of movements in prior year claims provisions, in terms of their net value, and their impact on the reported loss ratio. This data is presented on an underwriting year basis.

	Financial year ended 31 December			
	2009 £m	2010 £m	2011 £m	2012 £m
<b>Underwriting year:</b>				
2009 and prior	31.3	23.5	8.7	(5.5)
2010	–	–	1.6	8.4
2011	–	–	–	14.7
<b>Total net release</b>	<b>31.3</b>	<b>23.5</b>	<b>10.3</b>	<b>17.6</b>
Net releases on Admiral net share <sup>1</sup>	31.3	23.1	7.8	16.3
Releases on commuted quota share reinsurance contracts <sup>1</sup>	–	0.4	2.5	1.3
<b>Total net release as above</b>	<b>31.3</b>	<b>23.5</b>	<b>10.3</b>	<b>17.6</b>

<sup>1</sup> Admiral typically commutes quota share reinsurance contracts in its UK Car Insurance business 24 or 36 months following the start of the underwriting year. After commutation, any changes in claims costs on the commuted proportion of the business are reflected within claims costs and are separately analysed here.

## (vi) Reconciliation of movement in net claims provision:

	31 December 2012 £m	31 December 2011 £m
Net claims provision at start of period	446.9	269.0
Net claims incurred	393.7	351.9
Movement in net claims provision due to commutation	102.2	44.0
Net claims paid	(282.4)	(218.0)
Net claims provision at end of period	660.4	446.9

## (vii) Reconciliation of movement in net unearned premium provision:

	31 December 2012 £m	31 December 2011 £m
Net unearned premium provision at start of period	247.0	180.6
Written in the period	488.1	506.4
Earned in the period	(501.6)	(440.0)
Net unearned premium provision at end of period	233.5	247.0

**5. Investments****5a Accounting policies****(i) Investment income:**

Investment income from financial assets comprises interest income and net gains (both realised and unrealised) on financial assets classified as fair value through profit and loss and interest income on held to maturity deposits.

**(ii) Financial assets – investments and receivables:****• Initial recognition**

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables or held to maturity investments. At initial recognition assets are recognised at fair value and classified according to the purpose for which they were acquired.

The Group's investments in money market liquidity funds are designated as financial assets at fair value through profit or loss (FVTPL) at inception.

This designation is permitted under IAS 39, as the investments in money market funds are managed as a group of assets and internal performance evaluation of this group is conducted on a fair value basis.

The Group's deposits with credit institutions are classified as held to maturity investments, which is consistent with the intention for which they were purchased.

**• Subsequent measurement**

Financial assets at FVTPL are stated at fair value, with any resultant gain or loss recognised through the income statement.

Deposits with fixed maturities, classified as held to maturity investments are measured at amortised cost using the effective interest method. Movements in the amortised cost are recognised through the income statement, as are any impairment losses.

Loans and receivables are stated at their amortised cost less impairment using the effective interest method. Impairment losses are recognised through the income statement.

## Notes to the Financial Statements continued

- **Impairment of financial assets**

The Group assesses at each balance sheet date whether any financial assets or groups of financial assets held at amortised cost, are impaired. Financial assets are impaired where there is evidence that one or more events occurring after the initial recognition of the asset, may lead to a reduction in the estimated future cash flows arising from the asset.

Objective evidence of impairment may include default on cash flows due from the asset and reported financial difficulty of the issuer or counterparty.

- **Derecognition of financial assets**

A financial asset is derecognised when the rights to receive cash flows from that asset have expired or when the Group transfers the asset and all the attaching substantial risks and rewards relating to the asset, to a third party.

(iii) **Cash and cash equivalents**

Cash and cash equivalents includes cash in hand, deposits held at call with banks, and other short-term deposits with original maturities of three months or less. All cash and cash equivalents are measured at amortised cost.

**5b Investment and interest income**

	31 December 2012 £m	31 December 2011 £m
Net investment return	14.0	10.8
Interest receivable	1.9	2.9
Total investment and interest income	15.9	13.7

Interest received during the year was £1.9m (2011: £2.9m).

**5c Financial assets and liabilities**

The Group's financial instruments can be analysed as follows:

	31 December 2012 £m	31 December 2011 £m
<b>Financial assets:</b>		
Investments held at fair value	1,025.4	862.1
Held to maturity deposits with credit institutions	375.8	297.0
Held to maturity short dated debt securities	200.4	–
Receivables – amounts owed by policyholders	403.5	423.9
Total financial assets per consolidated statement of financial position	2,005.1	1,583.0
Trade and other receivables	55.3	52.1
Cash and cash equivalents	216.6	224.6
	2,277.0	1,859.7
<b>Financial liabilities:</b>		
Trade and other payables	1,006.5	856.6

All investments held at fair value are invested in AAA-rated money market liquidity funds. These funds target a short term cash return with capital security and low volatility and continue to achieve these goals.

The approximate fair value of held to maturity deposits plus short dated debt securities is £562.8m (2011: £280.8m) based on a calculation to discount expected cashflows arising at the Group's weighted average cost of capital (WACC). The amortised cost carrying amount of receivables is a reasonable approximation of fair value.

The maturity profile of financial assets and liabilities at 31 December 2012 is as follows:

	On demand £m	< 1 Year £m	Between 1 and 2 years £m	> 2 Years £m
<b>Financial assets:</b>				
Investments held at fair value	1,025.4	–	–	–
Held to maturity deposits with credit institutions	–	213.8	162.0	–
Held to maturity short dated debt securities	–	200.4	–	–
Receivables – amounts owed by policyholders	–	403.5	–	–
Total financial assets	1,025.4	817.7	162.0	–
Trade and other receivables	–	55.3	–	–
Cash and cash equivalents	216.6	–	–	–
	1,242.0	873.0	162.0	–
<b>Financial liabilities:</b>				
Trade and other payables	–	1,006.5	–	–

The maturity profile of financial assets and liabilities at 31 December 2011 was as follows:

	On demand £m	< 1 Year £m	Between 1 and 2 years £m	> 2 Years £m
<b>Financial assets:</b>				
Investments held at fair value	862.1	–	–	–
Held to maturity deposits with credit institutions	–	175.3	79.2	42.5
Receivables – amounts owed by policyholders	–	423.9	–	–
Total financial assets	862.1	599.2	79.2	42.5
Trade and other receivables	–	52.1	–	–
Cash and cash equivalents	224.6	–	–	–
	1,086.7	651.3	79.2	42.5
<b>Financial liabilities:</b>				
Trade and other payables	–	856.6	–	–

#### Objectives, policies and procedures for managing financial assets and liabilities

The Group's activities expose it primarily to financial risks of credit risk, interest rate risk, liquidity risk and foreign exchange risk. The Board of Directors has delegated the task of supervising risk management and internal control to the Risk Committee. There is also an Investment Committee that makes recommendations to the Board on the Group's investment strategy.

There are several key elements to the risk management environment throughout the Group. These are detailed in full in the Corporate Governance statement. Specific considerations for the risks arising from financial assets and liabilities are detailed below.

- **Credit risk**

The Group defines credit risk as the risk of loss if another party fails to perform its obligations. The key areas of exposure to credit risk for the Group result through its reinsurance programme, investments, bank deposits and policyholder receivables.

Economic and financial market conditions have led the Directors to consider counterparty exposure more frequently and in significant detail. The Directors consider that the policies and procedures in place to manage credit exposure continue to be appropriate for the Group's risk appetite, and during 2012 and historically no material credit losses have been experienced by the Group.

There are no specific concentrations of credit risk with respect to investment counterparties due to the structure of the liquidity funds which invest in a wide range of very short duration, high quality securities. Cash balances and deposits are placed only with highly rated credit institutions. The detailed holdings are reviewed regularly by the Investment Committee.

## Notes to the Financial Statements continued

To mitigate the risk arising from exposure to reinsurers (in the form of reinsurance recoveries and profit commissions), the Group only conducts business with companies of appropriate financial strength. In addition, most reinsurance contracts are operated on a funds withheld basis, which substantially reduces credit risk, as the Group holds the cash received as collateral.

The other principal form of credit risk is in respect of amounts due from policyholders, largely due to the potential for default by instalment payers. The impact of this is mitigated by the large customer base and low average level of balance recoverable. There is also mitigation by the operation of numerous high- and low- level controls in this area, including payment on policy acceptance as opposed to inception and automated cancellation procedures for policies in default.

The Group's maximum exposure to credit risk at 31 December 2012 is £2,221.7m (2011: £1,807.6m) being the carrying value of financial assets and cash. The Group does not use credit derivatives or similar instruments to mitigate exposure. The amount of bad debt expense relating to policyholder debt charged to the income statement in 2011 and 2012 is insignificant.

There were no significant financial assets that were past due at the close of either 2012 or 2011.

The Group's credit risk exposure to assets with external ratings is as follows:

	Rating	31 December 2012 £m	31 December 2011 £m
Financial institutions – Money market funds	AAA	1,025.4	862.1
Financial institutions – Credit institutions	AAA	60.1	–
Financial institutions – Credit institutions	AA	169.2	178.2
Financial institutions – Credit institutions	A	506.4	98.0
Financial institutions – Credit institutions	BBB	57.1	20.8
Reinsurers	AA	117.8	–
Reinsurers	A	196.3	88.3
Reinsurers	BBB	6.5	–

- Interest rate risk

The Group considers interest rate risk to be the risk that unfavourable movements in interest rates could adversely impact on the capital values of financial assets and liabilities. This relates primarily to investments held at fair value.

As noted above, the Group invests in money market liquidity funds, which in turn invest in a mixture of very short dated fixed and variable rate securities, such as cash deposits, certificates of deposits, floating rate notes and other commercial paper.

The funds are not permitted to have an average maturity greater than 60 days and hence are not subject to large movements in yield and value resulting from changes in market interest rates (as longer duration fixed income portfolios can experience). Returns are likely to closely track the LIBID benchmark and hence while the Group's investment return will vary according to market interest rates, the capital value of these investment funds will not be impacted by rate movements. The interest rate risk arising is therefore considered to be minimal.

During the year the Group has placed funds into two segregated mandates. The guidelines of the investments retain the credit quality of the money market liquidity funds, whilst holding the securities on a hold to maturity basis. As the duration of the securities is short there is no material interest rate risk relating to these investments.

The Group also holds a number of fixed rate, longer-term deposits with strongly rated credit institutions. These are classified as held to maturity and valued at amortised cost. Therefore neither the capital value of the deposits, or the interest return will be impacted by fluctuations in interest rates.

No sensitivity analysis to interest rates has been presented on the grounds of materiality.

- **Liquidity risk**

Liquidity risk is defined as the risk that the Group does not have sufficient, available, financial resources to enable it to meet its obligations as they fall due, or can only secure them at excessive cost.

The Group is strongly cash-generative due to the large proportion of revenue arising from non-underwriting activity. Further, as noted above, a significant portion of insurance funds are invested in money market liquidity funds with same day liquidity, meaning that a large proportion of the Group cash and investments are immediately available.

A breakdown of the Group's financial liabilities – trade and other payables is shown in note 9. In terms of the maturity profile of these liabilities, all amounts will mature within 3 – 6 months of the balance sheet date. (Refer to the maturity profile at the start of this note for further detail.)

In practice, the Group's Directors expect actual cash flows to be consistent with this maturity profile except for amounts owed to co-insurers and reinsurers. Of the total amounts owed to co-insurers and reinsurers of £723.5m (2011: £579.4m), £609.6m (2011: £432.9m) is held under funds withheld arrangements and therefore not expected to be settled within 12 months.

A maturity analysis for insurance contract liabilities is included in note 4.

The maturity profile for financial assets is included at the start of this note. The Group's Directors believe that the cash flows arising from these assets will be consistent with this profile.

Liquidity risk is not, therefore considered to be significant.

- **Foreign exchange risks**

Foreign exchange risks arise from unfavourable movements in foreign exchange rates that could adversely impact the valuation of overseas assets.

The Group is exposed to foreign exchange risk through its expanding operations overseas. Although the relative size of the European and International operations means that the risks are relatively small, increasingly volatile foreign exchange rates could result in larger potential gains or losses. Assets held to fund insurance liabilities are held in the currency of the liabilities, however surplus assets held as regulatory capital in foreign currencies remain exposed.

The Group's exposures to net assets held in euros and dollars at the balance sheet date were £13.3m and £46.7m respectively.

### **Fair value**

For cash at bank and cash deposits, the fair value approximates to the book value due to their short maturity. For assets held at fair value through profit and loss, their value equates to level 1 (quoted prices in active markets) of the fair value hierarchy.

### **5d Cash and cash equivalents**

	31 December 2012 £m	31 December 2011 £m
Cash at bank and in hand	216.6	224.6
Total cash and cash equivalents	216.6	224.6

Cash and cash equivalents includes cash in hand, deposits held at call with banks, and other short-term deposits with original maturities of three months or less.

## **6. Other Revenue**

### **6a Accounting policy**

#### **(i) Ancillary and other revenue:**

Ancillary and other revenue includes revenue earned on the sale of ancillary products, administration and other charges paid by the policyholder, referral fees, revenue from policies paid by instalments and vehicle commission charges paid by co- and reinsurers. Revenue is credited to the income statement over the period matching the Group's obligations to provide services. Where the Group has no remaining contractual obligations, the revenue is recognised immediately. An allowance is made for expected cancellations where the customer may be entitled to a refund of ancillary amounts charged.

Commission from price comparison activities and earned by Gladiator is credited to revenue on the sale of the underlying insurance policy.

## Notes to the Financial Statements continued

## 6b Ancillary and other revenue

	31 December 2012 £m	31 December 2011 £m
Ancillary revenue	215.7	223.3
Price comparison revenue	103.5	90.4
Other revenue	41.9	35.3
Total other revenue	361.1	349.0

Refer to the Business review for further detail on the sources of revenue.

## 7. Expenses

## 7a Accounting policies

## (i) Acquisition costs, reinsurer vehicle commission and operating expenses:

Acquisition costs incurred in obtaining new and renewal business are charged to the income statement over the period in which those premiums are earned. Vehicle commissions relating to new and renewal business is also recognised over the period in which those premiums are earned. All other operating expenses are charged to the income statement in the period that they are incurred.

Insurance contract expenses, which comprise of the acquisition costs, vehicle commissions and operating expenses referred to above are included in the income statement net of recoveries from co-insurers and reinsurers.

## (ii) Employee benefits:

## Pensions

The Group contributes to defined contribution personal pension plans for its employees. The contributions payable to these schemes are charged in the accounting period to which they relate.

## Employee share schemes

The Group operates a number of equity settled compensation schemes for its employees. For schemes commencing 1 January 2004 and after, the fair value of the employee services received in exchange for the grant of free shares under the schemes is recognised as an expense, with a corresponding increase in equity.

The total charge expensed over the vesting period is determined by reference to the fair value of the free shares granted as determined at the grant date (excluding the impact of non-market vesting conditions). Non-market conditions such as profitability targets as well as staff attrition rates are included in assumptions over the number of free shares to vest under the applicable scheme.

At each balance sheet date, the Group revises its assumptions on the number of shares to be granted with the impact of any change in the assumptions recognised through income.

Refer to note 7e for further details on share schemes.

## 7b Operating expenses and share scheme charges

	31 December 2012			31 December 2011		
	Insurance contracts £m	Other £m	Total £m	Insurance contracts £m	Other £m	Total £m
Acquisition of insurance contracts	50.6	–	50.6	36.2	–	36.2
Administration and other marketing costs	26.7	137.3	164.0	26.7	125.9	152.6
Expenses	77.3	137.3	214.6	62.9	125.9	188.8
Share scheme charges	–	20.6	20.6	–	18.6	18.6
Total expenses and share scheme charges	77.3	157.9	235.2	62.9	144.5	207.4

**Analysis of other administration and other marketing costs:**

	31 December 2012 £m	31 December 2011 £m
Ancillary sales expenses	35.9	33.8
Price comparison operating expenses	85.5	79.9
Other expenses	15.9	12.2
<b>Total</b>	<b>137.3</b>	<b>125.9</b>

The £26.7m (2011: £26.7m) administration and marketing costs allocated to insurance contracts is principally made up of salary costs.

**Reconciliation of expenses related to insurance contracts to reported Group expense ratio:**

	31 December 2012 £m	31 December 2011 £m
Insurance contract expenses from above	77.3	62.9
Add: claims handling expenses	10.8	11.9
Adjusted expenses	88.1	74.8
Net insurance premium revenue	498.9	445.8
Reported expense ratio	17.7%	16.8%

**7c Staff costs and other expenses**

Included in gross expenses, before co-insurance arrangements, are the following:

	31 December 2012 £m	31 December 2011 £m
Salaries	137.1	114.5
Social security charges	13.8	10.3
Pension costs	1.0	1.3
Share scheme charges (see note 7e)	32.5	30.8
<b>Total staff expenses</b>	<b>184.4</b>	<b>156.9</b>
Depreciation charge:		
– Owned assets	5.4	5.4
– Leased assets	1.2	0.7
Amortisation charge:		
– Software	4.1	3.3
– Deferred acquisition costs	48.0	41.8
Operating lease rentals:		
– Buildings	10.5	7.9
Auditor's remuneration (including VAT):		
– Fees payable for the audit of the Company's annual accounts	–	–
– Fees payable for the audit of the Company's subsidiary accounts	0.3	0.2
– Fees payable for other services	0.3	0.3
Net foreign exchange losses	–	0.8
Analysis of fees paid to the auditor for other services:		
Tax compliance services	0.1	0.1
Tax advisory services	0.2	0.2
Other services	–	–
<b>Total as above</b>	<b>0.3</b>	<b>0.3</b>

Refer to the corporate governance report for details of the Audit Committee's policy on fees paid to the Company's auditor for non-audit services. The ratio of non-audit fees to audit fees in 2012 was 124% (2011: 119%).

The amortisation of software and deferred acquisition cost assets is charged to expenses in the income statement.

## Notes to the Financial Statements continued

## 7d Staff numbers (including Directors)

	Average for the year	
	2012 Number	2011 Number
Direct customer contact staff	4,991	4,264
Support staff	1,231	1,060
Total	6,222	5,324

## 7e Staff share schemes

Analysis of share scheme costs (per income statement):

	31 December 2012 £m	31 December 2011 £m
SIP charge (note i)	6.6	6.0
DFSS charge (note ii)	14.0	12.6
Total share scheme charges	20.6	18.6

The share scheme charges reported above are net of the co-insurer's share of the cost and therefore differ from the gross charge reported in note 7c (2012: £32.5m, 2011: £30.8m) and the gross credit to reserves reported in the consolidated statement of changes in equity (2012: £23.7m, 2011: £23.6m).

The consolidated cash flow statement also shows the gross charge in the reconciliation between 'profit after tax' and 'cash flows from operating activities'. The co-insurance share of the charge is included in the 'change in trade and other payables' line.

## (i) The Approved Share Incentive Plan (the SIP)

Eligible employees qualify for awards under the SIP based upon the performance of the Group in each half-year period. The current maximum award for each year is £3,000 per employee.

The awards are made with reference to the Group's performance against prior year profit before tax. Employees must remain in employment for the holding period (three years from the date of award) otherwise the shares are forfeited.

The fair value of shares awarded is either the share price at the date of award, or is estimated at the latest share price available when drawing up the financial statements for awards not yet made (and later adjusted to reflect the actual share price on the award date). Awards under the SIP are entitled to receive dividends, and hence no adjustment has been made to this fair value.

## (ii) The Discretionary Free Share Scheme (the DFSS)

Under the DFSS, details of which are contained in the remuneration policy section of the remuneration report, individuals receive an award of free shares at no charge. Staff must remain in employment until the vesting date in order to receive shares. The maximum number of shares that can vest relating to the 2012 scheme is 2,149,566 (2011 scheme: 1,791,234).

Individual awards are calculated based on the growth in the Company's earnings per share (EPS) relative to a risk free return (RFR), for which LIBOR has been selected as a benchmark. This performance is measured over the same three-year period.

For the 2011 and 2010 schemes, 50% of the shares awarded at the start of the three year vesting period are subject to these performance conditions.

The range of awards is as follows:

- If the growth in EPS is less than the RFR, no awards vest
- EPS growth is equal to RFR – 10% of maximum award vests
- To achieve the maximum award, EPS growth has to be 36 points higher than RFR over the three year period.

Between 10% and 100% of the maximum awards, a linear relationship exists.

Awards under the DFSS are not eligible for dividends (although a discretionary bonus is currently paid equivalent to the dividend that would have been paid on the respective shareholding) and hence the fair value of free shares to be awarded under this scheme has been revised downwards to take account of these distributions. The unadjusted fair value is based on the share price at the date on which awards were made (as stated in the Remuneration report).

#### Number of free share awards committed at 31 December 2012:

	Awards outstanding (*1)	Vesting date
SIP H209 scheme	377,641	March 2013
SIP H110 scheme	352,100	August 2013
SIP H210 scheme	346,590	March 2014
SIP H111 scheme	489,170	September 2014
SIP H211 scheme	598,528	March 2015
SIP H112 scheme	619,164	September 2015
DFSS 2010 scheme 1st award	1,542,453	April 2013
DFSS 2010 scheme 2nd award	121,051	August 2013
DFSS 2011 scheme 1st award	1,634,732	April 2014
DFSS 2011 scheme 2nd award	157,312	September 2014
DFSS 2012 scheme 1st award	181,668	March 2015
DFSS 2012 scheme 2nd award	1,967,898	October 2015
<b>Total awards committed</b>	<b>8,388,307</b>	

\*1 – being the maximum number of awards expected to be made before accounting for expected staff attrition.

During the year ended 31 December 2012, awards under the SIP H208 and H109 schemes and the DFSS 2009 scheme vested. The total number of awards vesting for each scheme is as follows.

#### Number of free share awards vesting during the year ended 31 December 2012:

	Original Awards	Awards vested
SIP H208 scheme	477,432	396,549
SIP H109 scheme	396,200	340,060
DFSS 2009 scheme, 1st award	1,313,865	1,166,379
DFSS 2009 scheme, 2nd award	127,020	81,855

## Notes to the Financial Statements continued

**8. Taxation****8a Accounting policy**

Income tax on the profit or loss for the periods presented comprises current and deferred tax.

**(i) Current tax:**

Current tax is the expected tax payable on the taxable income for the period, using tax rates that have been enacted or substantively enacted by the balance sheet date, and includes any adjustment to tax payable in respect of previous periods.

Current tax related to items recognised in other comprehensive income is also recognised in other comprehensive income and not in the income statement.

**(ii) Deferred tax:**

Deferred tax is provided in full using the balance sheet liability method, providing for temporary differences arising between the carrying amount of assets and liabilities for accounting purposes, and the amounts used for taxation purposes. It is calculated at the tax rates that have been enacted or substantially enacted by the balance sheet date, or that are expected to apply in the period when the liability is settled or the asset is realised.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

The principal temporary differences arise from depreciation of property and equipment and share scheme charges. The resulting deferred tax is charged or credited in the income statement, except in relation to share scheme charges where the amount of tax benefit credited to the income statement is limited to an equivalent credit calculated on the accounting charge. Any excess is recognised directly in equity.

**8b Taxation**

	31 December 2012 £m	31 December 2011 £m
<b>Current tax</b>		
Corporation tax on profits for the year	88.4	80.3
Under/(over) provision relating to prior periods	1.2	(3.2)
Current tax charge	89.6	77.1
<b>Deferred tax</b>		
Current period deferred taxation movement	(2.8)	(0.8)
(Over)/under provision relating to prior periods – deferred tax	(0.6)	1.5
Total tax charge per income statement	86.2	77.8

Factors affecting the total tax charge are:

	31 December 2012 £m	31 December 2011 £m
<b>Profit before tax</b>	344.6	299.1
Corporation tax thereon at effective UK corporation tax rate of 24.5% (2011: 26.5%)	84.4	79.3
Expenses and provisions not deductible for tax purposes	1.4	0.1
Difference in tax rates	0.7	0.5
Adjustments relating to prior periods	(0.4)	(1.7)
Other differences	0.1	(0.4)
Total tax charge for the period as above	86.2	77.8

## 8c Deferred income tax (asset)

	31 December 2012 £m	31 December 2011 £m
Brought forward at start of period	(10.3)	(12.4)
Movement in period	(4.9)	2.1
Carried forward at end of period	(15.2)	(10.3)

The net balance provided at the end of the year is made up as follows:

Analysis of net deferred tax (asset):

	31 December 2012 £m	31 December 2011 £m
Tax treatment of share scheme charges	(3.8)	(3.6)
Capital allowances	(1.9)	(1.5)
Carried forward losses	(5.7)	(2.6)
Other differences	(3.8)	(2.6)
Deferred tax (asset) at end of period	(15.2)	(10.3)

The UK corporation tax rate reduced from 26% to 24% on 1 April 2012. The average effective rate of tax for 2012 is 24.5% (2011: 26.5%). It will fall to 23% in April 2013, and is expected to fall to 22% in April 2014 although this change has not yet been substantively enacted. Deferred tax has therefore been calculated at 23% where the temporary difference is expected to reverse after this date.

The amount of deferred tax (expense)/income recognised in the income statement for each of the temporary differences reported above is:

Amounts credited/(charged) to income or expense:

	31 December 2012 £m	31 December 2011 £m
Tax treatment of share scheme charges	(1.3)	(1.9)
Capital allowances	0.4	0.2
Carried forward losses	3.1	1.3
Other difference	1.2	(0.3)
Net deferred tax credited/(charged) to income	3.4	(0.7)

The difference between the total movement in the deferred tax balance above and the amount charged to income relates to deferred tax on share scheme charges that has been credited directly to equity.

## Notes to the Financial Statements continued

### 9. Other assets and other liabilities

#### 9a Accounting policy

##### (i) Property and equipment, and depreciation

All property and equipment is stated at cost less accumulated depreciation. Depreciation is calculated using the straight-line method to write off the cost less residual values of the assets over their useful economic lives. These useful economic lives are as follows:

Motor vehicles	–	4 years
Fixtures, fittings and equipment	–	4 years
Computer equipment	–	2 to 4 years
Improvements to short leasehold properties	–	4 years

##### (ii) Impairment of property and equipment:

In the case of property and equipment, carrying values are reviewed at each balance sheet date to determine whether there are any indications of impairment. If any such indications exist, the asset's recoverable amount is estimated and compared to the carrying value. The carrying value is the higher of the fair value of the asset, less costs to sell and the asset's value in use. Impairment losses are recognised through the income statement.

##### (iii) Leased assets:

The rental costs relating to assets held under operating leases are charged to the income statement on a straight-line basis over the life of the lease.

Leases under the terms of which the Group assumes substantially all of the risks and rewards of ownership are classed as finance leases. Assets acquired under finance leases are included in property and equipment at fair value on acquisition and are depreciated in the same manner as equivalent owned assets. Finance lease and hire purchase obligations are included in creditors, and the finance costs are spread over the periods of the agreements based on the net amount outstanding.

##### (iv) Intangible assets:

#### Goodwill

All business combinations are accounted for using the purchase method. Goodwill has been recognised in acquisitions of subsidiaries, and represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

The classification and accounting treatment of acquisitions occurring before 1 January 2004 have not been reconsidered in preparing the Group's opening IFRS balance sheet at 1 January 2004 due to the exemption available in IFRS 1 (First time adoption). In respect of acquisitions prior to 1 January 2004, goodwill is included at the transition date on the basis of its deemed cost, which represents the amount recorded under UK GAAP, which was tested for impairment at the transition date. On transition, amortisation of goodwill has ceased as required by IAS 38.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash generating units (CGU's) according to business segment and is reviewed annually for impairment.

The Goodwill held on the balance sheet at 31 December 2012 is allocated solely to the UK car insurance segment.

#### Impairment of goodwill

The annual impairment review involves comparing the carrying amount to the estimated recoverable amount (by allocating the goodwill to CGUs) and recognising an impairment loss if the recoverable amount is lower. Impairment losses are recognised through the income statement and are not subsequently reversed.

The recoverable amount is the greater of the fair value of the asset less costs to sell and the value in use of the CGU.

The value in use calculations use cash flow projections based on financial budgets approved by management covering a three year period. Cash flows beyond this period are considered, but not included in the calculation. The discount rate applied to the cash flow projections in the value in use calculations is 9.0% (2011: 11.3%), based on the Group's weighted average cost of capital, which is in line with the market (source: Bloomberg).

The key assumptions used in the value in use calculations are those regarding growth rates and expected changes in pricing and expenses incurred during the period. Management estimates growth rates and changes in pricing based on past practices and expected future changes in the market.

The headroom above the goodwill carrying value is very significant, and there is no foreseeable event that would eliminate this margin.

#### Deferred acquisition costs:

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. Deferred acquisition costs represent the proportion of acquisition costs incurred that corresponds to the unearned premiums provision at the balance sheet date. This balance is held as an intangible asset. It is amortised over the term of the contract as premium is earned.

#### Software:

Purchased software is recognised as an intangible asset and amortised over its expected useful life (generally between two and four years). The carrying value is reviewed every six months for evidence of impairment, with the value being written down if any impairment exists. Impairment may be reversed if conditions subsequently improve.

### 9b Property and equipment

	Improvements to short leasehold buildings £m	Computer equipment £m	Office equipment £m	Furniture and fittings £m	Total £m
<b>Cost</b>					
At 1 January 2011	5.2	24.1	8.5	3.4	41.2
Additions	1.5	4.5	2.9	1.5	10.4
Disposals	–	(0.3)	–	–	(0.3)
At 31 December 2011	6.7	28.3	11.4	4.9	51.3
<b>Depreciation</b>					
At 1 January 2011	3.5	15.5	6.0	2.6	27.6
Charge for the year	0.9	3.5	1.2	0.5	6.1
Disposals	–	–	–	–	–
At 31 December 2011	4.4	19.0	7.2	3.1	33.7
<b>Net book amount</b>					
At 1 January 2011	1.7	8.6	2.5	0.8	13.6
<b>Net book amount</b>					
At 31 December 2011	2.3	9.3	4.2	1.8	17.6
<b>Cost</b>					
At 1 January 2012	6.7	28.3	11.4	4.9	51.3
Additions	0.6	3.4	1.5	0.1	5.6
Disposals	–	(0.1)	–	–	(0.1)
At 31 December 2012	7.3	31.6	12.9	5.0	56.8
<b>Depreciation</b>					
At 1 January 2012	4.4	19.0	7.2	3.1	33.7
Charge for the year	0.9	3.6	1.5	0.6	6.6
Disposals	–	–	–	–	–
At 31 December 2012	5.3	22.6	8.7	3.7	40.3
<b>Net book amount</b>					
At 31 December 2012	2.0	9.0	4.2	1.3	16.5

## Notes to the Financial Statements continued

The net book value of assets held under finance leases is as follows:

	31 December 2012 £m	31 December 2011 £m
Computer equipment	3.0	2.8

## 9c Intangible assets

	Goodwill £m	Deferred acquisition costs £m	Software £m	Total £m
At 1 January 2011	62.3	14.9	5.7	82.9
Additions	–	43.3	6.4	49.7
Amortisation charge	–	(41.8)	(3.3)	(45.1)
Disposals	–	–	–	–
At 31 December 2011	62.3	16.4	8.8	87.5
Additions	–	51.9	5.5	57.4
Amortisation charge	–	(48.0)	(4.1)	(52.1)
Disposals	–	–	(0.3)	(0.3)
At 31 December 2012	62.3	20.3	9.9	92.5

Goodwill relates to the acquisition of Group subsidiary EUI Limited (formerly Admiral Insurance Services Limited) in November 1999. It is allocated solely to the UK Car Insurance segment. As described in the accounting policies, the amortisation of this asset ceased on transition to IFRS on 1 January 2004. All annual impairment reviews since the transition date have indicated that the estimated recoverable value of the asset is greater than the carrying amount and therefore no impairment losses have been recognised. Refer to the accounting policy for goodwill for further information.

## 9d Trade and other receivables

	31 December 2012 £m	31 December 2011 £m
Trade receivables	54.8	51.1
Prepayments and accrued income	0.5	1.0
Total trade and other receivables	55.3	52.1

## 9e Trade and other payables

	31 December 2012 £m	31 December 2011 £m
Trade payables	13.0	12.1
Amounts owed to co-insurers and reinsurers	723.5	579.4
Finance leases due within 12 months	0.8	0.9
Other taxation and social security liabilities	22.9	21.9
Other payables	71.5	51.0
Accruals and deferred income (see below)	174.8	191.3
Total trade and other payables	1,006.5	856.6

Of amounts owed to co-insurers and reinsurers, £609.6m (2011: £432.9m) is held under funds withheld arrangements.

Analysis of accruals and deferred income:

	31 December 2012 £m	31 December 2011 £m
Premium receivable in advance of policy inception	115.4	110.1
Accrued expenses	41.4	55.8
Deferred income	18.0	25.4
Total accruals and deferred income as above	174.8	191.3

**9f Obligations under finance leases**

Analysis of finance lease liabilities:

	At 31 December 2012			At 31 December 2011		
	Minimum lease payments £m	Interest £m	Principal £m	Minimum lease payments £m	Interest £m	Principal £m
Less than one year	0.8	–	0.8	0.9	–	0.9
Between one and five years	–	–	–	–	–	–
More than five years	–	–	–	–	–	–
	0.8	–	0.8	0.9	–	0.9

The fair value of the Group's lease obligations approximates to their carrying amount.

**9g Financial commitments**

The Group was committed to total minimum obligations under operating leases on land and buildings as follows:

	31 December 2012 £m	31 December 2011 £m
Operating leases expiring		
Within one year	0.2	–
Within two to five years	12.3	12.0
Over five years	15.5	20.3
Total commitments	28.0	32.3

Operating lease payments represent rentals payable by the Group for its office properties.

In addition, the Group had entered into contracts at the end of 2012 in relation to the lease and fit-out of new premises in Cardiff and Newport, which are currently under construction and due for completion in 2014. There were no equivalent contracts in place at the end of 2011.

**10. Share capital****10a Accounting policies****(i) Share capital**

Shares are classified as equity when there is no obligation to transfer cash or other assets.

**(ii) Dividends**

Dividends are recorded in the period in which they are declared and paid.

**10b Dividends**

Dividends were declared and paid as follows.

	31 December 2012 £m	31 December 2011 £m
March 2011 (35.5p per share, paid May 2011)	–	94.5
August 2011 (39.1p per share, paid October 2011)	–	104.3
March 2012 (36.5p per share, paid June 2012)	98.0	–
August 2012 (45.1p per share, paid October 2012)	121.3	–
Total dividends	219.3	198.8

The dividends declared in March represent the final dividends paid in respect of the 2010 and 2011 financial years. The dividends declared in August are interim distributions in respect of 2011 and 2012.

A final dividend of 45.5p per share (£124.5m) has been proposed in respect of the 2012 financial year. Refer to the Chairman's statement and business review for further detail.

## Notes to the Financial Statements continued

## 10c Earnings per share

	31 December 2012 £m	31 December 2011 £m
Profit for the financial year after taxation attributable to equity shareholders (£m)	258.4	221.2
Weighted average number of shares – basic	271,714,535	269,903,301
Unadjusted earnings per share – basic	95.1p	81.9p
Weighted average number of shares – diluted	272,403,242	270,782,526
Unadjusted earnings per share – diluted	94.9p	81.7p

The difference between the basic and diluted number of shares at the end of 2012 (being 688,707; 2011: 879,225) relates to awards committed, but not yet issued under the Group's share schemes. Refer to note 7 for further detail.

## 10d Share capital

	31 December 2012 £m	31 December 2011 £m
<b>Authorised:</b>		
500,000,000 ordinary shares of 0.1p	0.5	0.5
<b>Issued, called up and fully paid:</b>		
273,523,594 ordinary shares of 0.1p	0.3	–
270,726,075 ordinary shares of 0.1p	–	0.3
	0.3	0.3

During 2012, 2,797,519 (2011: 2,217,350) new ordinary shares of 0.1p were issued to the trusts administering the Group's share schemes.

1,177,519 (2011: 717,350) of these were issued to the Admiral Group Share Incentive Plan Trust for the purposes of this share scheme. These shares are entitled to receive dividends.

1,620,000 (2011: 1,500,000) were issued to the Admiral Group Employee Benefit Trust for the purposes of the Discretionary Free Share Scheme. The Trustees have waived the right to dividend payments, other than to the extent of 0.001p per share, unless and to the extent otherwise directed by the Company from time to time.

## 10e Objectives, policies and procedures for managing capital

The Group manages its capital to ensure that all entities within the Group are able to continue as going concerns and also to ensure that regulated entities comfortably meet regulatory requirements. Excess capital above these levels within subsidiaries is paid up to the Group holding company in the form of dividends on a regular basis.

The Group's dividend policy is to make distributions after taking into account capital that is required to be held a) for regulatory purposes; b) to fund expansion activities; and c) as a further prudent buffer against unforeseen events. This policy gives the Directors flexibility in managing the Group's capital.

Capital continues to be held in equity form, with no debt.

## 10f Group subsidiary companies

The Parent Company's subsidiaries are as follows:

Subsidiary	Country of incorporation	Class of shares held	% Ownership	Principal activity
EUI Limited	England and Wales	Ordinary	100	General insurance intermediary
EUI (France) Limited	England and Wales	Ordinary	100	General insurance intermediary
Admiral Insurance Company Limited	England and Wales	Ordinary	100	Insurance Company
Admiral Insurance (Gibraltar) Limited	Gibraltar	Ordinary	100	Insurance Company
Able Insurance Services Limited	England and Wales	Ordinary	100	Intermediary
Inspop.com Limited	England and Wales	Ordinary	100	Internet insurance intermediary
Elephant Insurance Company	United States of America	Ordinary	100	Insurance Company
Elephant Insurance Services, LLC	United States of America	Ordinary	100	Insurance intermediary
Rastreator.com Limited	England and Wales	Ordinary	75	Internet insurance intermediary
Inspop Technologies Private Limited	India	Ordinary	100	Internet technology supplier
Inspop.com (France) Limited	England and Wales	Ordinary	100	Internet insurance intermediary
Inspop.com (Italy) Limited	England and Wales	Ordinary	100	Internet insurance intermediary
Admiral Syndicate Limited	England and Wales	Ordinary	100	Dormant
Admiral Syndicate Management Limited	England and Wales	Ordinary	100	Dormant
Admiral Life Limited	England and Wales	Ordinary	100	Dormant
Bell Direct Limited	England and Wales	Ordinary	100	Dormant
Confused.com Limited	England and Wales	Ordinary	100	Dormant
Diamond Motor Insurance Services Limited	England and Wales	Ordinary	100	Dormant
Elephant Insurance Services Limited	England and Wales	Ordinary	100	Dormant
Inspop USA LLC	United States of America	Ordinary	78.76%	Internet insurance intermediary
Comparenow.com Insurance Agency LLC	United States of America	Ordinary	78.76% (Indirect)	Internet insurance intermediary
Tooley Shelf Company 1 Limited	England and Wales	Ordinary	100	Dormant
Tooley Shelf Company 2 Limited	England and Wales	Ordinary	100	Dormant

For further information on how the Group conducts its business across UK, Europe and the USA, refer to the business review.

## 10g Related party transactions

### (i) Mapfre:

In 2012, the Group participated in transactions with Mapfre S.A. during the normal course of its Car Insurance and Price Comparison operations. Mapfre is a related party of Admiral Group due to its 25% minority interest in Group subsidiary Rastreator.com Limited. Details of the transactions with Mapfre and balances outstanding as at 31 December in respect of price comparison business are given in the table below.

	31 December 2012 £m	31 December 2011 £m
Total transactions in the course of price comparison business with Rastreator.com	0.7	0.7
Balances outstanding at 31 December	0.2	0.1

### (ii) Other:

Details relating to the remuneration and shareholdings of key management personnel are set out in the remuneration report (audited section). Key management personnel are able to obtain discounted motor insurance at the same rates as all other Group staff, typically at a reduction of 15%.

The Board considers that only the Board of Directors of Admiral Group plc are key management personnel.

# Parent Company Financial Statements

## Parent Company balance sheet

	Note	Year ended	
		31 December 2012 £m	31 December 2011 £m
<b>Fixed assets – investments</b>			
Shares in group undertakings	5	192.3	142.5
Other investments		74.6	35.0
<b>Current assets</b>			
Amounts owed from subsidiary undertakings		3.1	–
Cash at bank and in hand		10.4	54.7
		13.5	54.7
<b>Creditors – falling due within one year</b>			
Other creditors	6	(63.5)	(63.8)
		(63.5)	(63.8)
Net current liabilities		(50.0)	(9.1)
Total assets less current liabilities		216.9	168.4
<b>Net assets</b>		<b>216.9</b>	<b>168.4</b>
<b>Capital and reserves</b>			
Called up share capital	7		
Share premium account	8	0.3	0.3
Capital redemption reserve		13.1	13.1
Profit and loss account		–	–
		203.5	155.0
		<b>216.9</b>	<b>168.4</b>

These financial statements were approved by the Board of Directors on 5 March 2013 and were signed on its behalf by:



**Kevin Chidwick**

Director  
Admiral Group plc  
Company Number: 03849958

# Notes to the Parent Company Financial Statements

## Parent Company accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements:

### 1. Basis of preparation

The accounts have been prepared on a going concern basis. In considering the appropriateness of this assumption, the Board have reviewed the Company's projections for the next twelve months and beyond, including cash flow forecasts and regulatory capital surpluses. The Company has no debt.

As a result of this review the Directors have satisfied themselves that it is appropriate to prepare these financial statements on a going concern basis.

The adoption of new accounting standards during the year has not had a material impact on either the current year or comparative figures.

The Admiral Group plc Company financial statements have been prepared in accordance with applicable accounting standards, under the historical cost convention and in accordance with the provisions of Section 396 to the Companies Act 2006.

As permitted by Section 408 of the Companies Act 2006, the profit and loss account of the Parent Company is not presented. Under FRS 1 (Cash flow statements) the Company is exempt from having to present a cash flow statement on the grounds that its cash flows are included in the Group's published consolidated financial statements.

The Parent Company audit fee is not disclosed in these accounts as it is disclosed in the Consolidated financial statements for Admiral Group plc, which precede them at note 7.

Refer to note 10 of the Consolidated financial statements for disclosure of related party transactions.

### 2. Investments

Shares in Group undertakings are valued at cost less any provision for impairment in value.

### 3. Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax assets are recognised to the extent that they are regarded as recoverable. They are regarded as recoverable to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be sufficient taxable profits from which the future reversal of the underlying timing differences can be deducted.

### 4. Employee share schemes:

The Group operates a number of equity settled compensation schemes for its employees. For schemes commencing 1 January 2004 and after, the fair value of the employee services received in exchange for the grant of free shares under the schemes is recognised as an expense in the parent Company's subsidiaries, with a corresponding increase in equity in the parent Company.

Refer to note 7 of the consolidated financial statements for further details on share schemes.

## Notes to the Parent Company Financial Statements continued

**5. Shares in Group undertakings**

	£m
Investments in subsidiary undertakings:	
At 1 January 2011	125.0
Additions	17.5
At 31 December 2011	142.5
Additions	49.8
At 31 December 2012	192.3

A full list of the Company's subsidiaries is disclosed in note 10 of the Group financial statements.

**6. Other creditors – due within one year**

	31 December 2012 £m	31 December 2011 £m
Trade payables and other liabilities	0.4	0.1
Corporation tax payable	63.1	49.3
Amounts owed to subsidiaries	–	14.4
	63.5	63.8

**7. Reconciliation of movements in shareholders' funds**

Company figures	Share capital £m	Share premium account £m	Retained profit and loss £m	Total equity £m
At 1 January 2011	0.3	13.1	132.6	146.0
Retained profit for the period	–	–	197.6	197.6
Dividends	–	–	(198.8)	(198.8)
Issues of share capital	–	–	–	–
Share scheme charges	–	–	23.6	23.6
As at 31 December 2011	0.3	13.1	155.0	168.4
Retained profit for the period	–	–	244.1	244.1
Dividends	–	–	(219.3)	(219.3)
Issues of share capital	–	–	–	–
Share scheme charges	–	–	23.7	23.7
As at 31 December 2012	0.3	13.1	203.5	216.9

**8. Share capital**

Full details of the Company's share capital are included in the consolidated financial statements above.

# Consolidated Financial Summary

## Basis of preparation:

The figures below are as stated in the Group financial statements preceding this financial summary and issued previously. Only selected lines from the income statement and balance sheet have been included.

## Income statement

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
<b>Total premiums</b>	<b>1,897.2</b>	<b>1,841.3</b>	<b>1,308.6</b>	<b>847.7</b>	<b>716.3</b>
Net insurance premium revenue	498.9	445.8	288.1	211.9	169.8
Other revenue	361.1	349.0	276.2	232.6	193.9
Profit commission	108.4	61.8	67.0	54.2	34.7
Investment and interest income	15.9	13.7	9.5	8.8	24.4
<b>Net revenue</b>	<b>984.3</b>	<b>870.3</b>	<b>640.8</b>	<b>507.5</b>	<b>422.8</b>
Net insurance claims	(404.5)	(363.8)	(208.5)	(151.7)	(114.6)
Total expenses	(235.2)	(207.4)	(166.8)	(140.0)	(105.7)
<b>Operating profit</b>	<b>344.6</b>	<b>299.1</b>	<b>265.5</b>	<b>215.8</b>	<b>202.5</b>

## Balance sheet

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Property and equipment	16.5	17.6	13.6	12.1	11.0
Intangible assets	92.5	87.5	82.9	77.0	75.7
Deferred income tax	15.2	10.3	12.4	–	–
Reinsurance assets	803.0	639.8	357.0	212.9	170.6
Trade and other receivables	55.3	52.1	47.9	32.7	25.5
Financial assets	2,005.1	1,583.0	1,004.7	630.9	586.9
Cash and cash equivalents	216.6	224.6	246.7	211.8	144.3
Assets held for sale	–	–	1.5	–	–
<b>Total assets</b>	<b>3,204.2</b>	<b>2,614.9</b>	<b>1,766.7</b>	<b>1,177.4</b>	<b>1,014.0</b>
<b>Equity</b>	<b>460.7</b>	<b>394.4</b>	<b>350.7</b>	<b>300.8</b>	<b>275.6</b>
Insurance contracts	1,696.9	1,333.7	806.6	532.9	439.6
Deferred income tax	–	–	–	5.7	10.3
Trade and other payables	1,006.5	856.6	561.0	306.8	270.0
Current tax liabilities	40.1	30.2	48.4	31.2	18.5
<b>Total liabilities</b>	<b>3,204.2</b>	<b>2,614.9</b>	<b>1,766.7</b>	<b>1,177.4</b>	<b>1,014.0</b>

## INDEPENDENT AUDITOR'S REPORT

To the members of Admiral Group plc only

### Opinions and Conclusions Arising from our Audit

#### 1. Our Opinion on the Financial Statements is Unmodified

We have audited the financial statements of Admiral Group plc for the year ended 31 December 2013 set out on pages 70 to 101. 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 2013 and of the Group's profit for the year then ended
- > The Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU)
- > The Parent Company financial statements have been properly prepared in accordance with UK Accounting Standards
- > 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 IAS Regulation

#### 2. Our Assessment of Risks of Material Misstatement

In arriving at our audit opinion above on the financial statements the risks of material misstatement that had the greatest effect on our audit were as follows.

##### Insurance Liabilities

Refer to pages 46 to 49 (Audit Committee statement), note 5 (accounting policy and financial disclosures).

The Risk – The provision for claims outstanding comprises the estimated cost of settling all claims incurred but unpaid at the balance sheet date, whether reported or not. This is a judgemental and complex area due to the inherent uncertainty of estimating claims not yet reported, future costs of settling claims, discount rates and whether customers will be awarded a lump sum claim or a periodic payment. The amounts involved are potentially significant and the application of accounting standards to determine the amount, if any, to be provided as a liability, is inherently subjective.

Our Response – Our audit procedures included, among others, testing the controls over the underwriting process and performing substantive analysis over the trends in claims frequency and size. We assessed the level of reserves held for incurred claims through evaluating the competence, capability and objectivity of the Group's external actuary, assessing the actuarial methodologies employed, including the use of paid and incurred chain ladders and the average cost

per claim method, challenging key judgements made by management, for example the extent to which improvements in claims trends are taken into account in reserve projections, and benchmarking key assumptions against KPMG sourced market data.

One of the most significant uncertainties relates to the reserve held for large bodily injury claims and actual and potential Periodic Payment Order (PPO) settlements. In respect of these amounts, we investigated the process for identifying and assessing the required reserve for large claims and for updating this reserve as more information becomes available, investigated the process for assessing cases that have the potential to be settled as PPOs and benchmarked the key assumptions made in calculating large bodily injury claims reserves, including mortality (in the case of PPO cases) and discount rates applied.

In respect of the margin held above the actuarial best estimate, we assessed the rationale for this margin including consideration of the level of prudence within the margin, the consistency with which the underlying judgements have been applied in relation to the current year and prior periods, the existence of any management bias and the adequacy of the disclosure in the financial statements.

Our audit team included appropriately skilled actuarial specialists to support us in our challenge of the approach taken by the Group in calculating the liabilities. We have also considered the adequacy of the Group's disclosures about the degree of estimation and sensitivity to key assumptions. The focus of our work is on the UK Motor portfolio.

##### Co-insurance and reinsurance

Refer to pages 46 to 49 (Audit Committee statement), note 5 (accounting policy and financial disclosures).

The Risk – The group has in place a number of proportional risk sharing agreements, where insurers outside the Group underwrite a majority of the risk generated, either through co-insurance or quota share reinsurance contracts. For reinsurance contracts, there is judgement involved in the assessment of whether risk has been transferred, which impacts on the appropriate accounting. For co-insurance contracts, the accounting is driven by the fact that the Group does not retain the underlying risks and rewards of the business underwritten. The outcome of these judgements affect the recognition and timing of revenue along with profit recognition and disclosure of income and expenses associated with these risk sharing agreements.

Our Response – Our audit procedures included, among others, critically assessing the contract terms for these arrangements to ascertain whether, taking into account relevant accounting standards, the treatment of the Group's co-insurance and quota share reinsurance contracts is appropriate. We have also considered the adequacy of the Group's disclosures and appropriateness of the presentation of transactions and balances with these arrangements.

##### Profit Commission

Refer to pages 46 to 49 (Audit Committee statement), note 5 (accounting policy and financial disclosures).

The Risk – The recognition of profit commission income from co-insurers and quota share reinsurers is initially in line with the loss ratios booked in the financial statements and will vary with movements in the loss ratios, potentially introducing volatility into the reported profits. The recognition of this income is therefore subject to the same level of estimation as the claims liability noted above until, in the case of the quota share reinsurance, the relevant contracts are commuted, at which point no further profit commission is recognised. In addition, different contractual arrangements are in place with the Group's co-insurance and reinsurance partners and there is a risk that the differences in arrangements are not appropriately accounted for, resulting in significant misstatement.

Our Response – Our audit procedures included, among others and in addition to our procedures over insurance liabilities noted above, forming an expectation of the profit commission income based on loss ratios applied and contractual terms of each arrangement, comparing this to actual profit commission income recognised and corroborating any changes to the profit commission arrangements during the year. We have also considered the adequacy of the Group's disclosures about the arrangements in place.

### 3. Our Application of Materiality and an Overview of the Scope of our Audit

The materiality for the Group financial statements as a whole was set at £18.5 million. This has been determined with reference to a benchmark of Group profit before taxation (of which it represents 5%) which we consider to be one of the principal considerations for members of the Company in assessing financial performance of the Group.

We agreed with the audit committee to report to it all material corrected misstatements and those uncorrected misstatements we identified through our audit with a value in excess of £0.9 million, in addition to other audit misstatements below that threshold that we believe warranted reporting on qualitative grounds.

Audits for Group reporting purposes were performed by the Group audit team at the key reporting components in the UK and Italy. These audits covered 97% of total Group net revenue; 99% of Group profit before taxation; and 97% of total Group assets. The segment disclosures in note 4b set out the individual significance of specific countries.

The audits at key reporting components of the Group were all performed at local materiality levels which were set individually for each component and ranged from £300,000 to £16.5 million. The Group audit team performed the work over all significant components.

### 4. Our Opinion on Other Matters Prescribed by the Companies Act 2006 is Unmodified

In our opinion:

- > The part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006
- > The information given in the Strategic Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

### 5. We Have Nothing to Report in Respect of the Matters on Which we are Required to Report by Exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- > We have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy
- > The section of the annual report describing the work of the Group Audit and Risk Committee does not appropriately address matters communicated by us to the Audit and Risk Committee

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

- > 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
- > The Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns
- > Certain disclosures of Directors' remuneration specified by law are not made
- > We have not received all the information and explanations we require for our audit

Under the Listing Rules we are required to review:

- > The Directors' statement, set out on page 67, in relation to going concern
- > The part of the Corporate Governance Statement on pages 36 to 67 relating to the Company's compliance with the nine provisions of the 2010 UK Corporate Governance Code specified for our review

We have nothing to report in respect of the above responsibilities.

### Scope and Responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 67, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at [www.frc.org.uk/auditscopeukprivate](http://www.frc.org.uk/auditscopeukprivate). This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at [www.kpmg.com/uk/auditscopeukco2013a](http://www.kpmg.com/uk/auditscopeukco2013a), which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.



#### Salim Tharani (Senior Statutory Auditor)

for and on behalf of KPMG Audit Plc,  
Statutory Auditor  
Chartered Accountants  
3 Assembly Square  
Britannia Quay  
Cardiff  
CF10 4AX  
4 March 2014

## CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2013

	Note	Year ended	
		31 December 2013 £m	Restated* 31 December 2012 £m
Insurance premium revenue		1,136.4	1,156.5
Insurance premium ceded to reinsurers		(653.4)	(657.6)
<b>Net insurance premium revenue</b>	5	483.0	498.9
Other revenue	7	327.8	361.1
Profit commission	5	99.3	108.4
Investment and interest income	6	14.3	15.9
<b>Net revenue</b>		924.4	984.3
Insurance claims and claims handling expenses		(826.7)	(929.1)
Insurance claims and claims handling expenses recoverable from reinsurers		523.7	524.6
<b>Net insurance claims</b>		(303.0)	(404.5)
Operating expenses and share scheme charges	8	(467.0)	(443.2)
Operating expenses and share scheme charges recoverable from co- and reinsurers	8	215.8	208.0
<b>Net operating expenses and share scheme charges</b>		(251.2)	(235.2)
<b>Total expenses</b>		(554.2)	(639.7)
<b>Profit before tax</b>		370.2	344.6
Taxation expense	9	(83.3)	(86.2)
<b>Profit after tax</b>		286.9	258.4
Profit after tax attributable to:			
Equity holders of the parent		287.0	258.4
Non-controlling interests (NCI)		(0.1)	—
		286.9	258.4
<b>Earnings per share</b>			
Basic	11	104.6p	95.1p
Diluted	11	104.4p	94.9p
Dividends declared and paid (total)	11	255.8	219.3
Dividends declared and paid (per share)	11	94.4p	81.6p

\* Refer to note 3, Notes to the Financial Statements, page 76

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

For the year ended 31 December 2013

	Year ended	
	31 December 2013 £m	31 December 2012 £m
<b>Profit for the period</b>	286.9	258.4
<b>Other comprehensive income</b>		
<b>Items that are or may be reclassified to profit or loss</b>		
Exchange differences on translation of foreign operations	(1.3)	(2.7)
Other comprehensive income for the period, net of income tax	(1.3)	(2.7)
<b>Total comprehensive income for the period</b>	285.6	255.7
Total comprehensive income for the period attributable to:		
Equity holders of the parent	286.1	255.9
Non-controlling interests	(0.5)	(0.2)
	285.6	255.7

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2013

	Note	As at	
		31 December 2013 £m	31 December 2012 £m
<b>ASSETS</b>			
Property and equipment	10	12.4	16.5
Intangible assets	10	92.8	92.5
Deferred income tax	9	17.0	15.2
Reinsurance assets	5	821.2	803.0
Trade and other receivables	6, 10	77.5	55.3
Financial assets	6	2,265.0	2,005.1
Cash and cash equivalents	6	187.9	216.6
<b>Total assets</b>		<b>3,473.8</b>	<b>3,204.2</b>
<b>EQUITY</b>			
Share capital	11	0.3	0.3
Share premium account		13.1	13.1
Other reserves		(0.2)	0.7
Retained earnings		502.6	443.0
<b>Total equity attributable to equity holders of the parent</b>		<b>515.8</b>	<b>457.1</b>
Non-controlling interests		8.3	3.6
<b>Total equity</b>		<b>524.1</b>	<b>460.7</b>
<b>LIABILITIES</b>			
Insurance contracts	5	1,901.3	1,696.9
Trade and other payables	6, 10	1,013.7	1,006.5
Current tax liabilities		34.7	40.1
<b>Total liabilities</b>		<b>2,949.7</b>	<b>2,743.5</b>
<b>Total equity and total liabilities</b>		<b>3,473.8</b>	<b>3,204.2</b>

These financial statements were approved by the Board of Directors on 4 March 2014 and were signed on its behalf by:



**Kevin Chidwick**  
 Director  
 Admiral Group plc  
 Company Number: 03849958

**CONSOLIDATED CASH FLOW STATEMENT**

For the year ended 31 December 2013

	Note	Year ended	
		31 December 2013 £m	31 December 2012 £m
<b>Profit after tax</b>		<b>286.9</b>	258.4
Adjustments for non-cash items:			
– Depreciation		7.3	6.6
– Amortisation of software		4.9	4.1
– Change in unrealised gains on investments		—	(0.6)
– Other gains and losses		0.2	0.6
– Share scheme charges	8	25.7	23.7
Change in gross insurance contract liabilities		204.4	363.2
Change in reinsurance assets		(18.2)	(163.2)
Change in trade and other receivables, including from policyholders		14.3	13.1
Change in trade and other payables, including tax and social security		8.0	149.9
Taxation expense		83.3	86.2
<b>Cash flows from operating activities, before movements in investments</b>		<b>616.8</b>	742.0
Net cash flow into investments		(295.3)	(441.9)
Cash flows from operating activities, net of movements in investments		321.5	300.1
Taxation payments		(88.5)	(79.7)
<b>Net cash flow from operating activities</b>		<b>233.0</b>	220.4
<b>Cash flows from investing activities:</b>			
Purchases of property, equipment and software		(10.1)	(10.9)
<b>Net cash used in investing activities</b>		<b>(10.1)</b>	(10.9)
<b>Cash flows from financing activities:</b>			
Non-controlling interest capital contribution		6.4	4.6
Repayment of finance lease liabilities		(0.9)	(0.1)
Equity dividends paid	11	(255.8)	(219.3)
<b>Net cash used in financing activities</b>		<b>(250.3)</b>	(214.8)
<b>Net decrease in cash and cash equivalents</b>		<b>(27.4)</b>	(5.3)
Cash and cash equivalents at 1 January		216.6	224.6
Effects of changes in foreign exchange rates		(1.3)	(2.7)
<b>Cash and cash equivalents at end of period</b>	6	<b>187.9</b>	216.6

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2013

	Attributable to the owners of the Company				Total £m	Non- controlling interests £m	Total equity £m
	Share capital £m	Share premium account £m	Foreign exchange reserve £m	Retained profit and loss £m			
At 1 January 2012	0.3	13.1	3.2	377.3	393.9	0.5	394.4
Profit for the period	—	—	—	258.4	258.4	—	258.4
<b>Other comprehensive income</b>							
Currency translation differences	—	—	(2.5)	—	(2.5)	(0.2)	(2.7)
<b>Total comprehensive income for the period</b>	—	—	(2.5)	258.4	255.9	(0.2)	255.7
<b>Transactions with equity-holders</b>							
Dividends	—	—	—	(219.3)	(219.3)	—	(219.3)
Share scheme credit	—	—	—	23.7	23.7	—	23.7
Deferred tax charge on share scheme credit	—	—	—	1.5	1.5	—	1.5
Contributions by NCI's	—	—	—	1.4	1.4	3.3	4.7
<b>Total transactions with equity-holders</b>	—	—	—	(192.7)	(192.7)	3.3	(189.4)
<b>As at 31 December 2012</b>	0.3	13.1	0.7	443.0	457.1	3.6	460.7
At 1 January 2013	0.3	13.1	0.7	443.0	457.1	3.6	460.7
Profit for the period	—	—	—	287.0	287.0	(0.1)	286.9
<b>Other comprehensive income</b>							
Currency translation differences	—	—	(0.9)	—	(0.9)	(0.4)	(1.3)
<b>Total comprehensive income for the period</b>	—	—	(0.9)	287.0	286.1	(0.5)	285.6
<b>Transactions with equity-holders</b>							
Dividends	—	—	—	(255.8)	(255.8)	—	(255.8)
Share scheme credit	—	—	—	25.7	25.7	—	25.7
Deferred tax credit on share scheme credit	—	—	—	2.1	2.1	—	2.1
Contributions by NCI's	—	—	—	0.3	0.3	5.5	5.8
Changes in ownership interests without a change in control	—	—	—	0.3	0.3	(0.3)	—
<b>Total transactions with equity-holders</b>	—	—	—	(227.4)	(227.4)	5.2	(222.2)
<b>As at 31 December 2013</b>	0.3	13.1	(0.2)	502.6	515.8	8.3	524.1

## NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2013

### 1. General Information and Basis of Preparation

#### General Information

Admiral Group plc is a Company incorporated in England and Wales. Its registered office is at Capital Tower, Greyfriars Road, Cardiff CF10 3AZ and its shares are listed on the London Stock Exchange.

The Consolidated financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The Company has elected to prepare its parent company financial statements in accordance with UK Generally Accepted Accounting Practice (GAAP).

#### Adoption of New and Revised Standards

The Group has applied all adopted IFRS and interpretations endorsed by the EU at 31 December 2013, including all amendments to extant standards that are not effective until later accounting periods. This is inclusive of:

#### > Presentation of Items of Other Comprehensive Income (OCI)

As a result of the amendments to IAS 1, the Group has modified the presentation of items of OCI in its consolidated statement of changes in equity, to present separately items that would be reclassified to profit or loss from those that would never be. Comparative information has been represented accordingly.

#### > IFRS 13 Fair Value Measurement

IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair value measurements. IFRS 13 replaces and expands the disclosure requirements about fair value measurements in other IFRSs, including IFRS 7. In accordance with the transitional provisions of IFRS 13, the Group and the Company have applied the new fair value measurement guidance prospectively and has not provided any comparative information for new disclosures.

Notwithstanding the above, the change had no significant impact on the measurements of the Group's and the Company's assets and liabilities.

There are a number of standards, amendments to standards and interpretations that were issued by 31 December 2013 but have either yet to be endorsed by the EU, or were endorsed shortly after the year end. The following IFRSs have been issued but have not been applied by the Group in these financial statements. Their adoption is not expected to have a material effect on the financial statements unless otherwise indicated:

- > IFRS 10 Consolidated Financial Statements and IAS 27 (2011) Separate Financial Statements
- > IFRS 11 Joint Arrangements and Amendments to IAS 28 (2008)

Investments in Associates and Joint Ventures

- > IFRS 12 Disclosure of Interests in Other Entities
- > Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities
- > Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)
- > Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)
- > IFRIC Interpretation 21 Levies
- > IFRS 9 Financial Instruments

Phase I of IFRS 9 "Financial Instruments" was issued in November 2009 and has subsequently been updated and amended. The standard has not yet been endorsed for use in the EU and the effective date is to be confirmed. The standard introduces changes to the classification and measurement of financial assets, removes the restriction on electing to measure certain financial liabilities at fair value through the income statement from initial recognition and requires changes to the presentation of gains and losses relating to fair value changes.

The Group is currently assessing the impact of the above new pronouncements on its results, financial position and cash flows.

#### Basis of Preparation

The accounts have been prepared on a going concern basis. In considering the appropriateness of this assumption, the Board have reviewed the Group's projections for the next twelve months and beyond, including cash flow forecasts and regulatory capital surpluses. The Group has no debt.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis in preparing the annual financial statements.

Further information regarding the Company's business activities, together with the factors likely to affect its future development, performance and position, is set out in the Strategic Report on pages 6 to 35. Further information regarding the financial position of the Company, its cash flows, liquidity position and borrowing facilities are described in the Strategic Report on pages 16 to 19. In addition notes 6 and 11 to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk and liquidity risk.

The accounting policies set out in the notes to the financial statements have, unless otherwise stated, been applied consistently to all periods presented in these Group financial statements.

The financial statements are prepared on the historical cost basis, except for the revaluation of financial assets classified as at fair value through profit or loss.

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the Consolidated financial statements from the date that control commences until the date that control ceases.

The preparation of financial statements in conformity with adopted IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is reviewed if this revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years. To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, it is recognised by adjusting the carrying amount of the related asset or liability in the period of the change.

### 2. Critical Accounting Judgements and Estimates

#### Judgements

In applying the Group's accounting policies as described in the notes to the financial statements, management has primarily applied judgement in the classification of the Group's contracts with reinsurers as reinsurance contracts. A contract is required to transfer significant insurance risk in order to be classified as such. Management reviews all terms and conditions of each such contract, and if necessary obtains the opinion of an independent expert at the negotiation stage in order to be able to make this judgement.

#### Estimation Techniques Used in Calculation of Claims Provisions and Profit Commission

Estimation techniques are used in the calculation of the provisions for claims outstanding, which represent a projection of the ultimate cost of settling claims that have occurred prior to the balance sheet date and remain unsettled at the balance sheet date.

**2. Critical Accounting Judgements and Estimates** continued

**Estimation Techniques Used in Calculation of Claims Provisions and Profit Commission** continued

The key area where these techniques are used relates to the ultimate cost of reported claims. A secondary area relates to the emergence of claims that occurred prior to the balance sheet date, but had not been reported at that date.

The estimates of the ultimate cost of reported claims are based on the setting of claim provisions on a case-by-case basis, for all but the simplest of claims.

The sum of these provisions are compared with projected ultimate costs using a variety of different projection techniques (including incurred and paid chain ladder and an average cost of claim approach) to allow an actuarial assessment of their potential outcome. They include allowance for unreported claims.

The most significant sensitivity in the use of the projection techniques arises from any future step change in claims costs, which would cause future claim cost inflation to deviate from historic trends. This is most likely to arise from a change in the regulatory or judicial regime that leads to an increase in awards or legal costs for bodily injury claims that is significantly above or below the historical trend.

The Group's independent actuarial advisors project best estimate claims reserves using a variety of recognised actuarial techniques. The Group's reserving policy requires management to reserve within a range of potential outcomes above the projected best estimate outcome, to allow for unforeseen adverse claims development.

For further detail on objectives, policies and procedures for managing insurance risk, refer to note 5 of the financial statements.

Future changes in claims reserves also impact profit commission income, as the measurement of this income is dependent on the loss ratio booked in the financial statements, and cash receivable is dependent on actuarial projections of ultimate loss ratios.

**3. Re-presentation of Comparative Information**

Comparative amounts within the Consolidated Income Statement relating to expenses have been re-presented. Net expenses of £235.2 million reported in the prior period, have been analysed into gross operating expenses and share scheme charges and operating expenses and share scheme charges recoverable from co- and reinsurers. There is no impact on reported net expenses or profit before tax in the period.

**4. Group Consolidation and Operating Segments**

**4a. Accounting Policies**

**(i) Group Consolidation**

The Consolidated financial statements comprise the results and balances of the Company and its subsidiaries (together referred to as the Group) for the year ended 31 December 2013 and comparative figures for the year ended 31 December 2012. The financial statements of the Company's subsidiaries are consolidated in the Group financial statements. The Company controls 100% of the voting share capital of all its principal subsidiaries, except Rastreator.com Limited, Inspop USA LLC, Admiral Law Limited, BDE Law Limited and the indirect holding in comparenow.com Insurance Agency LLC.

The parent company financial statements present information about the Company as a separate entity and not about its Group. In accordance with International Accounting Standard (IAS) 24, transactions or balances between Group companies that have been eliminated on consolidation are not reported as related party transactions in the Consolidated financial statements.

**(ii) Foreign Currency Translation**

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The Consolidated financial statements are presented in millions of pounds sterling, which is the Group's presentation currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Non-monetary items measured at cost are translated at their historic rate and non-monetary items held at fair value are translated using the foreign exchange rate on the date that the fair value was established.

The financial statements of foreign operations whose functional currency is not pounds sterling are translated into the Group presentation currency (sterling) as follows:

- > Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet
- > Income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the date of the transaction)

- > All resulting exchange differences are recognised in other comprehensive income and in a separate component of equity except to the extent that the translation differences are attributable to non-controlling interests

On disposal of a foreign operation, the cumulative amount recognised in equity relating to that particular operation is recognised in the income statement.

**4b. Segment Reporting**

The Group has four reportable segments, as described below. These segments represent the principal split of business that is regularly reported to the Group's Board of Directors, which is considered to be the Group's chief operating decision maker in line with IFRS 8, Operating Segments.

**UK Car Insurance**

The segment consists of the underwriting of car insurance and other products that supplement the car insurance policy. It also includes the generation of revenue from additional products and fees from underwriting car insurance in the UK. The Directors consider the results of these activities to be reportable as one segment as the activities carried out in generating the revenue are not independent of each other and are performed as one business. This mirrors the approach taken in management reporting.

**International Car Insurance**

The segment consists of the underwriting of car insurance and the generation of revenue from additional products and fees, from underwriting car insurance outside of the UK. It specifically covers the Group operations Admiral Seguros in Spain, ConTe in Italy, L'olivier Assurances in France and Elephant Auto in the USA. None of these operations are reportable on an individual basis, based on the threshold requirements in IFRS 8.

**Price Comparison**

The segment relates to the Group's price comparison websites; Confused.com in the UK, Rastreator in Spain, LeLynx in France and comparenow.com in the USA. Each of the Price Comparison businesses are operating in individual geographical segments but are grouped into one reporting segment as Rastreator, LeLynx and comparenow.com do not individually meet the threshold requirements in IFRS 8.

**Other**

The "Other" segment is designed to be comprised of all other operating segments that do not meet the threshold requirements for individual reporting. It includes UK household insurance, the Group's commercial van insurance broker, Gladiador, and commercial van insurance.

#### 4. Group Consolidation and Operating Segments continued

##### 4b. Segment Reporting continued

###### Other continued

Taxes are not allocated across the segments and, as with the corporate activities, are included in the reconciliation to the Consolidated Income Statement and Consolidated Statement of Financial Position.

An analysis of the Group's revenue and results for the year ended 31 December 2013, by reportable segment, are shown below. The accounting policies of the reportable segments are consistent with those presented in the notes to the financial statements for the Group.

	Year ended 31 December 2013					
	UK Car Insurance £m	International Car Insurance £m	Price Comparison £m	Other £m	Eliminations £m	Segment total £m
Turnover <sup>1</sup>	1,698.9	187.8	112.7	30.8	—	2,030.2
Net insurance premium revenue	425.1	54.1	—	3.8	—	483.0
Other revenue and profit commission	293.4	6.6	112.7	14.4	—	427.1
Investment and interest income	12.4	—	—	—	—	12.4
Net revenue	730.9	60.7	112.7	18.2	—	922.5
Net insurance claims	(251.3)	(49.1)	—	(2.6)	—	(303.0)
Expenses	(85.7)	(33.7)	(92.3)	(13.2)	—	(224.9)
<b>Segment profit/(loss) before tax</b>	<b>393.9</b>	<b>(22.1)</b>	<b>20.4</b>	<b>2.4</b>	<b>—</b>	<b>394.6</b>
Other central revenue and expenses, including share scheme charges						(26.3)
Interest income						1.9
<b>Consolidated profit before tax</b>						<b>370.2</b>
Taxation expense						(83.3)
<b>Consolidated profit after tax</b>						<b>286.9</b>
Other segment items:						
Capital expenditure	3.2	2.2	4.0	0.7	—	10.1
Depreciation and amortisation	28.5	50.4	1.3	0.8	—	81.0

<sup>1</sup> Turnover is a non-GAAP measure and consists of total premiums written (including co-insurers share) and Other revenue. Refer to note 12 for further information.

Revenue and results for the corresponding reportable segments for the year ended 31 December 2012 are shown below.

	Year ended 31 December 2012					
	UK Car Insurance £m	International Car Insurance £m	Price Comparison £m	Other £m	Eliminations £m	Segment total £m
Turnover <sup>1</sup>	1,936.2	162.9	103.5	12.5	—	2,215.1
Net insurance premium revenue	455.6	43.3	—	—	—	498.9
Other revenue and profit commission	342.7	10.8	103.5	12.5	—	469.5
Investment and interest income	13.9	0.1	—	—	—	14.0
Net revenue	812.2	54.2	103.5	12.5	—	982.4
Net insurance claims	(355.1)	(49.4)	—	—	—	(404.5)
Expenses	(84.3)	(29.3)	(85.5)	(10.0)	—	(209.1)
<b>Segment profit/(loss) before tax</b>	<b>372.8</b>	<b>(24.5)</b>	<b>18.0</b>	<b>2.5</b>	<b>—</b>	<b>368.8</b>
Other central revenue and expenses, including share scheme charges						(26.1)
Interest income						1.9
<b>Consolidated profit before tax</b>						<b>344.6</b>
Taxation expense						(86.2)
<b>Consolidated profit after tax</b>						<b>258.4</b>
Other segment items:						
Capital expenditure	6.1	3.1	0.9	0.1	—	10.2
Depreciation and amortisation	28.8	26.2	1.0	0.3	—	56.3

<sup>1</sup> Turnover is a non-GAAP measure and consists of total premiums written (including co-insurers share) and Other revenue. Refer to note 12 for further information.

**4. Group Consolidation and Operating Segments** continued

**4b. Segment Reporting** continued

**Segment Revenues**

The UK and International Car Insurance reportable segments derive all insurance premium income from external policyholders. Revenue within these segments is not derived from an individual policyholder that represents 10% or more of the Group's total revenue.

The total of Price Comparison revenues from transactions with other reportable segments is £10.8 million (2012: £13.0 million). These amounts have not been eliminated on consolidation as the Directors consider that not doing so results in a better overall presentation of the financial statements. The impact on the financial statements in the current and prior period is not material. There are no other transactions between reportable segments.

Within the UK Car Insurance segment, transactions between the Group's intermediary and the Group's insurance companies relating to vehicle commission totalling £18.4 million have been eliminated (from the insurance expenses and Other revenue lines in the income statement) on the basis that the non-elimination would have materially distorted the presentation of key performance indicators. The equivalent amounts in the prior period have not been eliminated as there is no resulting material distortion of key performance indicators.

Revenues from external customers for products and services is consistent with the split of reportable segment revenues as shown on page 77.

**Information about Geographical Locations**

All material revenues from external customers, and net assets attributed to a foreign country, are shown within the International Car Insurance reportable segment shown on the previous page. The revenue and results of the three International Price Comparison businesses, Rastreator, LeLynx and comparenow.com are not yet material enough to be presented as a separate segment.

**Segment Assets and Liabilities**

The identifiable segment assets and liabilities at 31 December 2013 are as follows.

	As at 31 December 2013					Segment total £m
	UK Car Insurance £m	International Car Insurance £m	Price Comparison £m	Other £m	Eliminations £m	
Property and equipment	8.2	2.6	1.0	0.6	—	12.4
Intangible assets	76.5	13.1	2.6	0.6	—	92.8
Reinsurance assets	705.0	111.4	—	4.8	—	821.2
Trade and other receivables	104.1	(11.0)	7.1	35.1	(57.8)	77.5
Financial assets	2,113.4	122.2	—	—	—	2,235.6
Cash and cash equivalents	101.6	35.7	38.7	8.6	—	184.6
Reportable segment assets	3,108.8	274.0	49.4	49.7	(57.8)	3,424.1
Insurance contract liabilities	1,690.4	198.5	—	12.4	—	1,901.3
Trade and other payables	959.9	36.0	6.5	11.3	—	1,013.7
Reportable segment liabilities	2,650.3	234.5	6.5	23.7	—	2,915.0
Reportable segment net assets	458.5	39.5	42.9	26.0	(57.8)	509.1
Unallocated assets and liabilities						15.0
Consolidated net assets						524.1

Unallocated assets and liabilities consist of other central assets and liabilities, plus deferred and current corporation tax balances. These assets and liabilities are not regularly reviewed by the Board of Directors in the reportable segment format.

There is an asymmetrical allocation of assets and income to the reportable segments, in that the interest earned on cash and cash equivalent assets deployed in the UK Car Insurance, Price Comparison and International Car Insurance segments is not allocated in arriving at segment profits. This is consistent with regular management reporting.

Eliminations represent inter-segment funding and balances included in trade and other receivables.

#### 4. Group Consolidation and Operating Segments continued

##### 4b. Segment Reporting continued

##### Segment Assets and Liabilities continued

The segment assets and liabilities at 31 December 2012 are as follows.

	As at 31 December 2012					
	UK Car Insurance £m	International Car Insurance £m	Price Comparison £m	Other £m	Eliminations £m	Segment total £m
Property and equipment	11.6	2.8	1.7	0.4	—	16.5
Intangible assets	77.6	13.8	1.0	0.1	—	92.5
Reinsurance assets	717.1	85.9	—	—	—	803.0
Trade and other receivables	98.7	(20.6)	9.1	9.5	(41.4)	55.3
Financial assets	1,833.2	97.3	—	—	—	1,930.5
Cash and cash equivalents	125.0	50.2	25.4	5.6	—	206.2
Reportable segment assets	2,863.2	229.4	37.2	15.6	(41.4)	3,104.0
Insurance contract liabilities	1,543.0	153.9	—	—	—	1,696.9
Trade and other payables	961.8	31.9	6.5	6.3	—	1,006.5
Reportable segment liabilities	2,504.8	185.8	6.5	6.3	—	2,703.4
Reportable segment net assets	358.4	43.6	30.7	9.3	(41.4)	400.6
Unallocated assets and liabilities						60.1
Consolidated net assets						460.7

#### 5. Premium, Claims and Profit Commissions

##### 5a. Accounting Policies

##### (i) Revenue – Premiums

Premiums relating to insurance contracts are recognised as revenue proportionally over the period of cover. Premiums with an inception date after the end of the period are held in the statement of financial position as deferred revenue. Outstanding collections from policyholders are recognised within policyholder receivables.

##### (ii) Revenue – Profit Commission

Under some of the co-insurance and reinsurance contracts under which motor premiums are shared or ceded, profit commission may be earned on a particular year of account, which is usually subject to performance criteria such as loss ratios and expense ratios. The commission is dependent on the ultimate outcome of any year, with revenue being recognised when loss and expense ratios used in the preparation of the financial statements move below a contractual threshold.

##### (iii) Insurance Contracts and Reinsurance Assets

##### Premiums

The proportion of premium receivable on in-force policies relating to unexpired risks is reported in insurance contract liabilities and reinsurance assets as the unearned premium provision – gross and reinsurers' share respectively.

##### Claims

Claims and claims handling expenses are charged as incurred, based on the estimated direct and indirect costs of settling all liabilities arising on events occurring up to the balance sheet date.

The provision for claims outstanding comprises provisions for the estimated cost of settling all claims incurred but unpaid at the balance sheet date, whether reported or not. Anticipated reinsurance recoveries are disclosed separately as assets.

Whilst the Directors consider that the gross provisions for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided.

Adjustments to the amounts of claims provisions established in prior years are reflected in the income statement for the period in which the adjustments are made and disclosed separately if material. The methods used, and the estimates made, are reviewed regularly.

Provision for unexpired risks is made where necessary for the estimated amount required over and above unearned premiums (net of deferred acquisition costs) to meet future claims and related expenses.

##### Co-insurance

The Group has entered into certain co-insurance contracts under which insurance risks are shared on a proportional basis, with the co-insurer taking a specific percentage of premium written and being responsible for the same proportion of each claim. As the contractual liability is several and not joint, neither the premiums nor claims relating to the co-insurance are included in the income statement. Under the terms of these agreements the co-insurers reimburse the Group for the same proportionate share of the costs of acquiring and administering the business.

**5. Premium, Claims and Profit Commissions** continued

**5a. Accounting Policies** continued

**(iii) Insurance Contracts and Reinsurance Assets** continued

**Reinsurance Assets**

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on the insurance contracts issued by the Group are classified as reinsurance contracts. A contract is only accounted for as a reinsurance contract where there is significant insurance risk transfer between the insured and the insurer.

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.

The Group assesses its reinsurance assets for impairment on a regular basis, and in detail every six months. If there is objective evidence that the asset is impaired, then the carrying value will be written down to its recoverable amount.

On the commutation of reinsurance contracts, the reinsurer is discharged from all obligations relating to the contract. Reinsurance assets and liabilities relating to the commuted contracts are settled in the period in which the commutation agreement is signed.

**5b. Net Insurance Premium Revenue**

	31 December 2013 £m	31 December 2012 £m
Total motor insurance premiums written before co-insurance	1,737.6	1,897.2
Group gross premiums written after co-insurance	1,088.4	1,167.2
Outwards reinsurance premiums	(620.2)	(679.1)
Net insurance premiums written	468.2	488.1
Change in gross unearned premium provision	48.0	(10.7)
Change in reinsurers' share of unearned premium provision	(33.2)	21.5
<b>Net insurance premium revenue</b>	<b>483.0</b>	<b>498.9</b>

The Group's share of the car insurance business was underwritten by Admiral Insurance (Gibraltar) Limited, Admiral Insurance Company Limited and Elephant Insurance Company. All contracts are short term in duration, lasting for 10 or 12 months.

**5c. Profit Commission**

	31 December 2013 £m	31 December 2012 £m
Underwriting year:		
2009 & prior	3.1	(2.3)
2010	24.9	9.4
2011	26.7	98.1
2012	44.6	3.2
<b>Total profit commission</b>	<b>99.3</b>	<b>108.4</b>

**5d. Reinsurance Assets and Insurance Contract Liabilities**

**(i) Objectives, Policies and Procedures for the Management of Insurance Risk**

The Group is involved in issuing motor insurance contracts that transfer risk from policyholders to the Group and its underwriting partners.

Insurance risk involves uncertainty over the occurrence, amount or timing of claims arising on insurance contracts issued.

Reserving risk is the risk that value of insurance liabilities established is insufficient to cover the ultimate cost of claims incurred at the balance sheet date, whether reported or unreported. Other risks include inadequate pricing and reinsurance policies, and inappropriate claims management processes and controls.

The Board of Directors is responsible for the management of insurance risk, although as mentioned in note 6, it has delegated the task of supervising risk management to the Group Risk Committee.

The Group also has a Reserving Committee. This Committee, comprised senior managers within the finance, claims, pricing and actuarial functions, primarily recommends the approach for UK Car Insurance reserving but also reviews the systems and controls in place to allow accurate reserving and material reserving issues such as Periodic Payment Order (PPO) and claims inflation that represent the key uncertainties in the amount or timing of claims settlements.

The Board implements certain policies in order to mitigate and control the level of insurance risk accepted by the Group. These include pricing policies and claims management and administration processes, in addition to reserving policies and co- and reinsurance arrangements as detailed on the following page.

## 5. Premium, Claims and Profit Commissions continued

### 5d. Reinsurance Assets and Insurance Contract Liabilities continued

#### (i) Objectives, Policies and Procedures for the Management of Insurance Risk continued

##### Reserving Policies and Controls

Reserving risk is mitigated through a series of processes and controls. The key processes are as follows:

- > Regular management and internal actuarial review of individual and aggregate case claim reserves, including regular reporting of management information and exception reporting of significant movements
- > Regular management and internal actuarial review of large claims, including claims settled or potentially settled by PPOs for which the uncertainty is increased by factors such as the lifetime of the claimant and movements in the indexation for the cost of future care of the claimant
- > Bi-annual external actuarial review of best estimate claims reserves using a variety of recognised actuarial techniques, including reviews of the potential ranges around best estimates
- > Use of a Reserving policy which informs management's reserving decisions for the purposes of the Group's financial statements. As described in note 2, critical accounting judgements and estimates, the policy determines that reserves should be set within a pre-determined range above best estimate assumptions to allow for unforeseen adverse claims development

##### Co-insurance and Reinsurance

As noted in the Strategic Report, the Group shares a significant amount of the motor insurance business generated with external underwriters. In 2013, 40% of the UK risk was shared under a co-insurance contract, under which the primary risk is borne by the co-insurer. A further 35% of the UK risk was ceded under quota share reinsurance contracts. Co-insurance and reinsurance contracts are also used in the International Car Insurance businesses. Further detail can be found in the Strategic Report on page 28.

As well as these proportional arrangements, an excess of loss reinsurance programme is also purchased to protect the Group against very large individual claims and catastrophe losses.

##### Concentration of Insurance Risk

The Directors do not believe there are significant concentrations of insurance risk. This is because, although the Group has historically written only one significant line of UK insurance business, the risks are spread across a large number of people and a wide regional base. The introduction of the international car insurance businesses in recent years and the launch of UK household business in 2012, will further contribute to the diversification of the Group's insurance risk as these businesses grow.

#### (ii) Sensitivity of Recognised Amounts to Changes in Assumptions

The following table sets out the impact on equity and profit or loss at 31 December 2013 that would result from a 1% movement in the UK loss ratios used for each underwriting year for which material amounts remain outstanding.

	Underwriting year			2013
	2010	2011	2012	
Booked loss ratio	70%	72%	78%	85%
Impact of 1% change (£m)	8.3	12.0	12.0	1.5

The impact is stated net of reinsurance and includes the change in net insurance claims along with the associated profit commission movements that result from changes in loss ratios. The figures are stated net of tax at the current rate.

#### (iii) Analysis of Recognised Amounts

	31 December 2013 £m	31 December 2012 £m
<b>Gross</b>		
Claims outstanding	1,400.4	1,147.7
Unearned premium provision	500.9	549.2
Total gross insurance liabilities	1,901.3	1,696.9
<b>Recoverable from reinsurers</b>		
Claims outstanding	537.4	487.3
Unearned premium provision	283.8	315.7
Total reinsurers' share of insurance liabilities	821.2	803.0
<b>Net</b>		
Claims outstanding	863.0	660.4
Unearned premium provision	217.1	233.5
<b>Total insurance liabilities – net</b>	<b>1,080.1</b>	<b>893.9</b>

## NOTES TO THE FINANCIAL STATEMENTS CONTINUED

### 5. Premium, Claims and Profit Commissions continued

#### 5d. Reinsurance Assets and Insurance Contract Liabilities continued

##### (iii) Analysis of Recognised Amounts continued

The maturity profile of gross insurance liabilities at the end of 2013 is as follows:

	< 1 year £m	1 – 3 years £m	> 3 years £m
Claims outstanding	419.9	478.0	502.5
Unearned premium provision	500.9	—	—
<b>Total gross insurance liabilities</b>	<b>920.8</b>	<b>478.0</b>	<b>502.5</b>

The maturity profile of gross insurance liabilities at the end of 2012 was as follows:

	< 1 year £m	1 – 3 years £m	> 3 years £m
Claims outstanding	344.1	391.7	411.9
Unearned premium provision	549.2	—	—
<b>Total gross insurance liabilities</b>	<b>893.3</b>	<b>391.7</b>	<b>411.9</b>

##### (iv) Analysis of UK Claims Incurred

The following tables illustrate the development of net UK Car Insurance claims incurred for the past four financial periods, including the impact of re-estimation of claims provisions at the end of each financial year. The first table shows actual net claims incurred, and the second shows the development of UK loss ratios. Figures are shown net of reinsurance and are on an underwriting year basis.

Analysis of claims incurred (net amounts)	Financial year ended 31 December					Total £m
	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	
<b>Underwriting year (UK only)</b>						
2009 and prior	(132.4)	(53.9)	8.7	(5.5)	5.0	(178.1)
2010	—	(130.2)	(128.6)	8.4	36.7	(213.7)
2011	—	—	(203.7)	(151.1)	39.7	(315.1)
2012	—	—	—	(191.3)	(139.6)	(330.9)
2013	—	—	—	—	(175.4)	(175.4)
UK net claims incurred (excluding claims handling costs)	(132.4)	(184.1)	(323.6)	(339.5)	(233.6)	
International net claims incurred	(13.6)	(15.9)	(28.3)	(54.2)	(59.9)	
Claims handling costs and other amounts	(5.7)	(8.5)	(11.9)	(10.8)	(9.5)	
Total net claims incurred	(151.7)	(208.5)	(363.8)	(404.5)	(303.0)	

UK loss ratio development	Financial year ended 31 December				
	2009	2010	2011	2012	2013
<b>Underwriting year (UK only)</b>					
2009	84%	75%	77%	77%	76%
2010	—	78%	77%	75%	70%
2011	—	—	82%	76%	72%
2012	—	—	—	84%	78%
2013	—	—	—	—	85%

**5. Premium, Claims and Profit Commissions** continued**5d. Reinsurance Assets and Insurance Contract Liabilities** continued**(v) Analysis of Net Claims Reserve Releases (UK Business Only)**

The following table analyses the impact of movements in prior year claims provisions, in terms of their net value, and their impact on the reported loss ratio. This data is presented on an underwriting year basis.

	Financial year ended 31 December				2013 £m
	2009 £m	2010 £m	2011 £m	2012 £m	
<b>Underwriting year</b>					
2009 and prior	31.3	23.5	8.7	(5.5)	5.0
2010	—	—	1.6	8.4	36.7
2011	—	—	—	14.7	39.7
2012					12.8
Total net release	31.3	23.5	10.3	17.6	94.2
Net releases on Admiral net share	31.3	23.1	7.8	16.3	53.3
Releases on commuted quota share reinsurance contracts <sup>*1</sup>	—	0.4	2.5	1.3	40.9
<b>Total net release as above</b>	31.3	23.5	10.3	17.6	94.2

<sup>\*1</sup> Admiral typically commutes quota share reinsurance contracts in its UK Car Insurance business 24 or 36 months following the start of the underwriting year. After commutation, any changes in claims costs on the commuted proportion of the business are reflected within claims costs and are separately analysed here. £40.9 million of releases on commuted quota share contracts is split as follows: 2011: £19.8 million; 2010: £18.4 million; 2009 & prior: £2.7 million.

Profit commission is analysed in note 5c.

**(vi) Reconciliation of Movement in Net Claims Provision**

	31 December 2013 £m	31 December 2012 £m
Net claims reserve at start of period	660.4	446.9
Net claims incurred (excluding releases)	387.7	411.3
Net reserve releases	(94.2)	(17.6)
Movement in net claims reserve due to commutation	208.7	102.2
Net claims paid	(299.6)	(282.4)
Net claims reserve at end of period <sup>*1</sup>	863.0	660.4

<sup>\*1</sup> The increase in net claims reserve from £660.4 million at 31 December 2012 to £863.0 million is partly as a result of the increase in the size of gross claims reserves but largely due to the impact of commutations of reinsurance contracts in the UK Car Insurance business.

**(vii) Reconciliation of Movement in Net Unearned Premium Provision**

	31 December 2013 £m	31 December 2012 £m
Net unearned premium provision at start of period	233.5	247.0
Written in the period	468.2	488.1
Earned in the period	(484.6)	(501.6)
Net unearned premium provision at end of period	217.1	233.5

**6. Investments**

**6a. Accounting Policies**

**(i) Investment Income**

Investment income from financial assets comprises interest income and net gains (both realised and unrealised) on financial assets classified as fair value through profit and loss and interest income on term deposits.

**(ii) Financial Assets – Investments and Receivables**

**Initial Recognition**

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables or held to maturity investments.

At initial recognition assets are recognised at fair value and classified according to the purpose for which they were acquired.

The Group's investments in money market liquidity funds and short term debt securities are designated as financial assets at fair value through profit or loss (FVTPL) at inception.

This designation is permitted under IAS 39, as the investments in money market funds and short dated securities are managed as a group of assets and internal performance evaluation of this group is conducted on a fair value basis.

The Group's deposits with credit institutions are classified as held to maturity investments, which is consistent with the intention for which they were purchased.

**Subsequent Measurement**

Financial assets at FVTPL are stated at fair value, with any resultant gain or loss recognised through the income statement.

Deposits with fixed maturities, classified as held to maturity investments are measured at amortised cost using the effective interest method. Movements in the amortised cost are recognised through the income statement, as are any impairment losses.

Loans and receivables are stated at their amortised cost less impairment using the effective interest method. Impairment losses are recognised through the income statement.

**Impairment of Financial Assets**

The Group assesses at each balance sheet date whether any financial assets or groups of financial assets held at amortised cost, are impaired. Financial assets are impaired where there is evidence that one or more events occurring after the initial recognition of the asset, may lead to a reduction in the estimated future cash flows arising from the asset.

Objective evidence of impairment may include default on cash flows due from the asset and reported financial difficulty of the issuer or counterparty.

**Derecognition of Financial Assets**

A financial asset is derecognised when the rights to receive cash flows from that asset have expired, or when the Group transfers the asset and all the attaching substantial risks and rewards relating to the asset, to a third party.

**Cash and Cash Equivalents**

Cash and cash equivalents includes cash in hand, deposits held at call with banks, and other short term deposits with original maturities of three months or less. All cash and cash equivalents are measured at amortised cost.

**6b. Investment and Interest Income**

	<b>31 December 2013 £m</b>	31 December 2012 £m
Net investment return	<b>12.4</b>	14.0
Interest receivable	<b>1.9</b>	1.9
<b>Total investment and interest income</b>	<b>14.3</b>	15.9

Interest received during the year was £1.9 million (2012: £1.9 million).

**6. Investments** continued**6c. Financial Assets and Liabilities**

The Group's financial instruments can be analysed as follows:

	31 December 2013 £m	31 December 2012 £m
<b>Financial assets</b>		
Investments held at fair value	1,406.1	1,025.4
Short dated debt securities held at fair value	202.4	—
Term deposits with credit institutions	288.4	375.8
Term deposits short dated debt securities	—	200.4
Receivables – amounts owed by policyholders	368.1	403.5
Total financial assets per consolidated statement of financial position	2,265.0	2,005.1
Trade and other receivables	77.5	55.3
Cash and cash equivalents	187.9	216.6
	2,530.4	2,277.0
<b>Financial liabilities</b>		
Trade and other payables	1,013.7	1,006.5

All investments held at fair value are invested in AAA-rated money market liquidity funds. These funds target a short term cash return with capital security and low volatility and continue to achieve these goals.

The measurement of investments at the end of the period, for investments held at fair value and short term debt securities held at fair value is based on active quoted market values (level 1).

Short term debt securities have been reclassified to fair value through profit and loss at the start of the period to align with the treatment of the money market fund holdings.

The deposits are held with well rated institutions; as such the approximate fair value is the book value of the investment as impairment of the capital is not expected. There is no quoted market for these holdings and as such a level 2 valuation is used. The book value of term deposits is £288.4 million (2012: £375.8 million).

The amortised cost carrying amount of receivables is a reasonable approximation of fair value.

The maturity profile of financial assets and liabilities at 31 December 2013 is as follows:

	On demand £m	< 1 year £m	Between 1 and 2 years £m	> 2 years £m
<b>Financial assets</b>				
Investments held at fair value	1,104.8	301.3	—	—
Term deposits with credit institutions	—	188.9	99.5	—
Short term debt securities	—	202.4	—	—
Receivables – amounts owed by policyholders	—	368.1	—	—
Total financial assets	1,104.8	1,060.7	99.5	—
Trade and other receivables	—	77.5	—	—
Cash and cash equivalents	187.9	—	—	—
	1,292.7	1,138.2	99.5	—
<b>Financial liabilities</b>				
Trade and other payables	—	1,013.7	—	—

**6. Investments** continued

**6c. Financial Assets and Liabilities** continued

The maturity profile of financial assets and liabilities at 31 December 2012 was as follows:

	On demand £m	< 1 year £m	Between 1 and 2 years £m	> 2 years £m
<b>Financial assets</b>				
Investments held at fair value	1,025.4	—	—	—
Term deposits with credit institutions	—	213.8	162.0	—
Short term debt securities	—	200.4	—	—
Receivables – amounts owed by policyholders	—	403.5	—	—
Total financial assets	1,025.4	817.7	162.0	—
Trade and other receivables	—	55.3	—	—
Cash and cash equivalents	216.6	—	—	—
	1,242.0	873.0	162.0	—
<b>Financial liabilities</b>				
Trade and other payables	—	1,006.5	—	—

**Objectives, Policies and Procedures For Managing Financial Assets and Liabilities**

The Group's activities expose it primarily to financial risks of credit risk, interest rate risk, liquidity risk and foreign exchange risk. The Board of Directors has delegated the task of supervising risk management and internal control to the Group Risk Committee. There is also an Investment Committee that makes recommendations to the Board on the Group's investment strategy.

There are several key elements to the risk management environment throughout the Group. These are detailed in full in the Corporate Governance Statement. Specific considerations for the risks arising from financial assets and liabilities are detailed below.

**Credit Risk**

The Group defines credit risk as the risk of loss if another party fails to perform its obligations. The key areas of exposure to credit risk for the Group result through its reinsurance programme, investments, bank deposits and policyholder receivables.

Economic and financial market conditions have led the Directors to consider counterparty exposure more frequently and in significant detail. The Directors consider that the policies and procedures in place to manage credit exposure continue to be appropriate for the Group's risk appetite, and during 2013 and historically, no material credit losses have been experienced by the Group.

There are no specific concentrations of credit risk with respect to investment counterparties due to the structure of the liquidity funds which invest in a wide range of very short duration, high quality securities. Cash balances and deposits are placed only with highly rated credit institutions. The detailed holdings are reviewed regularly by the Investment Committee.

To mitigate the risk arising from exposure to reinsurers (in the form of reinsurance recoveries and profit commissions), the Group only conducts business with companies of appropriate financial strength ratings. In addition, most reinsurance contracts are operated on a funds withheld basis, which substantially reduces credit risk, as the Group holds the cash received as collateral.

The other principal form of credit risk is in respect of amounts due from policyholders, largely due to the potential for default by instalment payers. The impact of this is mitigated by the large customer base and low average level of balance recoverable. There is also mitigation by the operation of numerous high- and low-level controls in this area, including payment on policy acceptance as opposed to inception and automated cancellation procedures for policies in default.

The Group's maximum exposure to credit risk at 31 December 2013 is £2,644.8 million (2012: £2,415.1 million), being the carrying value of financial assets and cash, and the excess of reinsurance assets over amounts owed to reinsurers under funds withheld arrangements. The Group does not use credit derivatives or similar instruments to mitigate exposure. The amount of bad debt expense relating to policyholder debt charged to the income statement in 2013 and 2012 is insignificant.

There were no significant financial assets that were past due at the close of either 2013 or 2012.

The Group's credit risk exposure to assets with external ratings is as follows:

	Rating	31 December 2013 £m	31 December 2012 £m
Financial institutions – Money market funds	AAA	1,406.1	1,025.4
Financial institutions – Credit institutions	AAA	61.8	60.1
Financial institutions – Credit institutions	AA	184.5	169.2
Financial institutions – Credit institutions	A	352.4	506.4
Financial institutions – Credit institutions	BBB and below	80.0	57.1
Reinsurers	AA	239.9	117.8
Reinsurers	A	20.0	196.3
Reinsurers	BBB	23.4	6.5

## 6. Investments continued

### 6c. Financial Assets and Liabilities continued

#### Objectives, Policies And Procedures For Managing Financial Assets and Liabilities continued

##### Interest Rate Risk

The Group considers interest rate risk to be the risk that unfavourable movements in interest rates could adversely impact on the capital values of financial assets and liabilities. This relates primarily to investments held at fair value.

As noted above, the Group invests in money market liquidity funds, which in turn invest in a mixture of very short dated fixed and variable rate securities, such as cash deposits, certificates of deposits, floating rate notes and other commercial paper.

The funds are not permitted to have an average maturity greater than 60 days and hence are not subject to large movements in yield and value resulting from changes in market interest rates (as longer duration fixed income portfolios can experience). Returns are likely to closely track the LIBID benchmark and hence while the Group's investment return will vary according to market interest rates, the capital value of these investment funds will not be impacted by rate movements. The interest rate risk arising is therefore considered to be minimal.

Other Group holdings include funds placed into two segregated mandates. The guidelines of the investments retain the credit quality of the money market liquidity funds. As the duration of the securities is short there is no material interest rate risk relating to these investments.

The Group also holds a number of fixed-rate, longer term deposits with strongly rated credit institutions. These are classified as term and valued at amortised cost. Therefore neither the capital value of the deposits, nor the interest return will be impacted by fluctuations in interest rates.

No sensitivity analysis to interest rates has been presented on the grounds of materiality.

##### Liquidity Risk

Liquidity risk is defined as the risk that the Group does not have sufficient, available, financial resources to enable it to meet its obligations as they fall due, or can only secure them at excessive cost.

The Group is strongly cash-generative due to the large proportion of revenue arising from non-underwriting activity. Further, as noted above, a significant portion of insurance funds are invested in money market liquidity funds with same day liquidity, meaning that a large proportion of the Group cash and investments are immediately available.

A breakdown of the Group's financial liabilities – trade and other payables is shown in note 10. In terms of the maturity profile of these liabilities, all amounts will mature within three to six months of the balance sheet date. (Refer to the maturity profile at the start of this note for further detail.)

In practice, the Group's Directors expect actual cash flows to be consistent with this maturity profile except for amounts owed to co-insurers and reinsurers. Of the total amounts owed to co-insurers and reinsurers of £785.3 million (2012: £723.5 million), £629.3 million (2012: £609.6 million) is held under funds withheld arrangements and therefore not expected to be settled within 12 months.

A maturity analysis for insurance contract liabilities is included in note 5.

The maturity profile for financial assets is included at the start of this note. The Group's Directors believe that the cash flows arising from these assets will be consistent with this profile.

Liquidity risk is not, therefore, considered to be significant.

##### Foreign Exchange Risks

Foreign exchange risks arise from unfavourable movements in foreign exchange rates that could adversely impact the valuation of overseas assets.

The Group is exposed to foreign exchange risk through its operations overseas. Although the relative size of the International operations means that the risks are relatively small, increasingly volatile foreign exchange rates could result in larger potential gains or losses. Assets held to fund insurance liabilities are held in the currency of the liabilities; however, surplus assets held as regulatory capital in foreign currencies remain exposed.

The Group's exposures to net assets held in euros and dollars at the balance sheet date were £7.1 million and £60.2 million respectively (2012: £13.3 million and £46.7 million).

##### Fair Value

For cash at bank and cash deposits and other receivables, the fair value approximates to the book value due to their short maturity. For assets held at fair value through profit and loss, their value equates to level 1 (quoted prices in active markets) of the fair value hierarchy.

### 6d. Cash and Cash Equivalents

	31 December 2013 £m	31 December 2012 £m
Cash at bank and in hand	187.9	216.6
Total cash and cash equivalents	187.9	216.6

Cash and cash equivalents includes cash in hand, deposits held at call with banks, and other short term-term deposits with original maturities of three months or less.

**7. Other Revenue**

**7a. Accounting Policy**

**(i) Contribution from Additional Products and Fees and Other Revenue**

Contribution from additional products and fees and other revenue includes revenue earned on the sale of products supplementing the core motor insurance policy, administration and other charges paid by the policyholder, referral fees, revenue from policies paid by instalments and vehicle commission charges paid by co- and reinsurers. Revenue is credited to the income statement over the period matching the Group's obligations to provide services. Where the Group has no remaining contractual obligations, the revenue is recognised immediately. An allowance is made for expected cancellations where the customer may be entitled to a refund of amounts charged.

Commission from price comparison activities and broking commission earned by Gladiator is credited to revenue on the sale of the underlying insurance policy.

**7b. Contribution from Additional Products and Fees and Other Revenue**

	31 December 2013 £m	31 December 2012 £m
Contribution from additional products and fees	177.0	215.7
Price comparison revenue	112.7	103.5
Other revenue	38.1	41.9
<b>Total Other revenue</b>	<b>327.8</b>	<b>361.1</b>

Refer to the Strategic Report for further detail on the sources of revenue.

**8. Expenses**

**8a. Accounting Policies**

**(i) Acquisition Costs and Operating Expenses**

Acquisition costs incurred in obtaining new and renewal business are charged to the income statement over the period in which those premiums are earned. All other operating expenses are charged to the income statement in the period that they are incurred.

**(ii) Employee Benefits**

**Pensions**

The Group contributes to defined contribution personal pension plans for its employees. The contributions payable to these schemes are charged in the accounting period to which they relate.

**Employee Share Schemes**

The Group operates a number of equity and cash settled compensation schemes for its employees. The fair value of the employee services received in exchange for the grant of free shares under the equity settled schemes is recognised as an expense, with a corresponding increase in equity. For cash settled schemes, the fair value of services received are also recognised as an expense, with a corresponding increase in liability.

For equity settled schemes, the total charge expensed over the vesting period is determined by reference to the fair value of the free shares granted as determined at the grant date (excluding the impact of non-market vesting conditions). Non-market conditions such as profitability targets as well as staff attrition rates are included in assumptions over the number of free shares to vest under the applicable scheme.

For cash settled schemes, the total charge expensed over the vesting period is determined by reference to the closing Admiral Group share price at the end of the period. Prior to the vesting of each scheme, the closing share price at the end of the reporting period is used as an approximation for the closing share price at the end of the vesting period. As with equity settled schemes, non-market vesting conditions also impact on the total charge expensed over the vesting period.

At each balance sheet date, the Group revises its assumptions on the number of shares to be granted with the impact of any change in the assumptions recognised through income.

Refer to note 8f for further details on share schemes.

**8b. Operating Expenses and Share Scheme Charges**

	31 December 2013		
	Gross £m	Recoverable from co- and reinsurers £m	Net £m
Acquisition of insurance contracts	85.5	(51.8)	33.7
Administration and other marketing costs (Insurance contracts)	203.5	(150.5)	53.0
Insurance contract expenses	289.0	(202.3)	86.7
Administration and other marketing costs (Other)	142.0	—	142.0
Share scheme charges	36.0	(13.5)	22.5
<b>Total expenses and share scheme charges</b>	<b>467.0</b>	<b>(215.8)</b>	<b>251.2</b>

**8. Expenses** continued**8b. Operating Expenses and Share Scheme Charges** continued

	31 December 2012		
	Gross £m	Recoverable from co- and reinsurers £m	Net £m
Acquisition of insurance contracts	95.3	(44.7)	50.6
Administration and other marketing costs (Insurance contracts)	178.2	(151.4)	26.8
Insurance contract expenses	273.5	(196.1)	77.4
Administration and other marketing costs (Other)	137.2	—	137.2
Share scheme charges	32.5	(11.9)	20.6
<b>Total expenses and share scheme charges</b>	<b>443.2</b>	<b>(208.0)</b>	<b>235.2</b>

The £53.0 million (2012: £26.8 million) administration and marketing costs allocated to insurance contracts is principally made up of salary costs.

Analysis of other administration and other marketing costs:

	31 December 2013 £m	31 December 2012 £m
Expenses relating to additional products and fees	34.4	35.9
Price comparison operating expenses	92.3	85.5
Other expenses	15.3	15.8
<b>Total</b>	<b>142.0</b>	<b>137.2</b>

Refer to note 12 for a reconciliation between insurance contract expenses and the reported expense ratio.

**8c. Staff Costs and Other Expenses**

	31 December 2013		31 December 2012	
	Gross £m	Net £m	Gross £m	Net £m
Salaries	148.5	49.2	137.1	44.3
Social security charges	16.7	5.7	13.8	4.4
Pension costs	4.1	1.4	1.0	0.3
Share scheme charges (see note 8f)	36.0	9.0	32.5	8.1
<b>Total staff expenses</b>	<b>205.3</b>	<b>65.3</b>	<b>184.4</b>	<b>457.1</b>
Depreciation charge:				
– Owned assets	7.2	2.6	5.4	2.2
– Leased assets	0.1	—	1.2	0.3
Amortisation charge:				
– Software	4.9	1.9	4.1	1.2
– Deferred acquisition costs	68.8	18.6	48.0	11.7
Operating lease rentals:				
– Buildings	11.4	3.6	10.5	3.3
Auditor's remuneration (including VAT):				
– Fees payable for the audit of the Company's annual accounts	—	—	—	—
– Fees payable for the audit of the Company's subsidiary accounts	0.3	0.2	0.3	0.2
– Fees payable for other services	0.3	0.1	0.3	0.1
Net foreign exchange losses	1.5	1.5	—	—
Analysis of fees paid to the auditor for other services:				
Tax compliance services	0.1	—	0.1	—
Tax advisory services	0.2	0.1	0.2	0.1
Other services	—	—	—	—
<b>Total as above</b>	<b>0.3</b>	<b>0.1</b>	<b>0.3</b>	<b>0.1</b>

**8. Expenses** continued

**8c. Staff Costs and Other Expenses** continued

Gross and net expenses are before and after co- and reinsurance arrangements respectively.

Refer to the Corporate Governance Report for details of the Audit Committee's policy on fees paid to the Company's auditor for non-audit services. The ratio of non-audit fees to audit fees in 2013 was 108% (2012: 124%).

The amortisation of software and deferred acquisition cost assets is charged to expenses in the income statement.

**8d. Staff Numbers (including Directors)**

	Average for the year	
	2013 Number	2012 Number
Direct customer contact staff	5,145	4,991
Support staff	1,420	1,231
<b>Total</b>	<b>6,565</b>	<b>6,222</b>

**8e. Directors' Remuneration**

**(i) Directors' Remuneration**

	31 December 2013 £m	31 December 2012 £m
Directors' emoluments	2.0	2.1
Amounts receivable under long term incentive schemes	0.8	0.7
Company contributions to money purchase pension plans	—	—
<b>Total</b>	<b>2.8</b>	<b>2.8</b>

**(ii) Number of Directors**

	2013 Number	2012 Number
Retirement benefits are accruing to the following number of Directors under:		
Money purchase schemes	1	1
Defined benefit schemes	—	—

**8f. Staff Share Schemes**

Analysis of share scheme costs (per income statement):

	31 December 2013 £m	31 December 2012 £m
SIP charge (i)	7.6	6.6
DFSS charge (ii)	14.9	14.0
<b>Total share scheme charges</b>	<b>22.5</b>	<b>20.6</b>

The share scheme charges reported above are net of the co- and reinsurers share of the cost and therefore differ from the gross charge reported in note 8c (2013: £36.0 million; 2012: £32.5 million) and the gross credit to reserves reported in the consolidated statement of changes in equity (2013: £25.7 million; 2012: £23.7 million).

The consolidated cash flow statement also shows the gross charge in the reconciliation between "profit after tax" and "cash flows from operating activities". The co-insurance share of the charge is included in the 'change in trade and other payables' line.

**(i) The Approved Share Incentive Plan (the "SIP")**

Eligible employees qualified for awards under the SIP based upon the performance of the Group in each half-year period. The current maximum award for each year is £3,000 per employee. The awards are made with reference to the Group's performance against prior year profit before tax. Employees must remain in employment for the holding period (three years from the date of award) otherwise the shares are forfeited.

The fair value of shares awarded is either the share price at the date of award, or is estimated at the latest share price available when drawing up the financial statements for awards not yet made (and later adjusted to reflect the actual share price on the award date). Awards under the SIP are entitled to receive dividends, and, hence, no adjustment has been made to this fair value.

**(ii) The Discretionary Free Share Scheme (the "DFSS")**

Under the DFSS, details of which are contained in the remuneration policy section of the Directors' Remuneration Report, individuals receive an award of free shares at no charge. Staff must remain in employment until the vesting date in order to receive shares. The maximum number of shares that can vest relating to the 2013 scheme is 2,344,321 (2012 scheme: 2,149,566).

The amount of award that actually vests is based on the growth in the Company's earnings per share (EPS) relative to a risk free return (RFR), for which LIBOR has been selected as a benchmark. This performance is measured over the three-year period the award applies to. For the 2013 and 2012 schemes, 50% of the shares awarded at the start of the three year vesting period are subject to these performance conditions.

## 8. Expenses continued

### 8f. Staff Share Schemes continued

#### (ii) The Discretionary Free Share Scheme (the "DFSS") continued

The range of awards is as follows:

- > If the growth in EPS is less than the RFR, no awards vest
- > EPS growth is equal to RFR – 10% of maximum award vests
- > To achieve the maximum award, EPS growth has to be 36 points higher than RFR over the three year period

Between 10% and 100% of the maximum awards, a linear relationship exists.

Awards under the DFSS are not eligible for dividends (although a discretionary bonus is currently paid equivalent to the dividend that would have been paid on the respective shareholding) and hence the fair value of free shares to be awarded under this scheme has been revised downwards to take account of these distributions. The unadjusted fair value is based on the share price at the date on which awards were made (as stated in the Directors' Remuneration Report).

#### Number of Free Share Awards Committed at 31 December 2013

	Awards outstanding <sup>†1</sup>	Vesting date
SIP H210 scheme	346,590	March 2014
SIP H111 scheme	489,280	September 2014
SIP H211 scheme	598,400	March 2015
SIP H112 scheme	617,778	September 2015
SIP H212 scheme	533,792	March 2016
SIP H113 scheme	603,084	September 2016
DFSS 2011 scheme 1st award	1,634,732	April 2014
DFSS 2011 scheme 2nd award	157,312	September 2014
DFSS 2012 scheme 1st award	181,668	March 2015
DFSS 2012 scheme 2nd award	1,977,452	October 2015
DFSS 2013 scheme 1st award	173,348	March 2016
DFSS 2013 scheme 2nd award	2,170,973	October 2016
<b>Total awards committed</b>	<b>9,484,409</b>	

<sup>†1</sup> Being the maximum number of awards expected to be made before accounting for expected staff attrition.

During the year ended 31 December 2013, awards under the SIP H209 and H110 schemes and the DFSS 2010 scheme vested. The total number of awards vesting for each scheme is as follows.

#### Number of Free Share Awards Vesting During the Year Ended 31 December 2013

	Original awards	Awards vested
SIP H209 scheme	377,641	314,358
SIP H110 scheme	352,100	287,000
DFSS 2010 scheme 1st award	1,542,453	1,380,210
DFSS 2010 scheme 2nd award	121,051	70,973

## 9. Taxation

### 9a. Accounting Policy

Income tax on the profit or loss for the periods presented comprises current and deferred tax.

#### (i) Current Tax

Current tax is the expected tax payable on the taxable income for the period, using tax rates that have been enacted or substantively enacted by the balance sheet date, and includes any adjustment to tax payable in respect of previous periods.

Current tax related to items recognised in other comprehensive income is also recognised in other comprehensive income and not in the income statement.

#### (ii) Deferred Tax

Deferred tax is provided in full using the balance sheet liability method, providing for temporary differences arising between the carrying amount of assets and liabilities for accounting purposes, and the amounts used for taxation purposes. It is calculated at the tax rates that have been enacted or substantively enacted by the balance sheet date, or that are expected to apply in the period when the liability is settled or the asset is realised.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

The principal temporary differences arise from depreciation of property and equipment and share scheme charges. The resulting deferred tax is charged or credited in the income statement, except in relation to share scheme charges where the amount of tax benefit credited to the income statement is limited to an equivalent credit calculated on the accounting charge. Any excess is recognised directly in equity.

9. Taxation continued

9b. Taxation

	31 December 2013 £m	31 December 2012 £m
<b>Current tax</b>		
Corporation tax on profits for the year	83.4	88.4
Under provision relating to prior periods	0.4	1.2
Current tax charge	83.8	89.6
<b>Deferred tax</b>		
Current period deferred taxation movement	0.1	(2.8)
(Over) provision relating to prior periods – deferred tax	(0.6)	(0.6)
<b>Total tax charge per income statement</b>	<b>83.3</b>	<b>86.2</b>

Factors affecting the total tax charge are:

	31 December 2013 £m	31 December 2012 £m
<b>Profit before tax</b>	<b>370.2</b>	<b>344.6</b>
Corporation tax thereon at effective UK corporation tax rate of 23.25% (2012: 24.5%)	86.1	84.4
Expenses and provisions not deductible for tax purposes	0.2	1.4
Impact of change in UK tax rate on deferred tax balances	2.7	0.7
Adjustments relating to prior periods	(0.2)	(0.4)
Impact of different overseas tax rates	(5.6)	—
Other differences	0.1	0.1
<b>Total tax charge for the period as above</b>	<b>83.3</b>	<b>86.2</b>

9c. Deferred Income Tax (Asset)

Analysis of Deferred Tax (Asset)

	Tax treatment of share schemes £m	Capital allowances £m	Carried forward losses £m	Other differences £m	Total £m
<b>Balance brought forward at 1 January 2012</b>	<b>(3.6)</b>	<b>(1.5)</b>	<b>(2.6)</b>	<b>(2.6)</b>	<b>(10.3)</b>
Tax treatment of share scheme charges through income or expense	1.3	—	—	—	1.3
Tax treatment of share scheme charges through reserves	(1.5)	—	—	—	(1.5)
Capital allowances	—	(0.4)	—	—	(0.4)
Carried forward losses	—	—	(3.1)	—	(3.1)
Other difference	—	—	—	(1.2)	(1.2)
<b>Balance carried forward at 31 December 2012</b>	<b>(3.8)</b>	<b>(1.9)</b>	<b>(5.7)</b>	<b>(3.8)</b>	<b>(15.2)</b>
Tax treatment of share scheme charges through income or expense	1.8	—	—	—	1.8
Tax treatment of share scheme charges through reserves	(2.1)	—	—	—	(2.1)
Capital allowances	—	(1.4)	—	—	(1.4)
Carried forward losses	—	—	(2.1)	—	(2.1)
Other difference	—	—	—	2.0	2.0
<b>Balance carried forward at 31 December 2013</b>	<b>(4.1)</b>	<b>(3.3)</b>	<b>(7.8)</b>	<b>(1.8)</b>	<b>(17.0)</b>

The UK corporation tax rate reduced from 24% to 23% on 1 April 2013. The average effective rate of tax for 2013 is 23.25% (2012: 24.5%). It will fall to 21% in April 2014, and to 20% in April 2015. Deferred tax has therefore been calculated at 20% where the temporary difference is expected to reverse after this date.

## 10. Other Assets and Other Liabilities

### 10a. Accounting Policy

#### (i) Property and Equipment, and Depreciation

All property and equipment is stated at cost less accumulated depreciation. Depreciation is calculated using the straight line method to write off the cost less residual values of the assets over their useful economic lives. These useful economic lives are as follows:

Motor vehicles	– four years
Fixtures, fittings and equipment	– four years
Computer equipment	– two to four years
Improvements to short leasehold properties	– four years

#### (ii) Impairment of Property and Equipment

In the case of property and equipment, carrying values are reviewed at each balance sheet date to determine whether there are any indications of impairment. If any such indications exist, the asset's recoverable amount is estimated and compared to the carrying value. The carrying value is the higher of the fair value of the asset, less costs to sell and the asset's value in use. Impairment losses are recognised through the income statement.

#### (iii) Leased Assets

The rental costs relating to assets held under operating leases are charged to the income statement on a straight line basis over the life of the lease.

Leases under the terms of which the Group assumes substantially all of the risks and rewards of ownership are classed as finance leases. Assets acquired under finance leases are included in property and equipment at fair value on acquisition and are depreciated in the same manner as equivalent owned assets. Finance lease and hire purchase obligations are included in creditors, and the finance costs are spread over the periods of the agreements based on the net amount outstanding.

#### (iv) Intangible Assets

##### Goodwill

All business combinations are accounted for using the purchase method. Goodwill has been recognised in acquisitions of subsidiaries, and represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

The classification and accounting treatment of acquisitions occurring before 1 January 2004 have not been reconsidered in preparing the Group's opening IFRS balance sheet at 1 January 2004 due to the exemption available in IFRS 1 (First time adoption). In respect of acquisitions prior to 1 January 2004, goodwill is included at the transition date on the basis of its deemed cost, which represents the amount recorded under UK GAAP, which was tested for impairment at the transition date. On transition, amortisation of goodwill has ceased as required by IAS 38.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash generating units (CGUs) according to business segment and is reviewed annually for impairment.

The goodwill held on the balance sheet at 31 December 2013 is allocated solely to the UK car insurance segment.

##### Impairment of Goodwill

The annual impairment review involves comparing the carrying amount to the estimated recoverable amount (by allocating the goodwill to CGUs) and recognising an impairment loss if the recoverable amount is lower. Impairment losses are recognised through the income statement and are not subsequently reversed.

The recoverable amount is the greater of the fair value of the asset less costs to sell and the value in use of the CGU.

The value in use calculations use cash flow projections based on financial budgets approved by management covering a three year period. Cash flows beyond this period are considered, but not included in the calculation. The discount rate applied to the cash flow projections in the value in use calculations is 9.8% (2012: 9.0%), based on the Group's weighted average cost of capital, which is in line with the market (source: Bloomberg).

The key assumptions used in the value in use calculations are those regarding growth rates and expected changes in pricing and expenses incurred during the period. Management estimates growth rates and changes in pricing based on past practices and expected future changes in the market.

The headroom above the goodwill carrying value is very significant, and there is no foreseeable event that would eliminate this margin.

##### Deferred Acquisition Costs

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. Deferred acquisition costs represent the proportion of acquisition costs incurred that correspond to the unearned premiums provision at the balance sheet date. This balance is held as an intangible asset. It is amortised over the term of the contract as premium is earned.

##### Software

Purchased software is recognised as an intangible asset and amortised over its expected useful life (generally the licence term). The carrying value is reviewed every six months for evidence of impairment, with the value being written down if any impairment exists. Impairment may be reversed if conditions subsequently improve.

## NOTES TO THE FINANCIAL STATEMENTS CONTINUED

### 10. Other Assets and Other Liabilities continued

#### 10b. Property and Equipment

	Improvements to short leasehold buildings £m	Computer equipment £m	Office equipment £m	Furniture and fittings £m	Total £m
<b>Cost</b>					
At 1 January 2012	6.7	28.3	11.4	4.9	51.3
Additions	0.6	3.4	1.5	0.1	5.6
Disposals	—	(0.1)	—	—	(0.1)
At 31 December 2012	7.3	31.6	12.9	5.0	56.8
<b>Depreciation</b>					
At 1 January 2012	4.4	19.0	7.2	3.1	33.7
Charge for the year	0.9	3.6	1.5	0.6	6.6
Disposals	—	—	—	—	—
At 31 December 2012	5.3	22.6	8.7	3.7	40.3
<b>Net book amount</b>					
At 1 January 2012	2.3	9.3	4.2	1.8	17.6
<b>Net book amount</b>					
At 31 December 2012	2.0	9.0	4.2	1.3	16.5
<b>Cost</b>					
At 1 January 2013	7.3	31.6	12.9	5.0	56.8
Additions	1.2	1.7	0.1	0.3	3.3
Disposals	—	(0.5)	—	—	(0.5)
At 31 December 2013	8.5	32.8	13.0	5.3	59.6
<b>Depreciation</b>					
At 1 January 2013	5.3	22.6	8.7	3.7	40.3
Charge for the year	1.0	3.9	1.7	0.7	7.3
Disposals	—	(0.4)	—	—	(0.4)
At 31 December 2013	6.3	26.1	10.4	4.4	47.2
<b>Net book amount</b>					
<b>At 31 December 2013</b>	<b>2.2</b>	<b>6.7</b>	<b>2.6</b>	<b>0.9</b>	<b>12.4</b>

The net book value of assets held under finance leases is as follows:

	31 December 2013 £m	31 December 2012 £m
Computer equipment	—	3.0

#### 10c. Intangible Assets

	Goodwill £m	Deferred acquisition costs £m	Software £m	Total £m
At 1 January 2012	62.3	16.4	8.8	87.5
Additions	—	51.9	5.5	57.4
Amortisation charge	—	(48.0)	(4.1)	(52.1)
Disposals	—	—	(0.3)	(0.3)
At 31 December 2012	62.3	20.3	9.9	92.5
Additions	—	67.7	6.8	74.5
Amortisation charge	—	(68.8)	(4.9)	(73.7)
Disposals	—	—	(0.5)	(0.5)
<b>At 31 December 2013</b>	<b>62.3</b>	<b>19.2</b>	<b>11.3</b>	<b>92.8</b>

Goodwill relates to the acquisition of Group subsidiary EUI Limited (formerly Admiral Insurance Services Limited) in November 1999. It is allocated solely to the UK Car Insurance segment. As described in the accounting policies, the amortisation of this asset ceased on transition to IFRS on 1 January 2004. All annual impairment reviews since the transition date have indicated that the estimated recoverable value of the asset is greater than the carrying amount and therefore no impairment losses have been recognised. Refer to the accounting policy for goodwill for further information.

**10. Other Assets and Other Liabilities** continued**10d. Trade and Other Receivables**

	31 December 2013 £m	31 December 2012 £m
Trade receivables	73.9	54.8
Prepayments and accrued income	3.6	0.5
<b>Total trade and other receivables</b>	<b>77.5</b>	<b>55.3</b>

**10e. Trade and Other Payables**

	31 December 2013 £m	31 December 2012 £m
Trade payables	16.9	13.0
Amounts owed to co-insurers and reinsurers	785.3	723.5
Finance leases due within 12 months	0.1	0.8
Other taxation and social security liabilities	20.6	22.9
Other payables	90.1	71.5
Accruals and deferred income (see below)	100.7	174.8
<b>Total trade and other payables</b>	<b>1,013.7</b>	<b>1,006.5</b>

Of amounts owed to co-insurers and reinsurers, £629.3 million (2012: £609.6 million) is held under funds withheld arrangements.

Analysis of accruals and deferred income:

	31 December 2013 £m	31 December 2012 £m
Premium receivable in advance of policy inception	60.7	115.4
Accrued expenses	22.0	41.4
Deferred income	18.0	18.0
<b>Total accruals and deferred income as above</b>	<b>100.7</b>	<b>174.8</b>

**10f. Obligations Under Finance Leases**

Analysis of finance lease liabilities:

	At 31 December 2013			At 31 December 2012		
	Minimum lease payments £m	Interest £m	Principal £m	Minimum lease payments £m	Interest £m	Principal £m
Less than one year	0.1	—	0.1	0.8	—	0.8
Between one and five years	—	—	—	—	—	—
More than five years	—	—	—	—	—	—
	<b>0.1</b>	<b>—</b>	<b>0.1</b>	<b>0.8</b>	<b>—</b>	<b>0.8</b>

The fair value of the Group's lease obligations approximates to their carrying amount.

**10g. Financial Commitments**

The Group was committed to total minimum obligations under operating leases on land and buildings as follows:

	31 December 2013 £m	31 December 2012 £m
<b>Minimum payments due on operating leases</b>		
Within one year	5.3	8.0
Within two to five years	8.2	11.4
Over five years	1.8	0.1
<b>Total commitments</b>	<b>15.3</b>	<b>19.5</b>

Operating lease payments represent rentals payable by the Group for its office properties.

In 2014, the Group will enter into new operating lease commitments for premises in Newport and Cardiff which are currently under construction. The annual charge for these leases totals £3.4 million and both lease terms exceed five years.

**11. Share Capital**

**11a. Accounting Policies**

**(i) Share Capital**

Shares are classified as equity when there is no obligation to transfer cash or other assets.

**(ii) Dividends**

Dividends are recorded in the period in which they are declared and paid.

**11b. Dividends**

Dividends were declared and paid as follows:

	31 December 2013 £m	31 December 2012 £m
March 2012 (36.5 pence per share, paid June 2012)	—	98.0
August 2012 (45.1 pence per share, paid October 2012)	—	121.3
March 2013 (45.5 pence per share, paid June 2013)	123.1	—
August 2013 (48.9 pence per share, paid October 2013)	132.7	—
<b>Total dividends</b>	<b>255.8</b>	<b>219.3</b>

The dividends declared in March represent the final dividends paid in respect of the 2011 and 2012 financial years. The dividends declared in August are interim distributions in respect of 2012 and 2013.

A final dividend of 50.6 pence per share (£139.6 million) has been proposed in respect of the 2013 financial year. Refer to the Chairman's Statement and Strategic Report for further detail.

**11c. Earnings per Share**

	31 December 2013 £m	31 December 2012 £m
Profit for the financial year after taxation attributable to equity shareholders	286.9	258.4
Weighted average number of shares – basic	274,311,039	271,714,535
Unadjusted earnings per share – basic	104.6p	95.1p
Weighted average number of shares – diluted	274,813,144	272,403,242
Unadjusted earnings per share – diluted	104.4p	94.9p

The difference between the basic and diluted number of shares at the end of 2013 (being 502,105; 2012: 688,707) relates to awards committed, but not yet issued under the Group's share schemes. Refer to note 8 for further detail.

**11d. Share Capital**

	31 December 2013 £m	31 December 2012 £m
<b>Authorised</b>		
500,000,000 ordinary shares of 0.1 pence	0.5	0.5
<b>Issued, called up and fully paid</b>		
276,141,432 ordinary shares of 0.1 pence	0.3	—
273,523,594 ordinary shares of 0.1 pence	—	0.3
	<b>0.3</b>	<b>0.3</b>

During 2013 2,617,838 (2012: 2,797,519) new ordinary shares of 0.1 pence were issued to the trusts administering the Group's share schemes. 917,838 (2012: 1,177,519) of these were issued to the Admiral Group Share Incentive Plan Trust for the purposes of this share scheme to give a closing number at 31 December 2013 of 6,484,084 (31 December 2012: 5,566,246). These shares are entitled to receive dividends.

1,700,000 (2012: 1,620,000) were issued to the Admiral Group Employee Benefit Trust for the purposes of the Discretionary Free Share Scheme to give a closing number at 31 December 2013 of 11,061,948 (31 December 2012: 9,361,948). The Trustees have waived the right to dividend payments, other than to the extent of 0.001 pence per share, unless and to the extent otherwise directed by the Company from time to time.

The number of shares in issue at flotation was 258,595,400.

**11. Share Capital** continued**11e. Objectives, Policies and Procedures for Managing Capital**

The Group manages its capital to ensure that all entities within the Group are able to continue as going concerns and also to ensure that regulated entities comfortably meet regulatory requirements. Excess capital above these levels within subsidiaries is paid up to the Group holding company in the form of dividends on a regular basis.

The Group's dividend policy is to make distributions after taking into account capital that is required to be held a) for regulatory purposes; b) to fund expansion activities; and c) as a further prudent buffer against unforeseen events. This policy gives the Directors flexibility in managing the Group's capital.

Capital continues to be held in equity form, with no debt.

The Group's regulatory capital requirements are discussed in the Group Financial Review within the Strategic Report.

**11f. Group Subsidiary Companies**

The parent company's subsidiaries are as follows:

Subsidiary	Country of incorporation	Class of shares held	% Ownership	Principal activity
Able Insurance Services Limited	England and Wales	Ordinary	100	Insurance Intermediary
Admiral Insurance (Gibraltar) Limited	Gibraltar	Ordinary	100	Insurance Company
Admiral Insurance Company Limited	England and Wales	Ordinary	100	Insurance Company
Admiral Law Limited	England and Wales	Ordinary	90	Legal Company
Admiral Life Limited	England and Wales	Ordinary	100	Dormant
Admiral Syndicate Limited	England and Wales	Ordinary	100	Dormant
Admiral Syndicate Management Limited	England and Wales	Ordinary	100	Dormant
BDE Law Limited	England and Wales	Ordinary	90	Legal Company
Bell Direct Limited	England and Wales	Ordinary	100	Dormant
comparenow.com Insurance Agency LLC	United States of America	Ordinary	67.79 (Indirect)	Insurance Intermediary
Confused.com Limited	England and Wales	Ordinary	100	Dormant
Diamond Motor Insurance Services Limited	England and Wales	Ordinary	100	Dormant
Elephant Insurance Company	United States of America	Ordinary	100	Insurance Company
Elephant Insurance Services Limited	England and Wales	Ordinary	100	Dormant
Elephant Insurance Services LLC	United States of America	Ordinary	100	Insurance Intermediary
EUI (France) Limited	England and Wales	Ordinary	100	Insurance Intermediary
EUI Limited	England and Wales	Ordinary	100	Insurance Intermediary
Inspop Technologies Private Limited	India	Ordinary	100	Internet technology supplier
Inspop USA LLC	United States of America	Ordinary	67.79	Insurance Intermediary
Inspop.com (France) Limited	England and Wales	Ordinary	100	Insurance Intermediary
Inspop.com Limited	England and Wales	Ordinary	100	Insurance Intermediary
Rastreator.com Limited	England and Wales	Ordinary	75	Insurance Intermediary

For further information on how the Group conducts its business across the UK, Europe and the USA, refer to the Strategic Report.

**11g. Related Party Transactions**

Details relating to the remuneration and shareholdings of key management personnel are set out in the Directors' Remuneration Report. Key management personnel are able to obtain discounted motor insurance at the same rates as all other Group staff, typically at a reduction of 15%.

The Board considers that only the Executive Directors of Admiral Group plc are key management personnel. Aggregate compensation for the Executive Directors is disclosed in the Directors' Remuneration Report on pages 55 to 64.

## NOTES TO THE FINANCIAL STATEMENTS CONTINUED

### 12. Reconciliations

The following tables reconcile significant key performance indicators and non-GAAP measures included in the Strategic Report to items included in the financial statements.

#### 12a. Reconciliation of Turnover to Reported Total Premiums Written and Other Revenue as per the Financial Statements

	31 December 2013 £m	31 December 2012 £m
Total premiums written before co-insurance arrangements per note 5b of financial statements	1,737.6	1,897.2
Other revenue per note 7b of financial statements	327.8	361.1
	<b>2,065.4</b>	2,258.3
UK vehicle commission <sup>1</sup>	(48.1)	(46.8)
Other <sup>2</sup>	12.9	3.6
<b>Turnover as per note 4b of financial statements</b>	<b>2,030.2</b>	2,215.1

<sup>1</sup> During 2012 Admiral ceased earning Other revenue from the sale of legal protection policies. At the same point, the Group began charging its panel of co- and reinsurers a vehicle commission. The substance of these changes meant that the total premiums written increased by the amount of revenue that was previously earned from the sale of legal protection policies. The vehicle commission included within Other revenue is therefore eliminated from the turnover measure to avoid double counting.

<sup>2</sup> Other reconciling items represent co-insurer and reinsurer shares of Other revenue in the Group's International Car Insurance businesses.

#### 12b. Reconciliation of Claims Incurred to Reported Group Loss Ratio, Excluding Releases on Commuted Reinsurance

	31 December 2013		31 December 2012	
	UK Car £m	Group £m	UK Car £m	Group £m
Net insurance claims	243.3	303.0	350.3	404.5
Less: net claims handling expenses	(9.5)	(9.5)	(10.8)	(10.8)
Add back reserve releases on commuted reinsurance	40.9	40.9	1.3	1.3
Adjusted net claims	274.7	334.4	340.8	395.0
Net insurance premium revenue	403.9	483.0	445.9	498.9
Reported loss ratio	68.0%	69.2%	76.4%	79.2%

#### 12c. Reconciliation of Expenses Related to Insurance Contracts to Reported Group Expense Ratio

	31 December 2013		31 December 2012	
	UK Car £m	Group £m	UK Car £m	Group £m
Net insurance expenses	51.2	86.7	49.8	77.4
Add: net claims handling expenses	9.5	9.5	10.8	10.8
Adjusted net expenses	60.7	96.2	60.6	88.2
Net insurance premium revenue	403.9	483.0	445.9	498.9
Reported expense ratio	15.0%	19.9%	13.6%	17.7%

**PARENT COMPANY FINANCIAL STATEMENTS**

## Parent Company Balance Sheet

	Note	As at	
		31 December 2013 £m	31 December 2012 £m
<b>Fixed assets – investments</b>			
Shares in Group undertakings	5	212.6	192.3
Other investments	6	29.5	74.6
<b>Current assets</b>			
Amounts owed from subsidiary undertakings		8.0	3.1
Trade and other receivables		0.1	—
Cash at bank and in hand		3.3	10.4
		11.4	13.5
<b>Creditors – falling due within one year</b>			
Other creditors	7	(63.4)	(63.5)
		(63.4)	(63.5)
Net current liabilities		(52.0)	(50.0)
Total assets less current liabilities		190.1	216.9
<b>Net assets</b>			
		190.1	216.9
<b>Capital and reserves</b>			
Called up share capital	8	0.3	0.3
Share premium account	9	13.1	13.1
Capital redemption reserve		—	—
Profit and loss account		176.7	203.5
		190.1	216.9

These financial statements were approved by the Board of Directors on 4 March 2014 and were signed on its behalf by:



**Kevin Chidwick**  
 Director  
 Admiral Group plc  
 Company Number: 03849958

## NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

For the year ended 31 December 2013

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements:

### 1. Basis of Preparation

The accounts have been prepared on a going concern basis. In considering the appropriateness of this assumption, the Board have reviewed the Company's projections for the next 12 months and beyond, including cash flow forecasts and regulatory capital surpluses. The Company has no debt.

As a result of this review the Directors have satisfied themselves that it is appropriate to prepare these financial statements on a going concern basis.

The adoption of new accounting standards during the year has not had a material impact on either the current year or comparative figures.

The Admiral Group plc Company financial statements have been prepared in accordance with applicable accounting standards, under the historical cost convention and in accordance with the provisions of Section 396 to the Companies Act 2006.

As permitted by Section 408 of the Companies Act 2006, the profit and loss account of the parent company is not presented. Under FRS 1 (Cash Flow Statements) the Company is exempt from having to present a cash flow statement on the grounds that its cash flows are included in the Group's published Consolidated financial statements.

The parent company audit fee is not disclosed in these accounts as it is disclosed in the Consolidated financial statements for Admiral Group plc, which precede them at note 8c.

Refer to note 11 of the Consolidated financial statements for disclosure of related party transactions.

### 2. Investments

Shares in Group undertakings are valued at cost less any provision for impairment in value.

### 3. Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax assets are recognised to the extent that they are regarded as recoverable. They are regarded as recoverable to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be sufficient taxable profits from which the future reversal of the underlying timing differences can be deducted.

### 5. Shares in Group Undertakings

	£m
Investments in subsidiary undertakings:	
At 1 January 2012	142.5
Additions	49.8
At 31 December 2012	192.3
Additions	20.3
<b>At 31 December 2013</b>	<b>212.6</b>

A full list of the Company's subsidiaries is disclosed in note 11 of the Consolidated financial statements.

### 6. Other Investments

	£m
Other investments:	
At 1 January 2012	35.0
Additions	39.6
At 31 December 2012	74.6
Disposals	(45.1)
<b>At 31 December 2013</b>	<b>29.5</b>

Other investments are money market liquidity funds. Refer to note 6 of the Group financial statements details of the Group's investments, including money market liquidity funds.

### 7. Other Creditors – Due Within One Year

	31 December 2013 £m	31 December 2012 £m
Trade payables and other liabilities	0.4	0.4
Corporation tax payable	63.0	63.1
	<b>63.4</b>	<b>63.5</b>

## 8. Reconciliation of Movements in Shareholders' Funds

Company figures	Share capital £m	Share premium account £m	Retained profit and loss £m	Total equity £m
<b>At 1 January 2012</b>	0.3	13.1	155.0	168.4
Retained profit for the period	—	—	244.1	244.1
Dividends	—	—	(219.3)	(219.3)
Issues of share capital	—	—	—	—
Share scheme charges	—	—	23.7	23.7
<b>As at 31 December 2012</b>	0.3	13.1	203.5	216.9
Retained profit for the period	—	—	203.3	203.3
Dividends	—	—	(255.8)	(255.8)
Issues of share capital	—	—	—	—
Share scheme charges	—	—	25.7	25.7
<b>As at 31 December 2013</b>	0.3	13.1	176.7	190.1

## 9. Share Capital

Full details of the Company's share capital is included in note 11 of the Consolidated financial statements.

## CONSOLIDATED FINANCIAL SUMMARY

### Basis of Preparation

The figures below are as stated in the Group financial statements preceding this financial summary and issued previously. Only selected lines from the income statement and balance sheet have been included.

### Income Statement

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
<b>Total premiums</b>	<b>1,737.6</b>	1,897.2	1,841.3	1,308.6	847.7
Net insurance premium revenue	483.0	498.9	445.8	288.1	211.9
Other revenue	327.8	361.1	349.0	276.2	232.6
Profit commission	99.3	108.4	61.8	67.0	54.2
Investment and interest income	14.3	15.9	13.7	9.5	8.8
<b>Net revenue</b>	<b>924.4</b>	984.3	870.3	640.8	507.5
Net insurance claims	(303.0)	(404.5)	(363.8)	(208.5)	(151.7)
Net expenses	(251.2)	(235.2)	(207.4)	(166.8)	(140.0)
<b>Operating profit</b>	<b>370.2</b>	344.6	299.1	265.5	215.8

### Balance Sheet

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
Property and equipment	12.4	16.5	17.6	13.6	12.1
Intangible assets	92.8	92.5	87.5	82.9	77.0
Deferred income tax	17.0	15.2	10.3	12.4	—
Reinsurance assets	821.2	803.0	639.8	357.0	212.9
Trade and other receivables	77.5	55.3	52.1	47.9	32.7
Financial assets	2,265.0	2,005.1	1,583.0	1,004.7	630.9
Cash and cash equivalents	187.9	216.6	224.6	246.7	211.8
Assets held for sale	—	—	—	1.5	—
<b>Total assets</b>	<b>3,473.8</b>	3,204.2	2,614.9	1,766.7	1,177.4
Equity	524.1	460.7	394.4	350.7	300.8
Insurance contracts	1,901.3	1,696.9	1,333.7	806.6	532.9
Deferred income tax	—	—	—	—	5.7
Trade and other payables	1,013.7	1,006.5	856.6	561.0	306.8
Current tax liabilities	34.7	40.1	30.2	48.4	31.2
<b>Total liabilities</b>	<b>3,473.8</b>	3,204.2	2,614.9	1,766.7	1,177.4

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