Direct Line Insurance Group plc
Trading Update for the first nine months of 2016

8 November 2016

Direct Line Group's Trading Update relates to the nine months ended 30 September 2016, and contains information to the date of publication. Income statement comparisons are to the first nine months of 2015, in-force policy numbers are to 30 September 2015 and balance sheet comparisons are to 31 December 2015, unless otherwise stated.

Highlights

- Motor and Home own brands in-force policies up 4.3%, with strong customer retention. Continued growth in Green Flag direct and Direct Line for Business
- Gross written premium for ongoing operations[1] 4.2% higher, with continued growth in Motor own brands, up 9.7%
- Investment income yield of 2.5% in line with full year guidance and no material gains or losses in the quarter
- Total costs[2] of £669.5m up £16.1m from the first nine months of 2015, after absorbing £24m of Flood Re costs in Q2 2016. Q3 total costs 3.3% lower than Q3 2015. In line with previous guidance, full year business as usual costs expected to be no higher than in 2015. However, reported costs may be somewhat higher than in 2015, due to higher non-cash intangible asset impairments than in recent years
- Combined operating ratio[3] for ongoing operations still expected to be towards the lower end of the 93%-95% target range, assuming normal weather

Paul Geddes, CEO of Direct Line Group, commented:

"I'm pleased that we have traded well this quarter with good policy and premium growth, particularly for Direct Line, showing that customers like the value, service and brand propositions we offer them. We have achieved this while maintaining our underwriting discipline and reiterate that we expect to be towards the lower end of our 93%-95% combined operating ratio target range."

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Notes:
1. Ongoing operations include Direct Line Group's ongoing divisions: Motor, Home, Rescue and other personal lines and Commercial. It excludes discontinued operations, the Run-off segment and restructuring and other one-off costs.
2. Total costs comprise operating expenses and claims handling expenses for ongoing operations.
3. Combined operating ratio is the sum of the loss, commission and expense ratios. The ratio measures the amount of claims costs, commission and expenses compared to net earned premium generated.

Business update

Direct Line Group (the "Group") achieved good trading results in the first nine months of 2016 while making progress on delivering its strategy.

Motor and Home own brands in-force policies grew 4.3% since 30 September 2015 helped by continued investment in both brand and proposition. Total in-force policies for ongoing operations reduced by 2.4% compared to 30 September 2015, primarily due to partner volumes in Home and Rescue and other personal lines. Compared to the second quarter 2016, total in-force policies were stable.

The Group's gross written premium increased by 4.2% compared to the first nine months of 2015 mainly due to a 10.1% increase in Motor, driven by strength in own brands and partially offset by a reduction in Home partnerships of 6.0%.

Motor continued to trade broadly in line with the first half of 2016. In-force policies grew 4.0% since 30 September 2015 and Motor risk adjusted prices increased 10.0%. Claims inflation remained at or slightly above the Group's long-term expectations of 3%-5%. In these market conditions the Group continued to invest in own brand propositions and in attracting new Direct Line customers.

In Home, own brand risk adjusted prices were up 0.6% compared to the third quarter of 2015. Retention and new business sales remained strong. The Group continued to invest in brand differentiation such as the introduction this year of the three hour emergency plumber service for Direct Line Home Plus customers. This new service aims to improve the claims experience for customers, building on the brand's point of difference in the market.

Within Commercial, Direct Line for Business ("DL4B") continued to grow with in-force policies up 6.7% since 30 September 2015, more than sustaining the policy level achieved in the first half, which benefitted from a rise in sales of landlord policies ahead of changes in stamp duty.

In the first nine months of 2016, the Group's investment portfolio performed in line with expectations. The investment income yield for continuing operations was 2.5%, in line with the expectation previously referred to for the full year 2016. In the third quarter of 2016, there was no material movement in the valuation of the Group's investment property portfolio, nor any material realised gains or losses.

With the level of change the Group has been making to its IT infrastructure, it expects the annual assessment of the carrying value of intangible assets on the IFRS balance sheet may result in impairments that could be higher than in recent years. In terms of capital, the Solvency II balance sheet does not recognise intangible assets and any such impairments will have no material impact on the Group's capital position, nor on the Group's dividend paying ability.

Outlook

The combined operating ratio for ongoing operations is expected to be towards the lower end of the target range of 93% to 95%, assuming normal weather. In line with previous guidance, full year business as usual costs are expected to be no higher than in 2015. However, reported costs may be somewhat higher than in 2015, due to higher non-cash intangible asset impairments than in recent years.

The Group continues to expect its investment income yield to be 2.5% in 2016 and 2.4% in 2017.

Financial update

In-force policies (thousands)

As at	30 Sep 2016 ('000)	30 Jun 2016 ('000)	31 Mar 2016 ('000)	31 Dec 2015 ('000)	30 Sep 2015 ('000)
Own brands	3,607	3,541	3,487	3,459	3,441
Partnerships	233	238	244	248	252
Motor total	3,840	3,779	3,731	3,707	3,693
Own brands	1,751	1,743	1,729	1,719	1,696
Partnerships	1,638	1,660	1,677	1,699	1,725
Home total	3,389	3,403	3,406	3,418	3,421
Of which Nationwide and Sainsbury's	723	724	724	719	721
Rescue	3,621	3,670	3,805	3,932	3,997
Other personal lines	4,219	4,224	4,275	4,356	4,361
Rescue and other personal lines	7,840	7,894	8,080	8,288	8,358
Direct Line for Business	428	424	419	407	401
NIG and other	239	236	234	248	247
Commercial	667	660	653	655	648
Total	15,736	15,736	15,870	16,068	16,120

Total in-force policies have reduced by 2.4% since 30 September 2015. This was primarily due to a decline in partner volumes in the Rescue and other personal lines division. In-force policy growth continued across Motor and Home's own brands, Green Flag direct and Commercial direct.

Gross written premium

	Q3 2016 £m	Q3 2015 £m	9 months 2016 £m	9 months 2015 £m
Own brands	401.1	363.4	1,095.4	998.6
Partnerships	30.4	26.5	86.4	74.6
Motor total	431.5	389.9	1,181.8	1,073.2
Own brands	113.0	114.6	304.6	308.5
Partnerships	112.9	121.2	324.5	345.1
Home total	225.9	235.8	629.1	653.6
Of which Nationwide and Sainsbury's	56.4	58.3	161.4	164.9
Rescue	46.3	46.5	128.2	127.1
Other personal lines	61.7	59.4	177.5	173.6
Rescue and other personal lines	108.0	105.9	305.7	300.7
Direct Line for Business	29.5	28.1	82.5	77.1
NIG and other	88.0	84.8	296.9	291.9
Commercial	117.5	112.9	379.4	369.0
Total	882.9	844.5	2,496.0	2,396.5

Gross written premium of £2,496.0m increased by 4.2% compared with the first nine months of 2015 and by 4.5% compared with the third quarter of 2015, mainly driven by Motor, which was partially offset by a reduction in Home partnerships.

Motor

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

Change versus same quarter in previous year	Q3 2016	Q2 2016	Q1 2016
Change in price	10.0%	9.5%	9.4%
Change in risk mix and business mix[1]	(3.2%)	(3.3%)	(1.5%)

Total Motor in-force policies increased by 4.0% since 30 September 2015, in a market in which the demand for new cars has grown. Motor own brands grew by 4.8% and customer retention remained strong. The Direct Line brand continued to perform well. Following investment in brand propositions and competitive pricing, new business volumes have risen during 2016. Motor's risk-adjusted prices increased by 10.0% compared with the third quarter of 2015, while claims inflation remained at or slightly above the Group's long-term expectation of 3%-5%. Motor gross written premium increased by 10.1% compared with the first nine months of 2015, as the Direct Line brand continued to perform well.

Home

Effect on premium income of changes in price and risk and business mix[1] – own brands

Change versus same quarter in previous year	Q3 2016	Q2 2016	Q1 2016
Change in price	0.6%	(0.3%)	(2.3%)
Change in risk mix and business mix[1]	(4.2%)	(5.1%)	(2.2%)

In-force policies for Home's own brands increased by 3.2% since 30 September 2015, as own brand propositions continued to perform well in the market, which helped to offset a 5.0% reduction in partnerships. Retention continued at strong levels, and the division continued to focus on improving customer experience.

Home market pricing showed signs of stability for the second successive quarter, following a period of significant deflation. Home's own brands risk-adjusted prices were broadly stable compared with the third quarter of 2015. Risk and business mix decreased by 4.2% primarily due to model changes increasing the Group's competitiveness within lower average premium business. The division has grown new business, particularly online both in direct and via price comparison website channels, following investment in propositions and price comparison website customer journey improvements. Gross written premium was 3.7% lower compared with the first nine months of 2015, primarily due to partnerships which declined by 6.0%, while own brands reduced by 1.3%.

The Group's partnership with Nationwide Building Society will terminate for new business at the end of June 2017. The Group expects to finish earning these premiums by mid-2018.

The weather in the first nine months of 2016 was benign compared with the long-term average, although higher than the comparative period, with £18.0m of claims costs from major weather events[2] (first nine months 2015: £nil).

Rescue and other personal lines

Rescue and other personal lines experienced a reduction in in-force policies of 6.2% since 30 September 2015 primarily related to lower packaged bank account volumes. Gross written premium for Rescue and other personal lines grew by 1.7% compared to the first nine months of 2015. Rescue gross written premium increased by 0.9%, mainly due to higher Green Flag direct sales. Growth in Travel, partially offset by a reduction in Pet, led to an overall increase in gross written premium in other personal lines of 2.2%.

Commercial

Commercial in-force policies increased by 2.9% since 30 September 2015 driven by Commercial direct, which was partially offset by lower broker policy volumes, as the division balanced volume and profit in a competitive market. The increase in gross written premium of 2.8% compared with the first nine months of 2015 reflected growth in Commercial direct, in particular Landlord and Van products. Gross written premium for NIG and other increased by 1.7% in part reflecting premium rate increases.

Notes:

1. Risk and business mix measures the premium impact of channel, tenure and underlying mix. It reflects the risk models used in the period, the ouputs of which are revised when models are updated.
2. Home claims for major weather events, including inland and coastal flooding and storms.

Total costs – ongoing operations

	Q3 2016 £m	Q3 2015 £m	9 months 2016 £m	9 months 2015 £m
Operating expenses – total ongoing	171.8	165.4	546.4	505.1
Claims handling expenses	36.1	49.7	123.1	148.3
Total costs	207.9	215.1	669.5	653.4

Total costs for ongoing operations increased by £16.1m to £669.5m, as the Group partially offset the Flood Re levy of £24.0m. Claims handling expenses have reduced year on year partly as a result of a movement between claims handling expenses and operating expenses. Q3 total costs were down £7.2m or 3.3% compared with Q3 2015.

Investment return – ongoing operations

	Q3 2016 £m	Q3 2015 £m	9 months 2016 £m	9 months 2015 £m
Investment income	41.2	41.5	123.9	124.6
Net realised and unrealised gains	0.6	1.1	8.9	27.8
Total investment return	41.8	42.6	132.8	152.4

During the first nine months of 2016, the Group generated stable investment income of £123.9m and recognised net realised and unrealised gains of £8.9m (first nine months 2015: gains £27.8m), generating gains of £0.6m in the third quarter of 2016.

Total available-for-sale reserves, net of tax, increased by £48.0m to £109.6m during the quarter, with the increase reflecting a further reduction in market yields. The annualised investment income yield for the Group for the first nine months of 2016 was 2.5%, which remains in line with guidance provided for the full year 2016.

Investment holdings

As at	30 Sep 2016 £m	30 Jun 2016 £m	31 Dec 2015 £m
Corporate[1]	3,630.2	3,583.7	3,815.0
Supranational	100.1	99.5	140.1
Local government[1]	21.5	21.6	104.9
Investment-grade credit	3,751.8	3,704.8	4,060.0
Investment-grade private placements	70.0	60.0	13.5
High yield[1]	403.1	358.9	327.4
Credit	4,224.9	4,123.7	4,400.9
Securitised credit[1]	–	317.5	350.8
Sovereign[1]	343.6	456.6	442.7
Total debt securities	4,568.5	4,897.8	5,194.4
Infrastructure debt	336.2	342.7	329.6
Cash and cash equivalents[2]	1,309.0	989.7	947.3
Commercial real estate loans	56.6	17.7	–
Investment property	350.0	348.6	347.4
Total Group	6,620.3	6,596.5	6,818.7

At 30 September 2016, total investment holdings of £6,620.3m were 2.9% lower than at the start of the year reflecting operating cash flows and dividends paid. Total debt securities were £4,568.5m, of which 6.3% were rated as 'AAA' and a further 62.7% were rated as 'AA or 'A'. Corporate, supranational and local government debt securities accounted for 56.7% of the total portfolio. The average duration of total debt securities at 30 September 2016 was 2.5 years (30 June 2016: 2.4 years; 31 December 2015: 2.3 years).

During the third quarter of 2016, the Group sold its holdings of securitised credit (5% benchmark weighting) in part reflecting capital treatment under Solvency II and current returns.

The Group holds investment property to provide long-term cash flows to broadly match the cash flows of certain liabilities. The investment property portfolio is a segregated mandate focused on the prime sector of the market and is not a retail property fund. The portfolio is diversified by region, lease duration and type. There was no material movement in the values or holdings of the Group's investment property in the quarter.

Notes:

1. Asset allocation at 30 September 2016 includes investment portfolio derivatives, which have been netted and have a mark-to-market liability value of £211.8m, split £208.2m in corporate and £0.3m local government and £3.3m sovereign (30 June 2016: mark-to-market liability value of £257.5m, split £244.7m in corporate and £12.8m in securitised credit, and 31 December 2015: mark-to-market liability value of £45.7m, split £40.0m in corporate debt securities and £0.4m in local government and £5.3m in securitised credit). This excludes non-investment derivatives that have been used to hedge subordinated debt, operational cash flows and the disposal of the International division in 2015. The liability has significantly increased compared with 31 December 2015 due to the recent decline in the value of Sterling against the US Dollar. The increase in derivative liability closely matches the upward movement in the Sterling value of the Group's US Dollar denominated securities.
2. Net of bank overdrafts and include term deposits with financial institutions with maturities exceeding three months.

Corporate information

Direct Line Insurance Group plc is a public limited company registered in England & Wales, number 02280426. The address of the registered office is Churchill Court, Westmoreland Road, Bromley BR1 1DP.

The Annual Report & Accounts 2015 is available at: www.directlinegroup.com

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