

Investing in our future



Paul Geddes, Chief Executive Officer

“Our strategic progress and successful delivery of our targets is a direct result of the hard work demonstrated throughout the business. This has enabled us to deliver benefits to our customers and returns to our shareholders.”

Overview of financial performance

I am pleased that in 2013 we continued to make good progress with our strategic priorities and financial targets, while maintaining our disciplined approach to underwriting in a highly competitive and deflationary marketplace in the UK. We delivered an operating profit from ongoing operations of £526.5 million, an increase of 14.2% compared to 2012 (£461.2 million); and total Group profit before tax of £423.9 million (2012: £249.1 million).

With a COR of 96.1% we achieved our COR target of 98% for 2013. This contributed to a RoTE of 16.0%, ahead of our long-term target of 15.0%. While our results were helped by higher reserve releases than expected, the momentum of our transformation and ‘self-help’ agenda continued to create benefits and opportunities. We took positive steps towards reducing costs across the business and improving our operating efficiency. Within other areas of our strategy, such as pricing and claims, we continued to deliver sustainable benefits for our customers and shareholders.

Delivering value for our customers

Our focus on improving our pricing capability and claims infrastructure has particularly helped us to reduce prices for UK motor customers. In addition, we have been exploring new ways in which we can innovate to achieve better outcomes for customers. Direct Line's heritage is rooted in the revolution it unleashed by using the telephone to bypass the traditional high street insurance broker model and provide customers with more competitive products. That innovation gave way to the advent of PCWs, which emerged in response to the growing purchase of insurance via the internet.

We are on the cusp of a new era, when growing customer use of new technologies prompts them to seek a different experience from their insurer, and where nimble providers can harness technology to offer both competitive products and more personalised solutions. The strength of our data and brands, together with the operational and financial transformation of our platform, leaves us well placed to help draw the road map for this new age. For instance, we are piloting real-time online progress updates on car repairs, and we are offering telematics technology to give customers instant feedback on the quality of their driving, which can ultimately, if they drive well, improve road safety and save them money.

We have also been working hard to reduce customer complaints across the Group and for the second half of 2013 our complaint volumes decreased by 19% compared to the same period in 2012. This is a key area of focus for us. To ensure we are tracking how well we are responding to our customers' needs, we have introduced a new key performance indicator to measure the volume of customer complaints across the Group.

We recognise that, while we have made improvements in how we interact with our customers, we have not met all of our aspirations to develop and differentiate our customer propositions and brands. We have much to do to meet the evolving needs of our customers, but we are rising to the challenge with determination and energy.

Delivering for our people

Our people continue to be the main driver behind delivering better outcomes for our customers. Although we have had to remove 3,200 roles since the start of our cost savings initiatives, to ensure our organisation can operate in the most cost-efficient manner, our consistent aim has been to treat colleagues with the utmost fairness and respect throughout redeployment or redundancy processes. As we continue to drive an agenda of operational and cultural change through the organisation, we remain committed to investing in our people, which in turn will help us to deliver the products and services that our customers value.

Developing stand-alone systems

Ever since beginning our separation from RBS Group, we have made significant investments to design and started to build a stand-alone IT infrastructure capable of supporting a multi-brand, multi-product and multi-distribution channel business with 18 million in-force policies. Notwithstanding the complex operational risk associated with this task, we aim for the migration to have made substantial progress by the end of 2014. Alongside the construction of a stand-alone IT platform, we are continuing to develop our technological capabilities by investing in other systems designed to improve customer operations and business processes. The opening of our own, state-of-the-art data centres was a significant step forward in advancing our technology initiatives in 2013.

Regulatory environment

We have continued to operate within a highly dynamic and evolving regulatory landscape, particularly in the UK motor insurance market where over the past two years a number of reviews and initiatives have been announced by the UK Government, the Ministry of Justice ("MoJ"), the Financial Conduct Authority ("FCA"), and the Competition Commission ("CC").

The Group continues to engage proactively in new or emerging regulatory priorities. Good conduct is integral to the success of our business, which is why we decided to switch the sale of our motor legal protection product to opt in prior to the publication of regulatory guidance, and why we chose to lay the foundations for DLG Legal Services as an alternative business structure, which should help shield our existing customers from potentially excessive third-party solicitor fees.

In December, the CC published the provisional findings of its ongoing investigation into the UK private motor insurance market. We continue to work with the CC, and have always said we welcome the investigation, if it results in a level playing field and the removal of market dysfunction, to the benefit of our customers and consumers more broadly.

Strategic priorities for 2014

During 2014 we aim to progress further towards delivering the remainder of the strategic financial targets we have set ourselves. In particular, we aim to deliver our target of a total cost base¹ of approximately £1 billion, as well as our Commercial business achieving a COR² of less than 100%.

We will also continue to enhance our products and update our infrastructure to ensure we sharpen our customer experience, delivering what the customer has grown to expect, and doing so sustainably for all of our stakeholders, be they our customers, our people or our shareholders.

Outlook

The UK motor and home markets remain highly competitive. In this trading environment, we will continue to prioritise targeting appropriate margins, even if this is at the expense of premium or policy volumes. We continue to progress initiatives supporting our strategic priorities in order to seek to improve our competitive position and performance in the longer term.

For 2014, we aim to achieve a COR in the range of 95% to 97% for ongoing operations, assuming a normal level of claims from weather events. Assuming underlying claims trends continue, a significant contribution from prior-year reserve releases is currently expected, albeit at a lower level than in 2013.

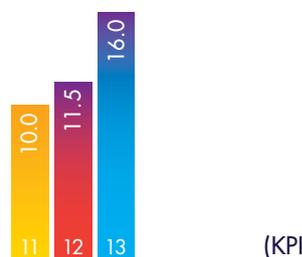
I would like to thank our people for the continuous hard work and dedication that they have demonstrated throughout the year. This has enabled us to continue to deliver benefits to our customers, shareholders, and wider stakeholders.



Paul Geddes, Chief Executive Officer

Return on tangible equity³ (%)

16.0%

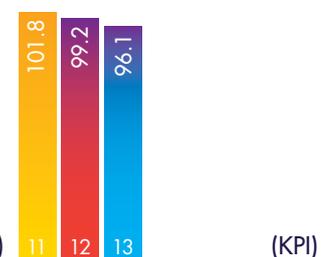


● 13.4% pro forma in 2012⁴

Combined operating ratio⁵ (%)

3.1ppts improvement

96.1%



Notes:

1. See note 2 on page 2
2. This assumes a normal level of claims from weather-related events and large losses.
3. See note 3 on page 2
4. See note 4 on page 2
5. See note 1 on page 2