Group highlights

Our performance reflects our focus on satisfying customers with the aim of delivering sustainable, profitable growth

Profit before tax

£582.6m
(2017: £539.0m)

Return on tangible equity[1]

21.5%
(2017: 23.0%)[2]

Combined operating ratio[1,3]

91.7%
(2017: 90.8%)[2]

Solvency capital ratio[1,4]

170%
(2017: 165%)

Operating profit[1]

£601.7m
(2017: £642.8m)[2]

Dividend per share[5]

29.3p
(2017: 35.4p)

Notes:
1. See glossary on pages 191 to 192 for definitions and Appendix A – Alternative performance measures on pages 193 and 194 for reconciliation to financial statement line items.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off profits within the Motor segment. The adjusted profit after tax reported in 2017 was £462.9 million and the return on tangible equity was 21.7%.
3. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration. See glossary on page 191 for definitions.
4. Estimates based on the Group's solvency II partial internal model. The 2017 comparative has been updated to reflect the amounts in the Group Solvency and Financial Condition Report for the year ended 31 December 2017.
5. See page 32 for the dividend policy.

One Group

We give people the protection they need to do the things they love in life.

Whether that be driving their car, enjoying their home and possessions, exploring the world, caring for their pets or building their businesses.

Our strength lies in the diversity of our propositions, offering a range of products, powerful brands and multiple routes to market, underpinned by a determination always to aim higher for our customers, people, shareholders and wider stakeholders.

Eight brands

Direct Line stands for speed, simplicity and a common-sense human touch. We sell products direct to customers by phone and online.

Direct Line customers want a premium product with exceptional customer care that is tailored to their needs at a competitive price.

Churchill is one of Britain's most recognisable brands, providing car, home, business, pet and travel insurance. Our products are available by phone and online, including price comparison websites.

Churchill customers are looking for a dependable partner which is reliable, trustworthy, and will spend time making sure they are happy.

Direct Line for Business understands that our customers' businesses are their livelihoods, so the right type of cover is vital. Our policies cover a range of trades, from start-ups, to growing businesses, from renting out a property to working as a single tradesman. We sell products direct via phone and online.

Green Flag is our roadside rescue and recovery service. It is a standalone and optional product offered alongside motor insurance across all of our brands.

Green Flag customers receive an award-winning breakdown service at a much cheaper price than its two biggest rivals.

Privilege targets customers who mainly buy through price comparison websites.

Privilege customers want a quick and efficient service at the best price.

NIG is our commercial insurance brand dedicated to the broker market and is focused on a number of specialisms including small and medium-sized enterprises, agriculture and real estate.

DLG Partnerships is the Group's partnerships arm. It specialises in providing personal insurance, and roadside rescue and recovery products to some well-known brands.

DLG Auto Services is the Group's UK network of bodyshops, repairing around 90,000 accident damaged vehicles every year, and supports our seven day repair proposition for Direct Line customers.

Find more details on our website

Four segments

Motor

We are Britain's leading personal motor insurer measured by in-force policies[1], mainly represented through our well-known brands Direct Line, Churchill and Privilege, and also through our partners.

Gross written premium

£1,671.2m

Operating profit

£415.2m

Home

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

Gross written premium

£606.9m

Operating profit

£83.1m

Rescue and other personal lines

We are one of the leading providers of rescue and other personal lines insurance in the UK[2,3], with 7.5 million in-force policies. This includes providing roadside assistance and recovery for customers through Green Flag, the UK's third largest roadside recovery provider[2]. We offer customers protection for their holidays and pets and are the third largest travel and the third largest pet insurer[3]. We also offer insurance packages tailored for mid-to high-net worth customers.

Gross written premium

£422.8m

Operating profit

£43.4m

Commercial

We protect commercial businesses through our brands, NIG, Direct Line for Business and Churchill. NIG sells its products exclusively through brokers operating across the UK.

Gross written premium

£511.0m

Operating profit

£60.0m

Find more details on pages 38 – 43

Notes:
1. Includes Direct Line, Churchill, Privilege and partner brands: RBS, NatWest, Prudential and Sainsbury's © GfK Financial Research Survey six months ending January 2018, 14,063 adults interviewed for motor insurance and 12,214 for home insurance.
2. Mintel Vehicle Recovery – UK, September 2018.
3. Mintel Pet Insurance – UK, August 2018 and Mintel Travel Insurance – UK, February 2019.

Three routes to market

Every customer is unique and we want our products to reach customers wherever they shop. But we don't stop there. We also want to give them choices about their insurance and we offer our products through the three main routes to market:

Direct

We give our customers a reason to come direct with our strong brands and great propositions, because we want to deliver excellent value for our customers and shareholders.

Price comparison websites

Strong brands and propositions are important but so are great prices. We are investing in the latest generation IT to improve our speed to market and pricing capabilities.

Partnerships

We partner with big brands to offer insurance to their customers and look for ways to be innovative to give people choice about how they insure the things they love.

1 million

Own brand policies added since 2014

710,000

Policies sold through price comparison websites[1]

173,000

Motor partnerships customers drove their new car away with our complimentary insurance[2]

Find more details on page 19

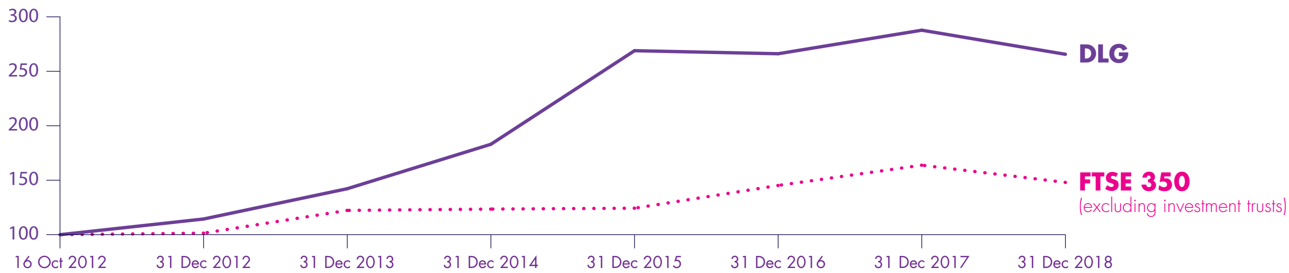
Note:
1. Number of new policies sold through Churchill and Privilege for Motor and Home in 2018.
2. www.directlinegroup.co.uk/en/brands/dlg-partnerships.html

Six years of returns

Creating shareholder value through customer focus

We have a track record of delivering strong returns to shareholders having distributed £2.5 billion in dividends over the past six years. This together with our share price performance has delivered an attractive total shareholder return.

Total shareholder return (%)



Our successful customer focused strategy, built around our 'rocket' (see page 19), also enables us to invest in future capabilities with the aim of sustaining our strong performance.

Medium-term financial targets

Combined operating ratio 93% – 95%	Return on tangible equity of at least 15%	Grow our regular dividend in line with business growth	Maintain solvency capital around the middle of the 140% – 180% solvency II target range

2018 results

91.7%	21.5%	21.0p	170%

Find more details on pages 24 – 25

Delivering sustainable returns

In 2018, the Group delivered profit before tax of £582.6 million (2017: £539.0 million). The Group's diversified product and channel portfolio, disciplined underwriting and our engaged employees have helped us to achieve this commendable result.

Governance highlights

Leadership
Your Board seeks to ensure that decisions are of the highest standard. It challenges strategic proposals, performance delivery and management responsibilities.
See page 66

Effectiveness
The effectiveness of your Board's and its Committees' performance is considered annually in an effectiveness review.
See page 70

Accountability
Your Board provides shareholders with an assessment of the Group's position and prospects. We monitor and review the effectiveness of the Group's risk management and internal control systems.
See page 74

Remuneration
Your Remuneration Committee ensures a close correlation between creating value for shareholders, and remunerating Executive Directors and senior executives appropriately.
See pages 75 and 88

Relations with shareholders and stakeholders
Your Board maintains strong relationships and regular interaction with shareholders. Their continued support for the strategic aims is important. Your Board also has regard to the interests of other stakeholders.
See pages 66 and 75

CEO succession

Following a rigorous search process, the Group was delighted to announce, on 26 February 2019, that Penny James, Chief Financial Officer ("**CFO**") had been selected to succeed Paul Geddes as Chief Executive Officer ("**CEO**") with effect from the conclusion of the Annual General Meeting ("**AGM**") on 9 May 2019. Paul will step down as a member of the Board and will leave the Group at the end of July 2019.

Penny joined the Board on 1 November 2017 and succeeded John Reizenstein as CFO on 1 March 2018. Penny's deep understanding of our sector, combined with outstanding leadership skills, financial and risk expertise and deep strategic thinking, gives the Board confidence that Penny is ideally suited to leading the delivery of the Group's short-term strategic imperatives, including technological and business transformation, and the development of the next stage of our strategy.

This year marks the 10th anniversary of Paul's appointment as CEO. In that time Paul has made a huge contribution to the Group and the Company is deeply indebted to him for his strong leadership. During his tenure, Paul has been leading the management team which successfully separated the business from the Royal Bank of Scotland Group, floated it on the London Stock Exchange and turned it into a successful FTSE 100 company. The Board thanks Paul for his enormous contribution and wishes him well for the future.

Strategy

The Group aims to make insurance much easier and better value for our customers. The Board supports and challenges the Group's management to develop and execute a strategy which is aligned to this aim. Our strategy looks to position us as a multi-brand, multi-product and multi-channel business, to enable us to meet our customers' needs now and in the future, regardless of their channel preference.

Supporting this strategy is a substantial and ongoing change and investment agenda. We look to continue to invest in our direct offering, as we believe it enables us to deliver the best value for our customers and our shareholders, through our differentiated brands and propositions and simple customer journeys. Our investments in technology and digitisation are intended to improve competitiveness, agility and efficiency. This also supports our ambition to grow our profitable share of the price comparison websites market, particularly by moving us towards best-in-class pricing. By leveraging our manufacturing strengths and investments in digital capabilities, we are continuing to support our aim of winning new partnerships.

Dividends and capital management

The Group's solvency capital ratio prior to all proposed dividends was 194%, resulting from good capital generation from the business and lower capital requirements due in part to increasing the level of reinsurance purchased by the Group in recent years. This was partially offset by higher unrealised mark to market losses due to credit spread widening and continued capital expenditure as the Group invests with the aim of improving its capabilities and efficiency.

The Group aims to grow the dividend in line with business growth. Accordingly, the Board has recommended a final dividend of 14.0 pence per share (2017: 13.6 pence), an increase of 0.4 pence per share. If approved, the total regular dividend of 21.0 pence per share will represent 2.9% growth on 2017's regular dividend (20.4 pence per share). This reflects the Board's continued confidence in the Group's earnings and the progress the business continued to make.

The Board also resolved to pay a special interim dividend of 8.3 pence per share. After both dividends, the solvency capital ratio will be 170% as at 31 December 2018[1].

The Board has taken into account the high level of political and economic uncertainty, including in relation to the UK's exit from the EU ("**Brexit**") and considers it appropriate for the time being to maintain a prudent solvency capital ratio towards the upper end of the solvency capital ratio risk appetite range of 140% to 180%. The Board will keep this position under review as it monitors developments in the political and economic environment. In normal circumstances, the Board expects the Group to operate around the middle of its solvency capital ratio risk appetite range.

Brexit

Brexit, when the UK is due to leave the EU, is scheduled to take place on 29 March 2019. Although the Group is predominantly a UK business, it does, for example, have exposure to financial markets and it imports goods and services in order to fulfil insurance claims, including from the EU. The Group has been monitoring events carefully and proactively taken steps to mitigate the likely impact on the Group to the extent we consider it to be appropriate and proportionate to do so, given the considerable uncertainties; however, in the event of a disruptive Brexit the Group will not be immune. We have more information on this in the Risk section, on page 48.

ESG practices

The Board subscribes to the principle that a business model that is sustainable in the long term will be better able to drive value for its shareholders and other stakeholders, contributing to the development of a sustainable economy. The Group has strong values and is customer focused to ensure it is continuing to meet customer needs. The Board is proud of the high level engagement of its people, whose wellbeing is one of the pillars in our approach to ESG, reflected in our support for Mind and the Scottish Association for Mental Health as well as numerous wellbeing initiatives across the Group. Our investment portfolio has started to be weighted towards 'green bonds' and investments which attract higher ESG ratings. Each of our UK offices seeks to act constructively with the local community and we encourage our people to allocate at least a day each year out of their working lives to support charitable or community initiatives. Our people donated nearly 4,800 hours of company time to volunteer within their communities during 2018.

Note:
1. Further information can be found on page 32.

Linking remuneration to performance

We remain committed to ensuring that executive pay is aligned with the Company's strategy of targeting sustainable shareholder and customer value. This is primarily achieved by the Annual Incentive Plan ("**AIP**") and Long Term Incentive Plan ("**LTIP**") being aligned to performance measures shareholders consider important. This is underpinned by the delivery of a significant proportion of remuneration through shares and shareholding requirements.

The Group achieved a return on tangible equity ("**RoTE**") of 21.5% for 2018. A decrease of 16.5% (2017: an increase of 3.3%) in the share price over the year to 318.7 pence (2017: 381.7 pence) at 31 December 2018, together with dividend payments, provided a total shareholder return ("**TSR**") of minus 7.7% for the year (2017: 8.1%). This compares favourably to the FTSE 350 which had an overall return of minus 9.5% at 31 December 2018 as financial markets reacted to global trade tensions and Brexit. Over the past five years, shareholders have received a TSR of 87% compared to the FTSE 350 (excluding investment trusts) of 22%. The Group has continued to deliver good results each year, which has enabled the Board to declare cumulative dividends, including special dividends, equivalent to approximately 106% of the Initial Public Offering ("**IPO**") share price. More information on the Group's remuneration policy and share awards are disclosed in the Directors' remuneration report on pages 88 – 117.

IT infrastructure

The Board continues to provide oversight of the ambitious programme of activity to upgrade and better integrate the major IT systems within the Group's technology infrastructure, aimed at improving the Group's digital offering, customer experience and operational efficiency. Good progress has been made in this area and 2019 is set to be an important year for the Group in terms of the delivery of the new platform.

Customer, culture and conduct

Meeting the needs of our customers is central to the Group's strategy and sustainability. The Board recognises that opportunities will arise to improve further the services offered to customers, and along with its investment in IT capability to improve the efficiency and effectiveness of the business, it has also encouraged a range of customer experience initiatives which are designed to deliver increased levels of customer satisfaction.

The Group maintains active relationships with its insurance regulators through constructive dialogue. The Board promotes an open and collaborative culture, and provides oversight of the Group's conduct with customers. It oversees the Group's culture and the conduct policy, which aims to ensure that fair customer outcomes are achieved and that employees behave with integrity. The Group also has an Employee Code of Conduct which sets out standards to which our employees are required to adhere.

Board and Committee membership changes

Further to the announcement of the new CEO you will recall from my statement last year that John Reizenstein and Andrew Palmer stepped down from the Board at the conclusion of the AGM in May 2018.

Three Non-Executive Directors ("**NEDs**") joined the Board in 2018: Mark Gregory and Gregor Stewart were appointed on 1 March; and Fiona McBain joined us on 1 September. The Board is already benefiting from their skills and experiences.

Clare Thompson, independent NED, has decided to step down from the Board at the conclusion of the 2019 AGM. Having served as a Director since 2012, Clare has made an immense contribution to the Group. Her experience and wisdom have been invaluable in helping the Board and senior management to deliver excellent results for shareholders and customers. She leaves the Board with our thanks and best wishes for the future.

The Chairs of three Board Committees also changed during 2018. Gregor and Mark were appointed as Chair of the Audit Committee and Investment Committee respectively replacing Andrew Palmer. Danuta Gray also replaced Clare Thompson as Chair of the Remuneration Committee.

I would like to thank each member of the Board for their significant contribution, commitment and service, and look forward to working with them in 2019 as the Group continues to strive to build on its success to date.

Employees

The Group's employees are fundamental to the Group's success and sustainability and to ensuring a high level of service to our customers. I would like to thank each of them for their hard work, initiative and commitment to our mission. Their positive energy, embodiment of the Group's values and unwavering dedication to our customers have helped our businesses progress over the successful years since the IPO, and have put us in a strong position for the future.

M N Biggs

MICHAEL N BIGGS
CHAIRMAN

Focusing on our customer-centric mission

"I am pleased to announce a strong set of results driven by our resilient business model which performed well in a highly competitive market."

I am pleased to report another strong set of results in a highly competitive market driven by the Group's resilient and customer-centric business model. We continued to make significant operational progress in 2018 and we head into a pivotal year of delivery in 2019, with the aim of delivering a springboard from which to grow the contribution from current-year profitability. We maintained good cost discipline in 2018 and are determined to leverage our investment in the business to step change our efficiency. The new technology and greater efficiency are, in turn, designed to support our ambition to innovate more rapidly and find new ways to serve our customers as their demands evolve. Financially, we continued to see the benefits of improving the efficiency of our balance sheet, which has contributed to another attractive dividend, while continuing to invest in the business and maintaining a prudent solvency margin.

Trusted brands and direct growth

Once again, the growth we achieved across Direct Line, Direct Line for Business and Green Flag demonstrated that by giving customers a reason to come to us direct, they will. Since 2014, our own brand in-force policies have grown by over one million, to over seven million policies.

In Direct Line we launched another two new unique propositions – in Home and Motor. Our new Motor proposition removed one of our customers' greatest frustrations and protected their no claim discount on no-fault claims. We now offer a combination of nine Direct Line propositions that our customers cannot get anywhere else in the market.

Direct Line for Business achieved its 11th consecutive year of premium growth. This time last year, we launched a more personalised approach for our business customers, from start-ups to growing businesses. Starting with Hair and Beauty and followed by Bed & Breakfast in 2017, this year we ramped up our delivery by releasing cover for over 500 new trades, taking us to 75% of our target trades on the new platform. A national marketing campaign was launched in the year and the early campaign metrics have been positive. This has driven higher volumes to the website and there has been a 100% increase in brand searches. Work is underway to re-launch two of our biggest products on our new system, Van and Tradesman in 2019. This continues to demonstrate our increased ability to work in an agile way and to launch new, innovative products quickly to meet the ever-changing needs of our customers.

And finally Green Flag, our challenger brand in the Rescue market, continued to display great growth potential and demonstrated this again by achieving another period of double digit percentage growth in policy count and premiums. Our Rescue network dealt with over 640,000 breakdowns in 2018, which is one every 49 seconds. There has been great progress in Rescue in 2018, launching a five-year transformational plan and the team have relocated to a Centre of Excellence, bringing together multi-skilled teams to recognise efficiencies and offer greater flexibility. The Rescue Me app, which is rated 4.8 in the Apple App store, was rebuilt using in-house digital capabilities and was used in over 35,000 claims.

Moving towards best in class in the price comparison website market

We see a real opportunity in strengthening our capabilities on price comparison websites. We increased our focus in 2018 and created a new trading hub in Motor and Home to support this. We made some tactical pricing changes driven by improved anti-fraud capabilities and this helped increase Churchill and Privilege Motor new business volumes by 18%. We believe there is an opportunity to strengthen margins in this channel.

Investing in technology

Whilst we have already made significant progress in delivering our Direct Line for Business systems, most of our transformational work has been going on behind the scenes on our core personal lines technology, as we continued our ambitious programme to build our latest generation IT capabilities.

These systems, which started to go into testing at the end of 2018, are designed to make insurance much easier for our customers by introducing more self-service and customer focused innovations. In addition they are designed also to enable a step change in our ability to use internal and external data more effectively to improve our pricing accuracy and improve our competitiveness. Our new pricing engine is designed to make it much easier and quicker to develop, test and deploy new models. This is intended to allow us to tailor our models better to the price comparison website channel and improve our speed to market. We are also in the process of testing our new digital Travel platform. 2019 is an important year in starting to deliver these systems which we see as a key enabler in transforming our business.

We continue to make good progress on our alternative pricing project which we expect to give us new capability by applying new data science methods and machine learning. We believe this approach will enable us to deepen our competitive footprint with more granular and flexible pricing capabilities. Testing is progressing well and we are aiming to launch in Q2 2019 under a new brand.

Improving our efficiency

In order to be able to give our customers the best value for money, we recognise it is imperative to operate efficiently. Over the past five years, we've made significant strides in reducing our costs, such as through improved marketing efficiency, where we reduced marketing spend by over 30% whilst returning our direct own brands to growth, and reducing our number of sites by nearly a half and annual rental costs by around 40%.

Over the past two years we have been expanding our robotic process automation capability and are now managing concurrently 28 processes and approximately 500,000 automated transactions each quarter. But we don't intend to stop there and have already identified a strong pipeline of processes to add to our existing portfolio and which has the potential to increase our transaction volume capability by a further 500,000 in 2019.

The actions we've taken supported the reduction in the operating expense ratio and we aim to continue to transform our business and improve our efficiency and long-term competitiveness.

Leveraging our scale via partnerships

In Home, we leveraged our capabilities in digital and data to streamline the customer experience. Our improved capabilities in digital are helping us have conversations with potential new partners.

In Travel, we are building a new system that is designed to enable customers to self-serve and interact with us day or night, offering greater support and helping us renew our partnerships with RBS Group and Nationwide.

In Motor, our new partnership with Volkswagen Insurance Service (Great Britain) Limited is going well. We provide both annual insurance cover and complimentary '5 day driveaway' cover for customers buying new and used cars from Volkswagen, Volkswagen Commercial Vehicles, SEAT, Audi and ŠKODA dealers.

Investing in our talented people

The success of the business is due to the commitment and dedication of our people who use their expertise to serve our customers. We rightly celebrate our diversity and are united in our customer focus. This focus is reflected in our unique propositions and the fact that on average we manage one claim every single minute of every single hour, every day of the year. The freezing weather earlier in the year hit many drivers, households and businesses hard, and the way our people helped our customers get their lives back on track during this difficult period demonstrated the value of our insurance cover and gives customers a reason to keep coming back to us. Nearly 10,000 of our people now own shares in our company which gives them a real sense of ownership and investment in our future success. Our engagement scores increased again in 2018 and I'm proud that this year we came third in the Sunday Times list of the 25 Best Big Companies to Work For in 2019[1]. This is a huge achievement and is testament to the value we place in our people.

Business performance

We ended 2018 having delivered a sixth successive year of strong financial performance and a return on tangible equity of 21.5% (2017: 23.0%), well ahead of our target of at least a 15% return on tangible equity.

Our direct own brands gross written premium increased by 1.8% whereas total gross written premium was lower as expected due to the exits from Nationwide and Sainsbury's Home partnerships. We achieved an operating profit of £601.7 million (2017: £642.8 million). The reduction in operating profit was primarily due to lower prior-year reserve releases and investment return. Both years benefited from reserve releases relating to the Ogden discount rate. In respect of 2018, we have now assumed a higher Ogden discount rate of 0%, following Royal Assent of the Civil Liability Act 2018 which contributed £55 million to operating profit (2017: £49 million) of which £51 million related to the prior years.

Weather returned to normal levels in 2018 after a benign 2017 and this offset the non-repeat in 2018 of the £57 million non-cash impairment charge incurred in 2017 in relation to IT projects. Normalised for weather and adjusted for the assumed Ogden discount rate change, the combined operating ratio was approximately 93.5%, towards the lower end of our medium-term target range of 93% to 95%.

Overall, our current-year combined operating ratio was stable, demonstrating the value in the Group's diversified product base and channel portfolio, as well as lower operating expenses.

Regulation

The Group has continued to operate within a highly dynamic and evolving regulatory landscape, where there are a number of reviews and initiatives, including those that have been announced by the UK Government, the FCA and the PRA.

In 2018 both the FCA and PRA have been focused on Brexit preparations and the implementation of the Senior Managers and Certification Regime. The PRA's focus continues to be on the pillars of its financial risk framework, namely reserving, pricing, reinsurance and investments. The FCA has also been focused on pricing practices including the launch of its market study. The Group is supportive of the FCA's market study. At this early stage however, the outcomes are not yet known.

The insurance market is very competitive with high levels of switching and lots of introductory discounts which leads to most people shopping around for the best deal. For those customers who don't shop around it is crucial that insurers have active pricing processes for all their long-term customers. We have had these measures in place for several years and increasing numbers of long-standing customers have seen their renewal premium either frozen or reduced as a result. We worked closely with the Association of British Insurers on their pricing principles and actions on premiums which we hope will embed best practice across the whole industry.

Outlook

The Group targets a combined operating ratio of 93% to 95% for 2019 and over the medium term, normalised for weather. Over time, the Group expects to increase the contribution from current-year underwriting as the contribution from prior-year reserve releases reduces. The latter is predominantly as a result of increasing the level of reinsurance purchased by the Group in recent years which has reduced the risk profile of the Group.

The targeted improvement in current-year underwriting profitability is supported by the significant investment the Group is making in building future capability. This aims to improve the current-year loss ratio by delivering additional pricing sophistication and supporting multiple initiatives to combat fraud. In addition, the Group is targeting to improve efficiency through self-service and digitalisation. These improvements are targeted to emerge over a number of years. In 2019, the Group expects to make further progress in reducing operating costs and is targeting operating expenses below £700 million. We reiterate our ongoing target of achieving at least a 15% return on tangible equity.

As I prepare to hand over the reins to Penny not only do I look back over the last ten years with great pride, I also look to the future with great excitement for our customers, people and shareholders. Over the next 12 months, as we begin the roll-out of our new core personal lines IT applications, we plan to increase our flexibility to deal with changing business requirements, offer more self-service and deliver more straight-through processing. This combined with our leading brands and great people will help Direct Line Group with its mission to make insurance much easier and better value for its customers.

PAUL GEDDES
CHIEF EXECUTIVE OFFICER

1. www.b.co.uk/the-lists/big-companies/

New customer expectations

The pace of technological change and new regulatory requirements demands an agile response, combined with smart investment choices, to deliver what our customers want.

	Development	Impact	Action
Technology	Digital technology	Digital innovation allows insurers to interact with consumers in new, more effective ways.	Our latest generation IT capabilities went into testing at the end of 2018. These are designed to allow us to provide more targeted products with improved customer journeys, by delivering greater pricing agility with increased data flows, more product flexibility and increased self-service, amongst other benefits.
	Data	Insurers are gaining greater data insight as devices become ever-more connected.	We are driving performance through advanced analytics, for instance by creating better understanding of rescue claims in our Green Flag business.
	Artificial Intelligence, Machine Learning and Robotics	New systems enable customers to access quicker self-service at lower cost and pricing to become fairer and more accurate.	We are exploring the use of new approaches across our value chain, including the use of machine learning techniques in pricing and the use of robotics across our business, which is currently delivering 500,000 transactions a quarter.
	Security	Digitalisation and technology bring a risk to information security.	We have invested in a range of cloud-enabling security measures and have been working closely with a range of peer groups to tackle security risks affecting the entire industry.
	In-Car Technology	Sophisticated technology is changing vehicles, including the advent of electric and autonomous cars.	We remain partners in leading in-car technology projects StreetWise and MOVE_UK, helping us to gain insight into the development of autonomous vehicles and the impact on liability and claims.
Market	Claims	Claims inflation has returned to long-term expected trends.	We have once again added to our accident and repair centre network, helping us to manage costs.
	Customers	Customers are increasingly looking for unique insurance products, tailored to their needs.	We have launched a combination of nine new Direct Line propositions unique in the insurance market. Direct Line for Business has extended its proposition to target over 500 small and micro trades.
	Partnerships	Partnerships enable us to leverage unique distribution and/or access data to streamline the customer experience and create competitive advantage in our pricing and underwriting.	We continued to grow the number of home insurance policies through our partnership with RBS Group, and renewed our Travel agreements with Nationwide and RBS Group for another five years. We also signed a five-year deal with Volkswagen Insurance Service (Great Britain) Limited, providing motor insurance using five Volkswagen Group brands.
Regulation	Civil Liability Act	The Act will introduce new measures to reform the soft-tissue whiplash injury compensation system and introduce a new framework for setting the Ogden discount rate.	We are working with the Government to help design the new online portal for whiplash claims that will come into force in 2020.
	Pricing	The Financial Conduct Authority has launched a General Insurance Pricing Practices Market Study.	We have signed up to the Association of British Insurers' guiding principles and action points to help with how renewal premiums are dealt with, building on our review of long-term and potentially vulnerable customers. Increasing numbers of long-standing customers have seen their renewal premium either frozen or reduced.

Find out more about our Strategy on pages 19 – 21

A strategy targeting sustainable growth

Our strategy looks to position us as a multi-brand, multi-product and multi-channel business to enable us to meet our customers' needs now and in the future, regardless of how and where they buy our products. Supporting this strategy is a substantial and ongoing change and investment agenda.

Our strategic pillars

Great retailer

We have compelling brands and multiple customer propositions and deliver a strong customer experience which we constantly evolve to meet the needs of our customers.

Smart and efficient manufacturer

Our scale and data allow us the efficiency and flexibility to deliver better customer and claims service and better risk insights.

Lead and disrupt

By embracing the future, we aim to shape it and launch new products and services which anticipate consumer trends so that we continue our tradition of disruptive change.

Our key enablers

Data and technology

We aim to harness the power of technology and the scale of our data to make things easier for our customers and our people.

Culture and capability

We invest in our people to help them realise their potential because it leads to better customer experience and more sustainable business performance.

Capital and risk management

We maintain an appropriate level of capital and solvency to manage our customers' pool of risks while understanding, monitoring and managing our own existing and emerging risks within carefully defined parameters.

Our multi-channel approach

Direct

The growth in Direct Line and Green Flag demonstrates that if you give customers a reason to come direct then they will, as we strive to deliver excellent value for our customers and our shareholders.

Price comparison websites

Strong brands and propositions are important but so are great prices. We are improving our effectiveness on price comparison websites through our work on pricing and in dealing with fraud, supported by our investment in latest generation IT systems.

Partnerships

We are leveraging our manufacturing strength through our digital capabilities to seek to develop innovative and profitable partnerships.

Read about our progress in 2018 on pages 20 – 21

Strategy in action

As a forward-looking and proactive business, we are constantly evolving our offer to meet our customers' needs and taking advantage of significant advances in technology. In 2018 we continued to improve our competitiveness, agility and efficiency across the business.

Connecting with our customers

Our people are committed to doing their very best for our customers and our business every day. We are particularly proud of how our people step up to the challenge to get our customers' lives back on track during severe weather periods such as the freezing weather we saw in Q1 2018. One of our values is to aim higher and we actively encourage everyone to push themselves and learn new strengths. We know that customers have differing needs when it comes to buying insurance, which is why we use our frontline experience to develop new propositions based on customer feedback.

It is also why we introduced a training programme called CONNECT, which has been accredited by the Institute of Customer Service, for our people in a customer facing role. This training helps to ensure that our customers receive a personalised service which matches their expectations and needs. The programme enables our people to learn about the different approaches customers may take and gives them the skills to respond with empathy, whilst also taking responsibility and accountability. This is important for our customers who are dealing with difficult situations such as illness or bereavement and vulnerable customers who need additional help to ensure that their cover is the right cover for them. Based on the CONNECT training, our people who successfully demonstrate high levels of customer service receive a certificate of accreditation from the Institute of Customer Service. The impact is clear from customer benchmarking studies which measure the willingness of customers to recommend products or services, adding to our ability to maintain strong customer retention rates.

Bristol

Our new Bristol office, The Core, has created a new and dynamic environment for our people to serve our customers. It has given our people a variety of new workspaces to support collaboration and flexible working, all in a fully refurbished building half the size of our previous site.

Environmental considerations were central to the design. LED lighting, new chillers, heating, ventilation and an air conditioning system have made the site more energy efficient. Run costs are now 55% lower than they were in 2016. The Core is the latest example of how we are looking to shape our technology and workspaces for the future, while meeting our environmental objectives. We are proud it has reduced our carbon emissions in our Bristol office by 62%.

Latest generation IT systems

We continue to build our latest generation IT capabilities designed to enable much more customer self-service and straight-through processing and to give our customers easier and quicker service at a lower cost whilst improving the efficiency and flexibility of the business.

Over the next few years we also plan to wind down and then remove our existing mainframe, while growing our use of the cloud. This is planned to give us flexibility in the future to deal with changing business requirements and changes in technology.

Green Flag

We believe our challenger brand has great growth potential and demonstrated this again by achieving another period of double digit growth in policy count and premiums. Our marketing targets the two-thirds of major competitors' customers who renew without much thought and aims to 'wake them up' by dramatising how we match the best things about their service whilst saving half their renewal premium.

We know that service matters a lot in this market – customers won't sacrifice it for price. We've brought in new leadership and brought the business together – not only in reporting lines but also physically to create rescue 'centres of excellence' to deliver this great service. We will be using many of the same agile techniques that have proved successful in delivering fast and affordable change for Direct Line for Business.

640,000

breakdowns responded to in 2018 – that's 1 every 49 seconds

Price comparison websites

This year a working group has focused on establishing a price comparison website hub aiming to drive capability across the Group by assessing customer needs throughout the entire price comparison website sales journey. A dedicated team, using digital resource and data analytics, is seeking to build greater expertise and agility in real time, enabling better insight on pricing and the opportunity for swifter decision-making. This is important for a sales platform that operates on very different market dynamics compared to selling direct. By working across product lines the working group has instilled a price comparison website-focused philosophy to safeguard against functional thinking that can otherwise restrict effectiveness.

Accident repair centres

We continued to expand our network of accident repair centres and now have 20 sites across the UK, giving us more capability to deliver our seven day repair proposition for Direct Line customers. This year alone, we repaired over 85,000 vehicles, building on our excellent record of customer service. By investing in the latest technology we are preparing the business for the future by better understanding how technology will affect the design and manufacture of cars.

Our high operating efficiency has also allowed us to deliver excellent cost control while meeting our environmental targets through lowering emissions and increased recycling of parts.

85,000+

vehicles repaired

Renewal pricing principles

The lack of barriers to shopping around for insurance brings substantial benefits to consumers who benefit from cheaper prices. However, we recognise that whilst shopping around can bring benefits to those who do it, it does create differences between new customer premiums and subsequent renewal premiums.

The Group has taken several steps to tackle this issue in recent years. In 2016 we backed the Association of British Insurers' and the British Insurance Brokers' Association's Code of Good Practice to ensure that our people were trained to identify potential vulnerable consumers. We believe that renewal premiums should not become excessive over time so we put in place checks and balances for our long-standing customers. Increasing numbers of long-standing customers have seen their renewal premium either frozen or reduced as a result. This year we welcomed the Association of British Insurers' principles which are intended to help embed best practice across the industry.

Find out more in our
Market overview on page 18

In-car technology

The automotive industry is undergoing dramatic change with improvements in in-car technology and the advent of electric, connected and autonomous vehicles. We are embracing these changes and the opportunities they may present for us to evolve our products. We are maintaining our industry-leading position through our partnerships with MOVE_UK in Greenwich and our participation in StreetWise, which aims to put driverless cars on the streets of Croydon in 2019. We also continue to work with motor manufacturers such as Volkswagen, Peugeot, Citroën and Tesla, evolving our products to match their customers' needs.

Creating value for our stakeholders

Our multi-brand, multi-product and multi-channel business offers different propositions to maximise choice for customers. We believe this approach enables us to provide good value for customers and sustainable returns for our shareholders.

Our core strengths

Customer focus
Customers are at the heart of everything we do. Our brands, products and distribution channels aim to make insurance much easier and better value for our customers.

Talented people
We invest in our people, encouraging everyone to aim higher. Our talented people constantly strive to improve and innovate to exceed the current and future expectations of our customers.

Brand power
Our well-known and trusted brands offer customers decades of experience, knowledge and service. The scale of being Britain's leading motor insurer and one of its leading home insurers[1] gives us a platform for product development.

Data and technology
Continuing our history of disrupting the insurance market, we are harnessing the power of technology and data to make life easier for both our customers and our people.

Capital and financial strength
Our cash-generative business model underpinned by proven underwriting discipline, claims excellence and cost control helps us to meet our customers' needs whilst targeting sustainable returns for our shareholders.

Note:
1. Measured by in-force policies (see page 7).

Find out more on pages 19 – 21

Our diverse proposition

We reach diverse customers by offering a range of products through many routes to market.

Eight brands

so that our customers can choose the proposition that suits them

Four segments

representing a range of products and services

Multiple channels

so that customers can choose how they wish to engage with us

Direct
Price comparison websites
Partnerships

Reinvest in the business

Find out more on pages 4 – 9

How we generate returns

We target sustainable returns for our shareholders through a combination of investing in future capabilities, improving efficiency and careful risk management.

Pricing

We seek to ensure our prices reflect the risks being underwritten by using data and actuarial techniques.

Claims

Our new propositions, such as Fast Response (see page 41) and our expanded network of accident repair centres delivering our seven day repair proposition (see page 21), not only get customers' lives back on track quickly but also aim to deliver high operating efficiency resulting in excellent claims cost control.

Cost control

Once again, we reduced our expense ratio during 2018, absorbing our investment in future capability. We aim to continue to make progress against our strategic initiatives with a focus on cost and efficiency.

Investments

As we gather premiums and provide for future claims payments we use these assets to invest in a diversified investment portfolio.

Risk framework

The Board has an established risk management model that separates responsibility into 'Three Lines of Defence' (see page 44 for more details).

Premiums − Net claims − Costs + Investment and other income = Profit

Find out more on pages 26 – 37

Sustainable value

Our objectives are to create value for all our stakeholders, putting our customers first and investing in our people, to support the communities we live and work in, and to generate sustainable profits for our shareholders.

Customers

Net Promoter Score

145.6pts

Employees

Engagement

81%

Communities

Percentage of staff who fundraised or volunteered on the Group's time

28%

Shareholders

Dividend per share

29.3p

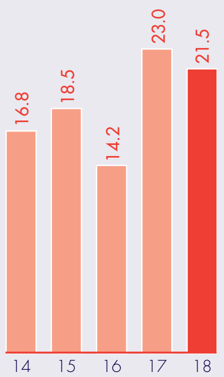
Dividends

Find out more on pages 24 – 25

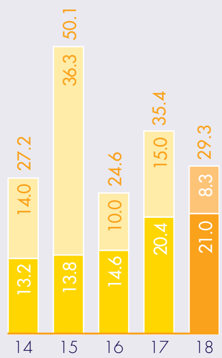
Delivering strong performance

These key performance indicators assess our performance against our strategy.

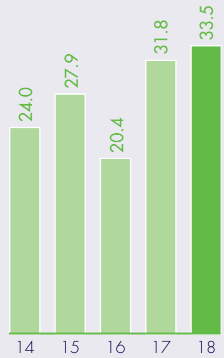
Return on tangible equity[1,2] (%)



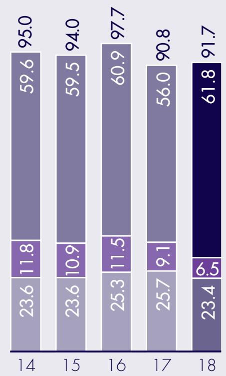
Dividend per share (pence)



Basic earnings per share (pence)



Combined operating ratio[2] (%)



	Return on tangible equity	Dividend per share	Basic earnings per share	Combined operating ratio
Definition	The return generated on the capital that shareholders have in the business. This is calculated by dividing adjusted earnings by average tangible equity.	The amount of cash paid to shareholders from the Group's retained profits. (See page 26 for dividend breakdown).	This is calculated by dividing the earnings attributable to shareholders by the weighted average number of Ordinary Shares in issue.	A measure of financial year underwriting profitability. A Combined operating ratio ("**COR**") of less than 100% indicates profitable underwriting. In addition to net claims, expense and commission ratios measure the cost of doing business and the COR is the sum of these costs divided by net earned premium, excluding instalment and other operating income and investment return.
Aim	We aim to achieve at least a 15% RoTE per annum over the long term.	We aim to grow the regular dividend in line with business growth. Additionally, we look to return any capital to shareholders which is expected to be surplus to our requirements for a prolonged period.	We have not set a target. However, growing earnings per share is considered an indicator of a healthy business.	We aim to make an underwriting profit. For 2019, we expect to achieve a COR in the range of 93% to 95% normalised for weather.
Performance	See Finance review page 31	See Finance review page 32	See Finance review page 31	See Finance review page 29
Link to Directors' remuneration	We base the LTIP awards partly on RoTE over a three-year performance period. See page 90	We base LTIP awards partly on relative total shareholder return performance, which includes dividends. Directors also receive dividends on their beneficial shareholdings and accrue these on unvested LTIP awards. See page 90	This is a broad measure of earnings and reflects the results of the Group after tax. We base part of the AIP awards on profit before tax and earnings per share is closely linked to this. See page 89	We base part of the AIP awards on profit before tax. COR is closely linked to this. See pages 89 and 96

Notes:
1. See glossary on pages 191 to 192 and alternative performance measures in Appendix A on pages 193 to 194.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data for 2017 has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.
3. Estimates based on the Group's solvency II partial internal model for 2016 to 2018. Solvency capital coverage based on the standard formula for 31 December 2015.

Changes to our KPIs in 2018

Our metrics are reviewed annually and updated as appropriate to ensure they remain an effective measure of delivery against our objectives. For 2018, the review of these metrics resulted in the following changes:

- Combined operating ratio has been split into its loss ratio, commission ratio and expense ratio elements to give greater clarity of its composition
- Employee engagement has been added in recognition of the importance of our people in meeting our strategic objectives
- A five-year view, where possible, was chosen to demonstrate our track record of performance

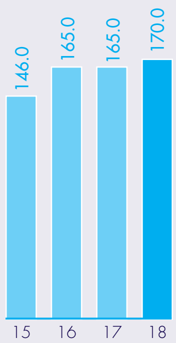
Key for combined operating ratio

Expense ratio | Commission ratio | Loss ratio

Key for dividend per share

Ordinary | Special

Solvency capital ratio[3] (%)



A risk-based measure expressing the level of capital resources held as a percentage of the level of capital that is required under solvency II.

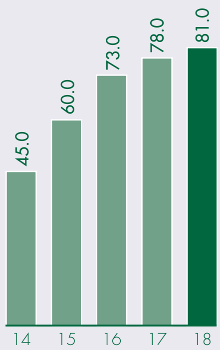
We target a solvency capital ratio in the range of 140% to 180%.

See Finance review page 32

Risk management within risk appetite, which includes an assessment of capital strength, and acts as a gateway for the AIP awards and underpin for LTIP awards.

See pages 89 and 90

Employee engagement (%)



Engagement is about being proud to work for Direct Line Group and helping us to succeed. It means that employees are not just happy or satisfied, but doing something to help us achieve our company goals.

To make the Group best for employees and best for our customers. We gauge employee engagement through our employee opinion survey and we aim to improve this year on year.

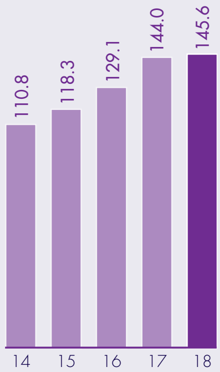
See People and culture page 56

The AIP awards include a weighting to a balance of employee metrics, including engagement.

See pages 89 and 98

Net promoter score[4]

Direct Line Brand (points)



Net promoter score ("NPS") is an index that measures the willingness of customers to recommend products or services to others. It is used to gauge customers' overall experience with a product or service, and customers' loyalty to a brand.

The launch of our customer experience strategy, along with a new transactional feedback tool and improved propositions have increased our overall brand score.

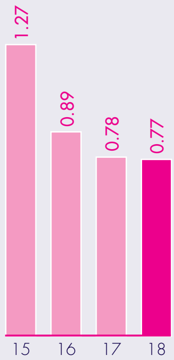
Customer claims experience programmes and improved propositions have contributed to an increase in our overall brand score.

The AIP awards include a weighting to a balance of customer metrics, including NPS.

See pages 89 and 97

Customer complaints[5]

Principal underwriter[6] (%)



The number of complaints we received during the year as a proportion of the average number of in-force policies.

This measure indicates the level of customer service we provide. We aim to improve this over time.

While the proportion of complaints received reduced compared to 2017 we recognise we have more to do to reduce these.

The AIP awards include a weighting to a balance of customer metrics, including complaints.

See pages 89 and 97

4. On an aggregated 12-month rolling basis, with 2013 rebased to 100.
5. FCA complaints reporting requirements have changed for periods after 29 June 2016. Before 29 June 2016, only complaints resolved after two business days were classed as FCA reportable. From July 2016 all complaints resolved are classed as FCA reportable.
6. For the Group's principal underwriter, U K Insurance Limited.

Strong results in a competitive market

Financial highlights

- Direct own brands premium up 1.8% compared to 2017, driven by growth across all segments. Total Group premium reduced by 5.3% year on year, as a result of the exit from Nationwide and Sainsbury's[1] Home partnerships.
- Operating profit decreased by £41.1 million compared to 2017, primarily due to reductions in prior-year reserve releases and investment return as expected. Operating profit included a £55 million benefit from moving to an assumed 0% Ogden discount rate (2017: £49 million benefit relating to Ogden).
- Demonstrating the value in the Group's diversified product base, current-year underwriting profitability was stable despite a reversal of the benign motor conditions in 2017. The expense ratio reduced to 23.4%.
- Profit before tax increased by 8.1% to £582.6 million (2017: £539.0 million) as the decrease in operating profit was more than offset by the non-repeat of finance costs in relation to the debt repurchased in 2017.
- Final ordinary dividend of 14.0 pence per share, an increase of 2.9% on 2017. Special dividend of 8.3 pence per share. Total dividends of 29.3 pence per share (2017: total dividends of 35.4 pence per share including a special dividend of 15.0 pence per share).
- Strong capital position with solvency capital ratio of 170% (after proposed dividends) reflecting prudence given current political and economic uncertainties.
- Reiteration of financial targets for 2019 and over the medium term of achieving a combined operating ratio in the range of 93% to 95% normalised for weather. In 2019, targeting operating expenses below £700 million. Reiteration of ongoing target of achieving at least a 15% return on tangible equity.

	FY 2018 £m	FY 2017[2] £m
In-force policies (thousands)	15,032	15,714
Of which: direct own brands (thousands)	7,132	6,909
Gross written premium	3,211.9	3,392.1
Of which: direct own brands	2,223.0	2,184.1
Net earned premium	3,089.5	3,135.0
Underwriting profit	255.1	288.1
Instalment and other operating income	192.0	179.3
Investment return	154.6	175.4
Operating profit	601.7	642.8
Finance costs	(19.1)	(103.8)
Profit before tax	582.6	539.0
Tax	(108.9)	(105.0)
Profit after tax	473.7	434.0
Key metrics		
Current-year attritional loss ratio[3]	72.5%	69.4%
Loss ratio[3]	61.8%	56.0%
Commission ratio[3]	6.5%	9.1%
Expense ratio[3]	23.4%	25.7%
Combined operating ratio[3]	91.7%	90.8%
Return on tangible equity[4]	21.5%	23.0%
Investment income yield[4]	2.5%	2.5%
Net investment income yield[4]	2.0%	2.1%
Investment return yield[4]	2.4%	2.6%
Basic earnings per share (pence)	33.5	31.8
Diluted earnings per share (pence)	33.1	31.5
Return on equity	17.3%	16.6%
Dividend per share[5]		
– interim (pence)	7.0	6.8
– final (pence)	14.0	13.6
– total ordinary (pence)	21.0	20.4
– special (pence)	8.3	15.0
– total (pence)	29.3	35.4

	31 Dec 2018	31 Dec 2017
Net asset value per share (pence)	188.6	198.9
Tangible net asset value per share (pence)	147.0	164.4
Solvency capital ratio[6] post-dividends	170%	165%

Notes:
1. Exit from Sainsbury's in respect of new business.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off profits within the Motor segment.
3. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration.
4. See glossary on pages 191 and 192 for definitions and Appendix A – Alternative performance measures on pages 193 and 194 for reconciliation to financial statement line items.
5. The Group's dividend policy states its expectation that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend and two-thirds will be paid as a final dividend in the second quarter of the following year.
6. Estimates based on the Group's solvency II partial internal model.

Performance

Operating profit

	FY 2018 £m	FY 2017 £m
Underwriting profit	255.1	288.1
Instalment and other operating income	192.0	179.3
Investment return	154.6	175.4
Total operating profit	601.7	642.8
Of which:		
Current-year operating profit	197.3	207.4
Prior-year reserve releases	404.4	435.4

Operating profit decreased by £41.1 million to £601.7 million (2017: £642.8 million) mainly due to a reduction in the underwriting profit and investment return, partly offset by an increase in instalment and other operating income. Overall, current-year operating profit was lower, with a stable current-year combined operating ratio offset by a lower investment return.

Underwriting profit decreased to £255.1 million (2017: £288.1 million) predominantly due to lower prior-year reserve releases of £31.0 million. Increased weather-related claims of £75 million, mainly associated with the major freeze event in Q1 2018 (2017: £13 million weather-related claims), were mostly offset by the non-repeat in 2018 of the £56.9 million impairment charge in 2017 in relation to IT projects.

The current-year attritional loss ratio increased by 3.1 percentage points to 72.5% (2017: 69.4%) as the Group experienced a reversal of the benign motor conditions in 2017 and a reduction in partnership business in Home. This was offset by a 2.6 percentage point reduction in the commission ratio as a result of both lower commission and profit share payments to Home partners, as a result of the exit of the Nationwide and Sainsbury's partnerships and changes to other partnership commissions arrangements. The current-year combined operating ratio was stable.

Effect of Ogden discount rate changes

	Motor £m	Commercial £m	FY 2018 Total £m	Motor £m	FY 2017 Total £m
Prior year	47.9	3.5	51.4	49.0	49.0
Current year	2.7	0.7	3.4	–	–
Total	50.6	4.2	54.8	49.0	49.0

Following Royal Assent of the Civil Liability Act 2018, which introduced a new framework for setting the personal injury discount rate, the Group reviewed the Ogden discount rate for reserves for large bodily injury claims and selected an assumed rate of 0% for reserving purposes. This has resulted in a release of £54.8 million in 2018 and this release was split across the Motor and Commercial segments. Given the Group's lower reinsurance retention in recent years, the majority of the reserve release related to prior years. In 2017, the Motor segment benefited from a reserve release of £49.0 million resulting from a lower than expected increase in claims costs following the change in the Ogden discount rate to minus 0.75%.

Instalment and other operating income increased to £192.0 million (2017: £179.3 million) and included a £9.6 million gain on sale of a property in Bristol.

Investment return decreased to £154.6 million (2017: £175.4 million) primarily due to a £7.9 million reduction year on year in investment income as a result of lower assets under management and a £12.9 million reduction year on year in realised and unrealised gains.

In-force policies and gross written premium

In-force policies (thousands)

At	31 Dec 2018	31 Dec 2017
Own brands	3,950	3,845
Partnerships	144	174
Motor	4,094	4,019
Own brands	1,789	1,794
Partnerships (excluding Nationwide and Sainsbury's)	803	823
Partnerships (Nationwide and Sainsbury's)	59	631
Home	2,651	3,248
Rescue	3,491	3,591
Travel	3,759	3,853
Pet	156	162
Other personal lines	126	133
Rescue and other personal lines	7,532	7,739
Of which: Green Flag direct	894	802
Direct Line for Business	499	468
NIG and other	256	240
Commercial	755	708
Total in-force policies	15,032	15,714
Of which: direct own brands	7,132	6,909

Total in-force policies reduced to 15.0 million (31 December 2017: 15.7 million), primarily due to lower partner volumes in Home, following the exit from the Nationwide and Sainsbury's partnerships, and reductions in Rescue and other personal lines, as a result of lower packaged bank account volumes. Own brands in-force policies grew to 7.1 million (31 December 2017: 6.9 million) with growth in Motor, Green Flag and Direct Line for Business, which partly offset the overall reduction.

Gross written premium

	FY 2018 £m	FY 2017 £m
Own brands	1,608.8	1,590.9
Partnerships	62.4	79.5
Motor	**1,671.2**	1,670.4
Own brands	412.6	409.7
Partnerships (excluding Nationwide and Sainsbury's)	181.7	195.6
Partnerships (Nationwide and Sainsbury's)	12.6	193.8
Home	**606.9**	799.1
Rescue	163.4	161.3
Travel	143.9	143.4
Pet	72.4	74.8
Other personal lines	43.1	41.6
Rescue and other personal lines	**422.8**	421.1
Of which: Green Flag direct	69.6	60.9
Direct Line for Business	132.0	122.6
NIG and other	379.0	378.9
Commercial	**511.0**	501.5
Total gross written premium	**3,211.9**	3,392.1
Of which: direct own brands	2,223.0	2,184.1

Gross written premium of £3,211.9 million (2017: £3,392.1 million) decreased by 5.3% primarily due to the exit from the Nationwide and Sainsbury's partnerships in Home. Direct own brands gross written premium of £2,223.0 million (2017: £2,184.1 million) grew by 1.8%.

Underwriting profit and combined operating ratio

	FY 2018	FY[1] 2017
Underwriting profit (£ million)	**255.1**	288.1
Loss ratio	61.8%	56.0%
Commission ratio	6.5%	9.1%
Expense ratio	23.4%	25.7%
COR	**91.7%**	90.8%

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.

The Group's combined operating ratio of 91.7% (2017: 90.8%) increased by 0.9 percentage points primarily due to a higher loss ratio which was partly offset by improvements in commission and expense ratios. Weather returned to close to normal levels in 2018 after a benign 2017 and this offset the non-repeat in 2018 of the £56.9 million non-cash impairment charge incurred in 2017. Normalised for weather and adjusted for the Ogden discount rate change, the combined operating ratio was approximately 93.5%, towards the lower end of the Group's medium-term target of 93% to 95%.

The loss ratio was 5.8 percentage points higher at 61.8% (2017: 56.0%) and reflected lower prior-year reserve releases, increases in Home and Commercial loss ratios due to the major freeze event in Q1 2018 and a reversal of benign motor conditions in 2017.

The expense ratio improved by 2.3 percentage points to 23.4% (2017: 25.7%), as the Group continued to reduce its operating expenses (0.5 percentage points excluding the impact of impairments in 2017). The reduction in the commission ratio of 2.6 percentage points primarily reflected both lower commissions and profit share payments to Home partners, as a result of the exit of the Nationwide and Sainsbury's partnerships, and changes to other partnership commissions arrangements. The remaining premium from these partnerships was substantially earned in 2018 and consequently the commission ratio is expected to reduce again in 2019 albeit at a significantly slower rate. In subsequent years the direction of the commission ratio will be dependent on the Group's partnership activities.

Ratio analysis by division

	Notes	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
For the year ended 31 December 2018						
Net earned premium	4	1,541.8	667.8	414.7	465.2	3,089.5
Net insurance claims	4	980.0	413.3	277.2	241.3	1,911.8
Prior-year reserve releases	33	276.3	32.6	16.1	79.4	404.4
Major weather events		n/a	(65.0)	n/a	(10.0)	(75.0)
Attritional net insurance claims		1,256.3	380.9	293.3	310.7	2,241.2
Loss ratio – current-year attritional		81.5%	57.0%	70.7%	66.8%	72.5%
Loss ratio – prior-year reserve releases		(17.9%)	(4.9%)	(3.9%)	(17.1%)	(13.1%)
Loss ratio – major weather events[1]		n/a	9.7%	n/a	2.1%	2.4%
Loss ratio – reported	4	63.6%	61.8%	66.8%	51.8%	61.8%
Commission ratio	4	2.0%	9.4%	4.6%	18.9%	6.5%
Expense ratio	4	23.3%	22.4%	23.8%	24.8%	23.4%
COR	4	88.9%	93.6%	95.2%	95.5%	91.7%
Current-year COR		106.8%	98.5%	99.1%	112.6%	104.8%
For the year ended 31 December 2017[2]						
Net earned premium	4	1,470.6	790.5	417.6	456.3	3,135.0
Net insurance claims	4	852.9	400.5	273.3	227.5	1,754.2
Prior-year reserve releases	33	318.6	23.7	6.8	86.3	435.4
Major weather events		n/a	(13.0)	n/a	n/a	(13.0)
Attritional net insurance claims		1,171.5	411.2	280.1	313.8	2,176.6
Loss ratio – current-year attritional		79.7%	52.0%	67.1%	68.8%	69.4%
Loss ratio – prior-year reserve releases		(21.7%)	(3.0%)	(1.7%)	(18.9%)	(13.9%)
Loss ratio – major weather events[1]		n/a	1.6%	n/a	n/a	0.4%
Loss ratio – reported	4	58.0%	50.6%	65.4%	49.9%	56.0%
Commission ratio	4	2.5%	17.7%	5.5%	19.1%	9.1%
Expense ratio	4	29.3%	21.1%	23.4%	24.4%	25.7%
COR	4	89.8%	89.4%	94.3%	93.4%	90.8%
Current-year COR		111.5%	92.4%	96.0%	112.3%	104.7%

Notes:
1. Home and Commercial claims for major weather events, including inland and coastal flooding and storms.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.

The movement in the current-year attritional loss ratio is an indicator of underlying accident year performance as it excludes prior-year reserve releases and claims costs from major weather events. The Group's current-year attritional loss ratio of 72.5% increased by 3.1 percentage points compared to 2017 primarily due to a change in business mix and a reversal of benign conditions experienced in 2017 in Motor.

Prior-year reserve releases continued to be significant at £404.4 million (2017: £435.4 million), were equivalent to 13.1% of net earned premium (2017: 13.9%) and were concentrated towards more recent accident years. Reserve releases in 2018 included a £51.4 million Ogden rate-related prior-year reserve release (2017: £49.0 million release). Assuming current claims trends continue, prior-year reserve releases are expected to reduce further in future years, although they are expected to remain a significant contribution to profits.

The Group's current-year combined operating ratio remained broadly steady at 104.8% (2017: 104.7%) as increases in attritional loss ratios were offset by reductions in commission and expense ratios.

Operating expenses

	FY 2018 £m	FY 2017 £m
Staff costs[1]	269.9	280.1
Other operating expenses[1,2]	253.3	273.6
Marketing	121.2	113.7
Amortisation and impairment of other intangible assets[3]	46.7	111.0
Depreciation	31.1	27.9
Total operating expenses	722.2	806.3

Notes:
1. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
2. Other operating expenses include IT costs, insurance levies, professional fees and property costs.
3. Amortisation and impairment of other intangible assets includes a £1.5 million impairment charge for year ended 31 December 2018 (2017: £56.9 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.

Operating expenses reduced by £84.1 million to £722.2 million (2017: £806.3 million) resulting in an expense ratio of 23.4% (2017: 25.7%). Excluding an impairment of intangible assets of £56.9 million in 2017, operating expenses reduced by 3.6% as reductions in staff costs and other operating expenses were partially offset by an increase in marketing spend in Motor and Commercial to drive brand awareness. The Group continued to invest in its significant IT programme and operational efficiency improvements while supporting business growth and investment in future capability.

The Group will apply IFRS 16 'Leases' from 1 January 2019. If the Group had applied this standard in 2018, the impact would have been a reduction in operating expenses of approximately £5 million and an increase in finance costs of approximately £7 million.

In 2019, the Group expects to make further progress in reducing operating costs and is targeting operating expenses below £700 million.

Instalment and other operating income

	Note	FY 2018 £m	FY 2017 £m
Instalment income		119.9	116.4
Other operating income:			
Vehicle replacement referral income	7	17.2	16.9
Revenue from vehicle recovery and repair services	7	11.7	11.3
Legal services income	7	11.2	11.0
Other income	7	32.0	23.7
Other operating income	7	72.1	62.9
Total instalment and other operating income		192.0	179.3

Instalment and other operating income increased by £12.7 million, with increased instalment income of £3.5 million due to higher Motor gross written premium partly offset by a reduction in Home due to the exit from Nationwide and Sainsbury's partnerships. Other operating income increased by £9.2 million, primarily relating to a one-off gain on disposal of the Bristol property of £9.6 million.

Investment return

	Note	FY 2018 £m	FY 2017 £m
Investment income		159.2	167.1
Hedging to a sterling floating rate basis		(30.8)	(27.0)
Net investment income		128.4	140.1
Net realised and unrealised gains excluding hedging		26.2	35.3
Total investment return	6	154.6	175.4

Investment yields

	FY 2018	FY 2017
Investment income yield[1]	2.5%	2.5%
Net investment income yield[1]	2.0%	2.1%
Investment return yield[1]	2.4%	2.6%

Note:
1. See glossary on pages 190 and 191 for definitions and Appendix A – Alternative performance measures on pages 193 and 194 for reconciliation to financial statement line items.

Total investment return decreased by £20.8 million to £154.6 million (2017: £175.4 million). This was due to a reduction in investment income primarily as a result of lower assets under management, and a reduction in realised and unrealised gains excluding hedging which was predominantly driven by a reduction in investment property valuations (2018: £12.7 million, 2017: £21.6 million) and debt security disposals.

The investment income yield for 2018 remained stable at 2.5% (2017: 2.5%). The net investment income yield was lower at 2.0% (2017: 2.1%) as a result of increased hedging costs.

Reconciliation of operating profit

	FY 2018 £m	FY[1] 2017 £m
Motor	415.2	396.4
Home	83.1	128.8
Rescue and other personal lines	43.4	43.6
Commercial	60.0	74.0
Operating profit	601.7	642.8
Finance costs	(19.1)	(103.8)
Profit before tax	582.6	539.0
Tax	(108.9)	(105.0)
Profit after tax	473.7	434.0

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.

Operating profit by segment

All divisions were profitable in 2018 with Motor increasing profits by £18.8 million compared to 2017. Home reported reduced operating profits primarily due to the major freeze event in Q1 2018. Commercial also experienced higher weather costs in 2018 although attritional claims performance improved. Rescue and other personal lines reported slightly lower profits. Rescue operating profit of £40.2 million (2017: £43.5 million) is included in the Rescue and other personal lines result.

Finance costs

Finance costs reduced to £19.1 million (2017: £103.8 million), with 2017 including costs and interest associated with the repurchase of £250 million nominal value of the subordinated debt in December 2017.

Effective corporation tax rate

The effective tax rate for 2018 was 18.7% (2017: 19.5%), which was lower than the standard UK corporation tax rate of 19.0% (2017: 19.25%) driven primarily by tax relief for the Tier 1 coupon payments offset by disallowable expenses.

Profit for the year and return on tangible equity[1]

Profit for the year was £473.7 million (2017: £434.0 million) as the decrease in operating profit was more than offset by the non-repeat of finance costs in relation to the debt repurchase in 2017.

Return on tangible equity decreased to 21.5% (2017: 23.0%) due primarily to a £31.5 million decrease in adjusted profit after tax to £457.1 million (2017: £488.6 million). Profit after tax in 2018 was adjusted for coupon payments in respect of Tier 1 notes, while profit after tax in 2017 was adjusted to add back finance costs for the one-off subordinated debt buy-back.

Earnings per share

Basic earnings per share increased by 5.3% to 33.5 pence (2017: 31.8 pence). Diluted earnings per share increased by 5.1% to 33.1 pence (2017: 31.5 pence) mainly reflecting an increase in profit after tax.

Cash flow

The Group's cash and cash equivalents decreased by £212.1 million during the year (2017: £193.7 million increase), to £1,092.4 million (31 December 2017: £1,304.5 million).

Operating activities before investment of insurance assets generated a cash inflow of £4.2 million (2017: £204.0 million generated). The decrease primarily reflected a reduction in insurance liabilities and trade payables partially offset by a reduction in insurance and other receivables.

Investment of insurance assets generated a cash inflow of £468.1 million (2017: inflow of £341.9 million). The increased inflow of £126.2 million is primarily due to the proceeds on disposal of financial investments.

Investing activities generated a cash outflow of £141.8 million (2017: outflow of £95.3 million) primarily due to an increase in the purchase of intangible assets, which was partially offset by lower tangible asset purchases and proceeds from the asset held for sale.

Financing activities generated a cash outflow of £542.6 million (2017: outflow of £256.9 million). The increased outflow primarily reflected an increase in dividends and appropriations paid in the year.

Net asset value

At 31 December	Note	2018 £m	2017 £m
Net assets[1]	16	2,573.1	2,715.1
Goodwill and other intangible assets	16	(566.8)	(471.1)
Tangible net assets	16	2,006.3	2,244.0
Closing number of Ordinary Shares (millions)	16	1,364.6	1,365.1
Net asset value per share (pence)	16	188.6	198.9
Tangible net asset value per share (pence)	16	147.0	164.4

The net assets at 31 December 2018 decreased to £2,573.1 million (31 December 2017: £2,715.1 million) and tangible net assets decreased to £2,006.3 million (31 December 2017: £2,244.0 million). These decreases mainly reflected the payment of the 2017 final and special dividends, a reduction in the available-for-sale reserves due to rising market yields and an increase in expenditure on intangible assets as the Group continued to invest in the business, partially offset by the 2018 retained profit.

Note:
1. See glossary on pages 191 and 192 for definitions and Appendix A – Alternative performance measures on pages 193 and 194 for reconciliation to financial statement line items.

Balance sheet management

Capital management and dividend policy

The Group aims to manage its capital efficiently and generate long-term sustainable value for shareholders, while balancing operational, regulatory, rating agency and policyholder requirements.

The Group aims to grow its regular dividend in line with business growth.

Where the Board believes that the Group has capital which is expected to be surplus to the Group's requirements for a prolonged period, it would intend to return any surplus to shareholders. In normal circumstances, the Board expects that a solvency capital ratio around the middle of its risk appetite range of 140% to 180% of the Group's solvency capital requirement ("SCR") would be appropriate and it will therefore take this into account when considering the potential for special distributions.

In the normal course of events the Board will consider whether or not it is appropriate to distribute any surplus capital to shareholders once a year, alongside the full year results.

The Group expects that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend, and two-thirds will be paid as a final dividend in the second quarter of the following year. The Board may revise the dividend policy from time to time. The Company may consider a special dividend and/or a repurchase of its own shares to distribute surplus capital to shareholders.

The Board has recommended a final dividend of 14.0 pence per share (2017: 13.6 pence), an increase of 0.4 pence per share (2.9%), in line with business growth. This reflects the Board's continued confidence in the Group's earnings and the progress the business continued to make.

The Board has also declared a special dividend of 8.3 pence per share. After both dividends the solvency capital ratio will be 170% as at 31 December 2018.

The Board has taken into account the high level of political and economic uncertainty, including in relation to Brexit, and considers it appropriate for the time being to maintain a prudent solvency capital ratio towards the upper end of the solvency capital ratio risk appetite range of 140% to 180%. The Board will keep this position under review as it monitors developments in the political and economic environment. In normal circumstances, the Board expects the Group to operate around the middle of its solvency capital ratio risk appetite range.

The final dividend and special dividend will be paid on 16 May 2019 to shareholders on the register on 5 April 2019. The ex-dividend date will be 4 April 2019.

Capital analysis

The Group is regulated under solvency II requirements by the PRA on both a Group basis and for the Group's principal underwriter, U K Insurance Limited. In its results, the Group has estimated its solvency II own funds, SCR and solvency capital ratio as at 31 December 2018.

Capital position

At 31 December 2018, the Group held a solvency II capital surplus of approximately £0.89 billion above its regulatory capital requirements, which was equivalent to an estimated solvency capital ratio of 170%, post the proposed final and special dividends.

The Group's SCR and solvency capital ratio are as follows:

At 31 December	2018	2017[1]
Solvency capital requirement (£ billion)	1.26	1.39
Capital surplus above solvency capital requirement (£ billion)	0.89	0.91
Solvency capital ratio post-dividend	170%	165%

Movement in capital surplus

	2018 £bn	2017[1] £bn
Capital surplus at 1 January	0.91	0.91
Capital generation excluding market movements	0.47	0.54
Market movements	(0.06)	–
Capital generation	0.41	0.54
Change in solvency capital requirement	0.13	0.01
Surplus generation	0.54	0.55
Capital expenditure	(0.15)	(0.10)
Management capital action	–	0.03
Capital distribution – ordinary dividends[2]	(0.30)	(0.28)
Capital distribution – special dividends[2]	(0.11)	(0.20)
Net surplus movement	(0.02)	–
Capital surplus at 31 December	0.89	0.91

Notes:
1. The 2017 comparative period has been updated to reflect the amounts in the Solvency and Financial Condition Report for the year ended 31 December 2017, published on 2 May 2018.
2. Foreseeable dividends included above are adjusted to exclude the expected dividend waivers in relation to shares held by the employee share trusts, which are held to meet obligations arising on the various share option awards.

During 2018, the Group's own funds decreased from £2.30 billion to £2.15 billion. The Group generated £0.41 billion of solvency II capital offset by £0.15 billion of capital expenditure and capital distribution of £0.41 billion for the 2018 dividend. The increased capital expenditure reflects the significant investment the Group is making in building future capability including the development of the latest generation core personal lines IT systems. In 2019, the level of expenditure is expected to be approximately £175 million, reducing to less than £150 million in 2020. Thereafter, expenditure levels are expected to reduce further.

Change in solvency capital requirement

	2018 £bn
Solvency capital requirement at 1 January	1.39
Model and parameter changes	(0.07)
Exposure changes	(0.06)
Solvency capital requirement at 31 December	1.26

The Group's SCR has reduced by £0.13 billion in the year. Model and parameter changes reduced the SCR by £0.07 billion. Exposure changes, as a result of the exited Home partnerships, a reduction in solvency II technical provisions including an assumed change in the Ogden discount rate to 0%, and lower assets under management, led to a reduction in the SCR of £0.06 billion.

Scenario and sensitivity analysis

The following table shows the impact on the Group's estimated solvency capital ratio in the event of the following scenarios as at 31 December 2018. The impact on the Group's solvency capital ratio arises from movements in both the Group's solvency capital requirement and own funds.

	Impact on solvency capital ratio	
Scenario	31 Dec 2018	31 Dec 2017
Motor small bodily injury deterioration equivalent to accident years 2008 and 2009	(7pts)	(7pts)
One-off catastrophe loss equivalent to the 1990 storm	(8pts)	(9pts)
One-off catastrophe loss based on extensive flooding of the River Thames	(8pts)	(9pts)
Change in reserving basis for PPOs to use a real discount rate of minus 1%[1]	(10pts)	(13pts)
100bps increase in credit spreads[2]	(11pts)	(11pts)
100bps decrease in interest rates with no change in the PPO real discount rate	(1pt)	(3pts)

Notes:
1. The PPO real discount rate used is an actuarial judgement which is reviewed annually based on the economic outlook for wage inflation relative to the European Insurance and Occupational Pensions Authority discount rate curve.
2. These sensitivities only include the assessed impact of the above scenarios in relation to AFS investments.

Own funds

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

At 31 December	2018 £bn	2017[1] £bn
Tier 1 capital before foreseeable dividends	1.76	2.04
Foreseeable dividends	(0.31)	(0.39)
Tier 1 capital – unrestricted	1.45	1.65
Tier 1 capital – restricted	0.35	0.35
Tier 1 capital	1.80	2.00
Tier 2 capital – subordinated debt	0.26	0.26
Tier 3 capital – deferred tax	0.09	0.04
Total own funds	2.15	2.30

Note:
1. The 2017 comparative period has been updated to reflect the amounts in the Solvency and Financial Condition Report for the year ended 31 December 2017, published on 2 May 2018.

Tier 1 capital after foreseeable dividends represents 84% of own funds and 143% of the estimated SCR. Tier 2 capital relates solely to the Group's £0.26 billion subordinated debt. The amount of Tier 2 and Tier 3 capital permitted under the solvency II regulations is 50% of the Group's SCR and of Tier 3 alone it is less than 15%. Therefore, the Group currently has no ineligible capital. The requirement that Tier 1 restricted capital should not exceed 20% of total Tier 1 capital, when satisfying the requirement that eligible Tier 1 items should be at least 50% of SCR, is not applicable to the Group.

The special dividend will be payable from surplus capital generated from continuing operations of the Group.

Reconciliation of IFRS shareholders' equity to solvency II own funds

At 31 December	2018 £bn	2017[1] £bn
Total shareholders' equity	2.57	2.72
Goodwill and intangible assets	(0.57)	(0.47)
Change in valuation of technical provisions	(0.15)	(0.13)
Other asset and liability adjustments	(0.09)	(0.08)
Foreseeable dividends	(0.31)	(0.39)
Tier 1 capital – unrestricted	1.45	1.65
Tier 1 capital – restricted	0.35	0.35
Tier 1 capital	1.80	2.00
Tier 2 capital – subordinated debt	0.26	0.26
Tier 3 capital – deferred tax	0.09	0.04
Total own funds	2.15	2.30

Note:
1. The 2017 comparative period has been updated to reflect the amounts in the Solvency and Financial Condition Report for the year ended 31 December 2017, published on 2 May 2018.

Leverage

The Group's financial leverage increased by 0.7 percentage points, but remained conservative at 19.1% (2017: 18.4%). The increase was primarily due to the reduction in shareholders' equity. While the Tier 1 notes issued during 2017 are presented as equity in the balance sheet, the Group considers this to be part of its total leverage.

At 31 December	2018 £m	2017 £m
Shareholders' equity	2,573.1	2,715.1
Tier 1 notes	346.5	346.5
Financial debt – subordinated debt	259.5	264.7
Total capital employed	3,179.1	3,326.3
Financial-leverage ratio[1]	19.1%	18.4%

Note:
1. Total IFRS financial debt and Tier 1 notes as a percentage of total IFRS capital employed.

Credit ratings

Standard & Poor's and Moody's Investors Service provide insurance financial-strength ratings for U K Insurance Limited, the Group's principal underwriter. U K Insurance Limited is currently rated 'A' (strong) with a stable outlook by Standard & Poor's, and 'A2' (good) with a positive outlook by Moody's.

Reserving

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling costs. The Group considers the class of business, the length of time to notify a claim, the validity of the claim against a policy, and the claim value. Claims reserves could settle across a range of outcomes, and settlement certainty increases over time. However, for bodily injury claims the uncertainty is greater due to the length of time taken to settle these claims. The possibility of annuity payments for injured parties also increases this uncertainty.

The Group seeks to adopt a conservative approach to assessing liabilities, as evidenced by the favourable development of historical claims reserves. Reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal actuarial best estimate. This margin is set by reference to various actuarial scenario assessments and reserve distribution percentiles. It also considers other short and long-term risks not reflected in the actuarial inputs, as well as management's view on the uncertainties in relation to the actuarial best estimate.

The most common method of settling bodily injury claims is by a lump sum paid to the claimant and, in the cases where this includes an element of indemnity for recurring costs such as loss of earnings or ongoing medical care, settlement calculations have reference to a standardised annuity factor at a discount rate normally referred to as the Ogden discount rate. The Ogden discount rate was 2.5% from 2001 until 2017, when it was changed to minus 0.75% based on a 3-year average of yields on index-linked government securities, in line with case law that claimants were entitled to invest their lump sum in a way which was very low or even zero risk. The Civil Liability Act 2018 changes this approach and instead requires the Government to reset the Ogden discount rate by reference to low risk rather than very low or zero risk investments. The process is due to conclude in 2019, but there is considerable uncertainty about its outcome and the date from which a new rate will apply.

The Group will continue to exercise judgement around the Ogden discount rate used in its reserves. Risks and uncertainties here are significant but the move to introduce additional asset classes into the assumed claimant portfolio points towards a higher rate than minus 0.75%. The Group has therefore made a judgement that it is likely that the Ogden discount rate will change and has selected an estimate of 0% to value its lump sum bodily injury reserves. An allowance for further movements in the Ogden rate is made within the Group's solvency II balance sheet and capital requirements. Details of the IFRS sensitivity analysis to the assumed Ogden discount rate are shown overleaf.

The Group's prior-year reserve releases were £404.4 million (2017: £435.4 million) with good experience in large bodily injury claims being a key contributor.

Looking forward, the Group expects to continue setting its initial management best estimate conservatively. Assuming current claims trends continue, the contribution from prior-year reserve releases will reduce over time, although it is expected to remain significant.

Claims reserves net of reinsurance

At 31 December	2018 £m	2017[1] £m
Motor	1,946.4	2,187.3
Home	323.8	293.3
Rescue and other personal lines	89.1	85.6
Commercial	541.4	578.3
Total	2,900.7	3,144.5

Note:
1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include Run-off segment profits within the Motor segment.

Sensitivity analysis – the discount rate used in relation to PPOs and changes in the assumed Ogden discount rate

The table below provides a sensitivity analysis of the potential net impact of a change in a single factor (the discount rate used for periodic payment orders ("**PPO**s") and separately the Ogden discount rate) with all other assumptions left unchanged. Other potential risks beyond the ones described could have an additional financial impact on the Group.

At 31 December	Increase/(decrease) in profit before tax [1,2] 2018 £m	2017 £m
PPOs[3]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	50.7	54.6
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(70.1)	(75.1)
Ogden discount rate[4]		
Impact of the Group reserving at a discount rate of 1% compared to 0% (2017: 0% compared to minus 0.75%)	56.2	68.4
Impact of the Group reserving at a discount rate of minus 1% compared to 0% (2017: minus 1.5% compared to minus 0.75%)	(76.3)	(102.9)

Notes:
1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at 31 December and should not be interpreted as predictions.
3. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0% for reserving. The PPO sensitivity has been calculated as the direct impact of the change in the real discount rate with all other factors remaining unchanged.
4. Ogden discount rate sensitivity has been calculated as the direct impact of a permanent change in the discount rate with all other factors remaining unchanged. The Group will consider the statutory discount rate when setting its reserves but not necessarily provide on this basis, as is the case at the year ended 31 December 2018. This is intended to ensure that reserves are appropriate for current and potential future developments.

The sensitivity above is calculated on the basis of a permanent change in the rate used for the actuarial best estimate reserves as at 31 December 2018. It does not take into account a change in the Ogden discount rate setting regime, nor any second order impacts such as those on the Group's PPO assumptions or reinsurance bad debt assumptions.

The reduction in sensitivity to a change in the Ogden discount rate since 31 December 2017 primarily reflects the overall reduction in bodily injury exposures. The reduction in exposure is due to continued positive prior-year development of claims reserves for large bodily injury claims, and a higher proportion of reserves benefiting from a lower reinsurance retention.

Reinsurance

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

– Catastrophe reinsurance to protect against an accumulation of claims arising from a natural perils event. The retained deductible is 14.88% of gross earned premium (£126.5 million at 31 December 2018) and cover is placed annually on 1 July up to a modelled 1-in-200 year loss event of 128.88% of gross earned premium (£1,095.5 million at 31 December 2018). At the last renewal, 1 July 2018, approximately 60% of the reinsurance programme was placed on a fixed price basis (reinsurers' rate on line) as the second year of a three-year contract.

– Motor reinsurance to protect against a single claim or an accumulation of large claims which renews on 1 January. The retained deductible is at an indexed level of £1 million per claim, providing a substantial level of protection against large motor bodily injury claims. This programme was renewed on 1 January 2019.

– Commercial property risk reinsurance to protect against large individual claims with a retained deductible of £4.0 million which renews annually on 1 July.

Investment portfolio

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

– to ensure there is sufficient liquidity available within the investment portfolio to meet stressed liquidity scenarios

– to match PPO and non-PPO liabilities in an optimal manner

– to deliver a suitable risk-adjusted investment return commensurate with the Group's risk appetite

Asset and liability management

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

Liabilities	Assets	Characteristics
More than 10 years, for example PPOs	Property and infrastructure debt	Inflation linked or floating
Short and medium term – all other claims	Investment-grade credit, short-term high yield and subordinated financial debt	Key rate duration matched
Tier 1 equity	Investment-grade credit	Fixed
Tier 2 sub-debt (swapped fixed to floating)	Commercial real estate loans and cash	Floating
Surplus – tangible equity	Investment-grade credit, cash and government debt securities	Fixed or floating

Asset allocation and benchmarks

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

At 31 December	Benchmark holding 2018	Actual holding 2018	Benchmark holding 2017	Actual holding 2017
Investment-grade credit	65.0%	58.5%	60.0%	58.1%
High-yield	6.0%	6.4%	6.0%	5.8%
Investment-grade private placements	3.0%	1.6%	4.0%	1.5%
Credit	74.0%	66.5%	70.0%	65.4%
Sovereign	5.0%	2.6%	8.0%	3.4%
Total debt securities	79.0%	69.1%	78.0%	68.8%
Infrastructure debt	5.0%	4.7%	5.0%	4.7%
Commercial real estate loans	4.0%	3.3%	3.0%	2.5%
Cash and cash equivalents	7.0%	17.7%	9.0%	19.4%
Investment property	5.0%	5.2%	5.0%	4.6%
Total	100.0%	100.0%	100.0%	100.0%

Investment holdings and yields – total Group

	2018			2017		
	Allocation (£m)	Income (£m)	Yield (%)	Allocation (£m)	Income (£m)	Yield (%)
Investment-grade credit[1]	3,606.6	99.6	2.7%	3,893.1	109.2	2.8%
High-yield	393.9	18.8	4.8%	388.6	19.7	4.9%
Investment-grade private placements	101.0	2.8	2.7%	103.6	2.4	2.6%
Credit	4,101.5	121.2	2.9%	4,385.3	131.3	3.0%
Sovereign	156.9	2.8	1.5%	224.8	6.2	2.2%
Total debt securities	4,258.4	124.0	2.8%	4,610.1	137.5	3.0%
Infrastructure debt	289.6	6.9	2.3%	316.4	6.8	2.1%
Commercial real estate loans	201.6	6.2	3.7%	169.0	3.7	3.0%
Cash and cash equivalents[2]	1,092.4	6.2	0.5%	1,304.5	2.9	0.2%
Investment property	322.1	15.9	5.1%	309.3	16.2	5.1%
Total Group	6,164.1	159.2	2.5%	6,709.3	167.1	2.5%

Notes:
1. Asset allocation at 31 December 2018 includes investment portfolio derivatives, which have been included and have a mark-to-market asset value of £11.8 million included in investment grade credit (31 December 2017: mark-to-market asset value of £55.1 million). This excludes non-investment derivatives that have been used to hedge interest on subordinated debt and operational cash flows.
2. Net of bank overdrafts: includes cash at bank and in hand and money market funds with no notice period for withdrawal.

At 31 December 2018, total investment holdings of £6,164.1 million were 8.1% lower than at the start of the year reflecting primarily the cash paid in 2018 for dividends and a decline in fair value of debt securities. Total debt securities were £4,258.4 million (31 December 2017: £4,610.1 million), of which 4.6% were rated as 'AAA' and a further 59.3% were rated as 'AA' or 'A'. The average duration at 31 December 2018 of total debt securities was 2.5 years (31 December 2017: 2.3 years).

Tax management

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

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

Tax authorities

The Group has open and cooperative relationships with the tax authorities with whom it deals in the countries where the Group operates, namely the UK, the Republic of Ireland, South Africa and India.

Tax policy and governance

The Group's tax policy has been reviewed and approved by the Audit Committee. The Group Tax team supports the Chief Financial Officer in ensuring the policy is adhered to at an operational level.

For more information please see our published Group Tax policy on the Group's website at www.directlinegroup.co.uk/en/who-we-are/governance/other-policies.html

Total tax contribution

The Group's direct and indirect tax contribution to the UK Exchequer is significantly higher than the UK corporation tax that the Group pays on its profits. The Group collects taxes relating to employees and customers on behalf of the UK Exchequer and other national governments. It also incurs a significant amount of irrecoverable value added tax relating to overheads and claims.

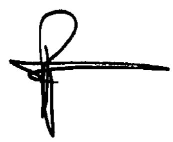
During 2018 the sum of taxes either paid or collected across the Group was £961.7 million. The composition of this between the various taxes borne and collected by the Group is shown below.

Total taxes borne

At 31 December	2018 £m
Current-year corporation tax charge	114.4
Irrecoverable VAT incurred on overheads	90.2
Irrecoverable VAT embedded within claims spend	197.2
Employer's national insurance contribution	39.2
Other taxes	8.7
Total	449.7

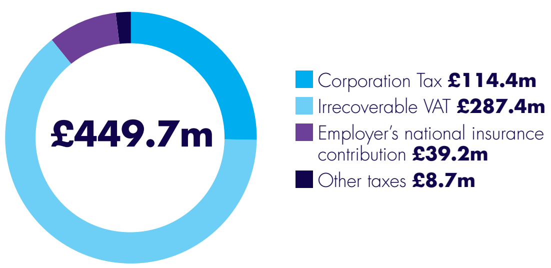
Total taxes collected

At 31 December	2018 £m
Insurance premium tax collected	400.6
VAT collected	12.2
Employees' PAYE and national insurance contribution	99.2
Total	512.0

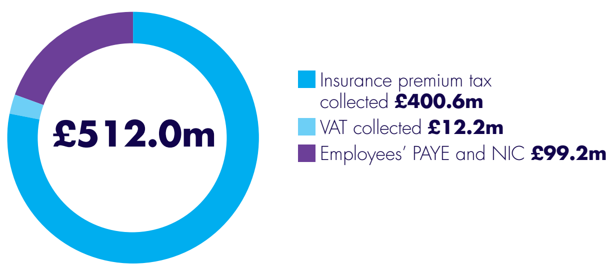


PENNY JAMES
CHIEF FINANCIAL OFFICER

Total taxes borne by tax type (£m)



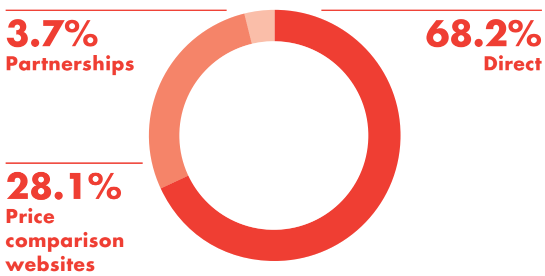
Total taxes collected by tax type (£m)



Motor

- Own brand in-force policies increased by 2.7% with overall growth in in-force policies of 1.9%, up to 4.1 million
- Own brand growth in gross written premium of £17.9 million, overall gross written premium broadly stable
- Operating profit of £415.2 million was £18.8 million higher than prior year primarily due to a non-repeat of 2017's intangible asset impairment of £56.9 million

Gross written premium by channel[1]



In-force policies ('000s)

4,094
(2017: 4,019)

Gross written premium

£1,671.2m
(2017: £1,670.4m)

Operating profit

£415.2m
(2017: £396.4m)

Combined operating ratio

88.9%
(2017: 89.8%)

	2018	2017
In-force policies (thousands)	4,094	4,019
Of which own brands	3,950	3,845
Gross written premium	£1,671.2m	£1,670.4m
Loss ratio	63.6%	58.0%
Commission ratio	2.0%	2.5%
Expense ratio	23.3%	29.3%
Combined operating ratio	88.9%	89.8%
Operating profit	£415.2m	£396.4m

Overview

In 2018, the Group grew its Motor policy count at target margins, in an increasingly competitive market, demonstrating the value that customers place on our brands and propositions.

Whilst the current-year attritional loss ratio was up by 1.8 percentage points, the current-year combined operating ratio was broadly stable (excluding the effect of the £56.9 million impairment of intangible assets in 2017), and operating profit was up 4.7%.

The Group continued its progress with its customer-focused initiatives launched in the year. The Group's Direct Line brand remained attractive as it continued to enhance the propositions and services customers value. The brand launched a new proposition in the first quarter: a 'No Blame' proposition which protects customers from losing their no claim discount for a range of common non-fault claims. A new Motor partnership was signed in 2018 with Volkswagen Insurance Service (Great Britain) Limited.

Performance

The Motor division grew in-force policies by 1.9% to 4.1 million and gross written premium was broadly stable at £1,671.2 million. The growth in in-force policies was across both direct and price comparison website channels, driven by growth in Direct Line and Churchill which showed the value of our multi-brand strategy. While new business volumes fell slightly, retention remained strong year on year across all channels.

Motor average premium[2] fell by 1.0% in 2018. Motor risk-adjusted prices increased by 0.6% in 2018 while risk mix reduced average premiums by 1.5%. The change in risk mix primarily reflected the attractiveness of the Group's free Motor legal protection cover to lower average premium Churchill aggregator customers.

Note:
1. By original channel.
2. Average incepted written premium excluding insurance premium tax for total Motor for the year ended 31 December 2018.

Keeping No Claim Discount for our customers

16,618 customers have benefited from Direct Line's 'No Blame' proposition which provides that a policyholder's No Claim Discount is not affected if their car is damaged in any of these circumstances:

- Potholes or poor road maintenance
- Fire and/or theft of/or from the car
- Hit whilst parked
- Flood
- If you hit or were hit by a wild or domestic animal
- Hit by object or debris (excluding vehicles)

This ensures that our customers are not being punished for something that is not their fault and are able to keep their hard earned no claims discount intact. Just another way that we are making insurance much easier and better value for our customers.

16,618
Customers benefited from 'No Blame' proposition

Our customers said:

// I felt valued and that you were on my side

// This promise is truly differentiating

The current-year attritional loss ratio in Motor increased by 1.8 percentage points to 81.5% (2017: 79.7%) following a reversal of benign conditions experienced in 2017. The Group observed higher claims frequency in 2018 following an unusually low frequency year in 2017. The Group's long-term view of claims inflation remains within the range of 3% to 5%.

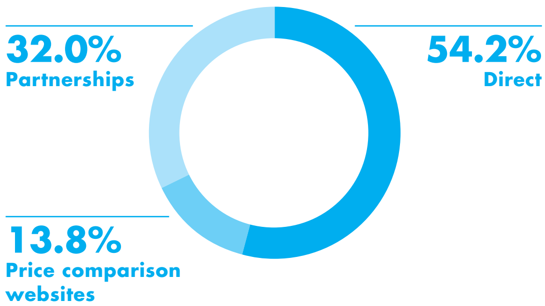
In total, prior-year reserve releases were £42.3 million lower year on year at £276.3 million, and included £47.9 million relating to the change in the assumed Ogden discount rate (2017: £49.0 million release). Bodily injury claims reserves continued to develop favourably.

Motor's reported combined operating ratio improved by 0.9 percentage points to 88.9% (2017: 89.8%). This was primarily as a result of the improvement in the expense ratio, following the non-repeat in 2018 of 2017's impairment of intangible assets.

Home

- Total in-force policies and gross written premium 18.4% and 24.1% lower, respectively, in 2018 following exit of Nationwide and Sainsbury's[1] partnerships
- Own brands in-force policies were broadly stable year-on-year and gross written premium on own brands increased by 0.7%
- Total operating profit was £45.7 million lower than in 2017, reflecting Q1 2018's freeze event

Gross written premium by channel[2]



In-force policies ('000s)

2,651
(2017: 3,248)

Gross written premium

£606.9m
(2017: £799.1m)

Operating profit

£83.1m
(2017: £128.8m)

Combined operating ratio

93.6%
(2017: 89.4%)

	2018	2017
In-force policies (thousands)	2,651	3,248
Of which own brands	1,789	1,794
Gross written premium	£606.9m	£799.1m
Loss ratio	61.8%	50.6%
Commission ratio	9.4%	17.7%
Expense ratio	22.4%	21.1%
Combined operating ratio	93.6%	89.4%
Operating profit	£83.1m	£128.8m

Overview

In 2018, the Group maintained underwriting discipline in a competitive market. The Group maintained strong retention rates, demonstrating the appeal of our brands and propositions. The shift in distribution of Home's business from partners to price comparison websites continued in 2018. Against this backdrop, the Group remained competitive across all channels.

Focusing on propositions that differentiate Home's products, 2018 saw the launch of Direct Line's 'Fast Response'. This proposition sees the Group agreeing an action plan with customers within 24 hours of major water damage.

Performance

In-force policies for Home's own brands were broadly stable compared with 2017 at 1.8 million policies, while partnerships volumes reduced by 40.7% predominantly due to the exit from the Nationwide and Sainsbury's partnerships. Excluding Nationwide and Sainsbury's, partnership volumes reduced by 2.4% in 2018.

Gross written premium was 24.1% lower than 2017, predominantly due to the reduction in partnerships. Own brands gross written premium rose by 0.7% with increases across all brands. New business volumes were lower during the second half of 2018 as shopping levels slowed following the anniversary of the introduction of the new rules requiring the previous year's premium to be included on renewal documents. Retention in Home own brands continued to be strong.

Home own brands average written premium[3] increased slightly by 0.4% compared with 2017, with a 3.5% price increase offset by a reduced risk mix.

Note:
1. The exit from Sainsbury's is in respect of new business.
2. By original channel.
3. Average incepted written premium excluding insurance premium tax for Home own brands for year ended 31 December 2018.

Providing an action plan within 24 hours for our customers

Fast Response was designed to enable our home insurance customers to get their home back on track, following damage caused by a severe water leak, with minimal disruption to their daily lives.

Our proposition provides for us to be there within 24 hours of the incident to make the important decisions on the repair that will get our customers' homes back to normal. Once a claim has been reported, our suppliers arrange an appointment with customers within 24 hours, including over weekends.

Our technician will leave the customer with clear next steps on when they will be contacted and what action they are recommending. During the first visit claims evidence is also captured on video and reported back to the office to speed up the process, all contributing to a fast response.

24 hour

response, including weekends

Our customers said:

// The company is being supportive at the worst time

// Immediate assistance is a great feature of the policy

The current-year attritional loss ratio, excluding major weather event claims, increased by 5.0 percentage points to 57.0%, reflecting changes in business mix, and was more than offset by lower commissions from partnerships. Claims inflation, excluding the impact of major weather events, remained within the Group's long-term expectation of 3% to 5%. Subsidence claims, including those associated with the dry summer weather in the UK, were not materially above normal annual expectations.

The commission ratio of 9.4% was 8.3 percentage points lower than for 2017, reflecting lower commission and profit share payments to partners resulting from the exit from the Nationwide and Sainsbury's partnerships and changes to other partnership commission arrangements.

Home's combined operating ratio increased by 4.2 percentage points to 93.6% (2017: 89.4%) with higher loss and expense ratios, in part offset by an improved commission ratio. The loss ratio was 11.2 percentage points higher at 61.8% compared to 2017 primarily as a result of the major weather events in Q1 2018. The impact of weather in Q1 was approximately £65 million (2017: £13 million), and no additional major weather events were experienced for the remainder of the year. Normalised for weather, the combined operating ratio was approximately 2.0 percentage points better than last year at 92% (2017: approximately 94%).

Rescue and other personal lines

- Total gross written premium remained broadly stable as growth in Green Flag Rescue and some premium inflation in Travel were offset by lower partnership and packaged account volumes
- The Group's direct Rescue brand, Green Flag, grew in-force policies by 11.5% and gross written premium by 14.3% in the year
- During 2018 the Group successfully renewed two major Travel partnerships with RBS Group and Nationwide for a further five years

	2018	2017
In-force policies (thousands)	7,532	7,739
Of which: own brands	894	802
Gross written premium	£422.8m	£421.1m
Of which: Rescue	£163.4m	£161.3m
Travel	£143.9m	£143.4m
Pet	£72.4m	£74.8m
Other personal lines	£43.1m	£41.6m
Loss ratio	66.8%	65.4%
Commission ratio	4.6%	5.5%
Expense ratio	23.8%	23.4%
Combined operating ratio	95.2%	94.3%
Operating profit	£43.4m	£43.6m

Overview

The Rescue and other personal lines segment consists of Rescue products which are sold through the Green Flag brand and other personal lines insurance, including Travel and Pet, which are sold through own brands and partnership arrangements.

Green Flag continued to position itself as the market disrupter, with the launch of a new advertising campaign in the year. Travel claims inflation remained in line with medium to long-term expectations during 2018. Less volatile currency movements drove lower claims inflation and this was reflected in lower premium inflation than in previous years. Brexit uncertainty remains a risk, however, with the impact on customers and claims with the possible withdrawal of the European Health Insurance Card scheme potentially leading to customers' greater reliance on travel insurance.

Performance

Rescue and other personal lines in-force policies fell by 2.7% to 7.5 million. Gross written premium for Rescue and other personal lines increased by 0.4% compared with 2017. Green Flag continued to grow its higher margin direct business during 2018, increasing in-force policies by 11.5% to over 894,000 as 2018's extreme weather events reminded potential customers of the benefits of having breakdown cover. Gross written premiums grew by 14.3% to £69.6 million which was driven by higher volumes and a shift towards higher levels of cover which attracted higher average premiums.

In-force policies for the Group's linked rescue channel reduced to 1.9 million, driven by the end of the Churchill 'Free Rescue' campaign in July, where Churchill Motor customers received a year's Rescue cover when they purchased their policy. Rescue partnerships in-force policies and gross written premiums, where margins tend to be lower than for direct, reduced, driven by a partnership exit and a reduction in packaged bank account volumes.

Other personal lines in-force policies reduced by 2.6% to 4.0 million primarily due to lower packaged bank account volumes. The rate of reduction of Pet in-force policies slowed considerably in 2018 and insurance packages tailored for mid-to high-net worth Home and Motor customers saw strong growth. Gross written premium remained broadly stable as a slight growth in Travel offset a reduction in Pet.

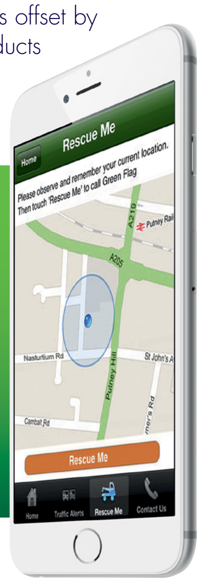
The combined operating ratio for Rescue and other personal lines increased by 0.9 percentage points to 95.2% (2017: 94.3%) primarily due to an increase in the loss ratio partially offset by a lower commission ratio. During the year, Rescue experienced a higher average claims cost due to a mix of recoveries, weather conditions and a restructuring of the Group's third-party recovery network. As a result, Rescue's combined operating ratio increased to 85.0% (2017: 82.8%). Other personal lines combined operating ratio was stable as improved performance in Pet and Travel was offset by weather-related and large claims in Home products for mid-to high-net worth customers.

Common sense to the rescue for our customers

The Rescue Me service on the Green Flag app is making a stressful situation a little less hassle for our customers. Using the app customers can:

- Request a rescue which will pinpoint their location so they don't have to worry about providing directions
- Track their technician so they know when they will be arriving
- Receive updates on the progress of their breakdown

With data driving every customer experience we are implementing technology to deliver the high level of service that customers expect from their breakdown provider. Our challenger status is reaffirmed in our most recent pledge to provide customers with 50% off their RAC or AA renewal quote.



Commercial

- Total gross written premium increased by 1.9% with direct own brands increasing by 7.7%
- Strong performance in Direct Line for Business, with new propositions rolled out on its innovative technology platform targeting small businesses
- NIG premium stable year on year as it focused on delivering its strategy and improving margins

	2018	2017
In-force policies (thousands)	755	708
Of which: own brands	499	468
Gross written premium	£511.0m	£501.5m
Of which: DL4B	£132.0m	£122.6m
NIG and other	£379.0m	£378.9m
Loss ratio	51.8%	49.9%
Commission ratio	18.9%	19.1%
Expense ratio	24.8%	24.4%
Combined operating ratio	95.5%	93.4%
Operating profit	£60.0m	£74.0m

Overview

The Commercial broker market continued to consolidate in 2018. Customers continued to seek cover that was flexibly tailored to their individual needs and demonstrated knowledge about their trade in the direct market. Against this backdrop, Commercial maintained underwriting discipline and grew its policy count.

Direct Line for Business continued to roll out a range of innovative propositions for small and micro businesses, including the launch of its Office, Professionals and Retail insurance products. Direct Line for Business also launched a national marketing campaign to increase awareness of its offering amongst its target market.

In NIG, the focus continued to be on profitability and delivering on its service proposition to be 'Effortless to Trade With'.

Performance

Commercial in-force policies increased by 6.6% compared with 2017 to 755,000. This reflected strong growth in both Direct Line for Business and NIG and other. Gross written premium increased by 1.9% to £511.0 million.

Direct Line for Business grew in-force policies by 6.6% as it grew in its traditionally strong areas of van and landlord, supplemented by growth in the small and micro business products on its new platform. Gross written premium increased by 7.7% to £132.0 million with increases across all product lines.

NIG and other in-force policies grew by 6.7%. Gross written premium remained steady at £379.0 million as the business continued to focus on improving margins and delivering on its strategy.

The current-year attritional loss ratio in Commercial improved by 2.0 percentage points to 66.8% as risk selection over volume remained the priority. Prior-year reserve releases were £6.9 million lower at £79.4 million.

The combined operating ratio for Commercial increased by 2.1 percentage points to 95.5% (2017: 93.4%), primarily due to a 1.9 percentage points increase in the loss ratio as a result of the major weather events in Q1 2018 and the reduction in prior-year reserve releases, partially offset by an improvement in the current-year attritional claims ratio. The impact of weather events in 2018 was approximately £10 million.

Commission and expense ratios remained broadly stable compared to 2017 despite increased pressure on commissions due to broker consolidation.

Flexible insurance that keeps up with our small business customers

In 2016 Direct Line for Business launched a new end-to-end business transformation programme to create a proposition that enables small business owners to buy insurance direct and with confidence. The proposition targets a number of trades, ranging from hairdressers and dog walkers to IT consultants and cake makers, and allows them to create a flexible policy that is unique to their business.

- An intuitive online tool asks small and medium-sized enterprise owners four or five questions about their business that are used to personalise the rest of their journey according to their trade and individual circumstances
- Each cover option gets broken down in the policy, showing individual prices and giving business owners full transparency when buying their policy
- No mid-term amendment admin fees means that customers have the flexibility to make changes to their policy, whether they are increasing their workforce, moving to new premises or working from multiple locations, giving them peace of mind that they have an insurance policy flexible enough to keep up with their world.

Managing our risks

We have a comprehensive risk management framework in place to ensure we have a strong understanding of the risks we run in the course of our business; and appropriate controls are in place with the aim of ensuring we remain within risk appetite.

Managing risk in line with our strategy

Management, with oversight and challenge from the Board, is responsible for developing our strategy. Our strategic planning process aims to ensure we have developed clear objectives and targets, and identified the actions needed to deliver them, including the management of risk. The delivery of a strategic plan will, by its very nature, result in risks and therefore understanding and managing those risks appropriately is a key aspect of the strategic planning process. The Group's risk strategy is aligned with the Group strategy and supports business decision-making through the proactive identification, assessment and management of risks. The Group's risk strategy is consistent with our overall long-term ambition of sustainable growth and at least a 15% RoTE per annum delivered while remaining within our risk appetite.

Our risk governance framework

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

Our First Line of Defence is management who are responsible for owning and managing risks to achieve our business objectives on a day-to-day basis. The Second Line of Defence is the Risk function which is responsible for the design and implementation of the Enterprise Risk Management Strategy and Framework ("**risk management framework**"), and for providing proportionate oversight of, and challenge to, the business's handling of risks, events and management actions. Group Audit is the Third Line of Defence, providing an independent and objective view of the adequacy and effectiveness of the Group's risk management, governance and internal control framework.

The Group's governance structure is set out in more detail in the corporate governance section.

Risk appetite

Our risk appetite statements define the risks we are prepared to accept to achieve our business objectives. The processes for setting risk appetite, particularly the cascade, assessment, mitigation and reporting of risk exposures against risk appetite, are documented in the Group's policies and underlying minimum standards. To monitor whether the business remains within risk appetite, we use key risk indicators, among other information.

We derive the key risk indicators from the risk appetite statements which are used to drive and monitor risk-aware decision-making.

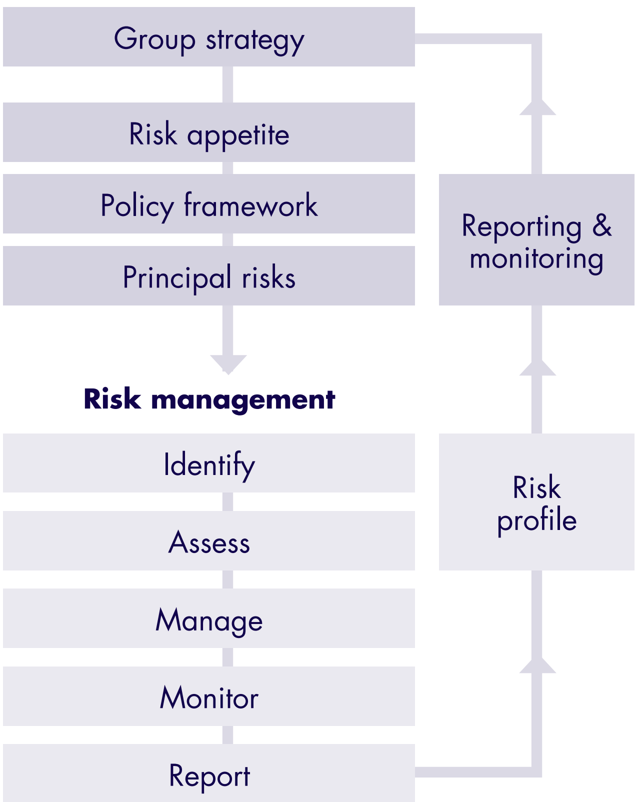
These key risk indicators are qualitative and quantitative, and forward and backward-looking. We review our risk appetite statements and key risk indicators annually.

Risk objective	Risk appetite statement
Overarching risk objective	The Group recognises that its long-term sustainability is dependent on having sufficient economic capital to meet its liabilities as they fall due, thus protecting its reputation and the integrity of its relationship with policyholders and other stakeholders. As part of this, its appetite is for general insurance risk, focusing on personal lines retail and small and medium-sized enterprise insurance in the UK. The Group has appetite for non-insurance risks, as appropriate, to enable and assist it to undertake its primary activity of insurance.
Maintain capital adequacy	The Group seeks to hold capital resources in the range of 140% to 180% of the internal model solvency capital requirement. The Group also seeks to maintain sufficient economic capital consistent with its strategic aim of maintaining a credit rating in the 'A' range.
Stable and efficient access to funding and liquidity	The Group aims to meet planned and unexpected cash outflow requirements, including those requirements that arise following a 1-in-200 years insurance, market or credit risk event.
Maintain stakeholder confidence	The Group has no appetite for material risks resulting in reputational damage, regulatory or legal censure, poor customer outcomes, fines or prosecutions, and other types of non-budgeted operational risk losses associated with Group conduct and activities. The Group will maintain a robust and proportionate internal control environment.

Our Enterprise Risk Management Strategy and Framework

This section sets out, at a high level, our approach to setting risk strategy and the risk management framework for managing risks. It documents the high-level principles and practices to achieve appropriate risk management standards and demonstrates the inter-relationships between components of the risk management framework – see diagram.

The risk management framework enables us to manage the business with the necessary understanding of our risks and controls, while also having the appropriate levels of oversight to ensure risks are managed proactively. The risk management framework is aligned to the Three Lines of Defence model, and provides a comprehensive approach for managing our risks. Our Policy Framework is a central part of the risk management framework, and includes policies and minimum standards which provide the context and risk appetite boundaries within which the business conducts its activities.



Our risk culture

Our risk culture underpins our business and decision-making, and helps us embed a robust approach to managing risk. Our risk culture is demonstrated in the understanding and business-wide use of the risk management systems and processes and through risk-aware decision-making. The Board is committed to promoting a culture of high standards of corporate governance, business integrity, ethics and professionalism in all our activities. An annual assessment of risk behaviours and attitudes is undertaken jointly by the Risk function and Group Audit and considers a range of factors influencing risk culture. This process is overseen by the Board Risk Committee on behalf of the Board.

Principal risks and uncertainties

We carefully assess the principal risks facing us. Principal risks are defined as having a residual risk impact of £40 million or more on a 1-in-200 years basis, taking into account customer, financial and reputational impacts.

	Principal risks	Management and mitigation examples
Insurance risk	The risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting. Key drivers of the outlook for insurance risk across our business plan include reserve, underwriting, distribution, pricing and reinsurance risks. See pages 146 to 148	– We set our reserves using the latest internal and external data and trends – Third-party experts review the majority of our reserves – Underwriting guidelines are set for all transacted business, and pricing refined by analysing comprehensive data – Catastrophe and motor excess of loss reinsurance limits our exposure to events and large losses – We invest in enhanced external data to analyse and mitigate exposures – We estimate technical reserves using various actuarial and statistical techniques. Management's best estimate of total reserves is set at not less than the actuarial best estimate
Market risk	The risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments. Key drivers of market risk are the sensitivity of the values of our assets and investments to changes in credit spreads, and our exposure losses as a result of changes in interest rate term structure or volatility. See pages 148 to 151	– We have an investment strategy approved by the Board – We diversify asset classes including by country of risk, and by investing in US dollar assets to broaden the pool of available assets – We set limits on exposure to individual asset classes and the amount of illiquid investments – We carry out an annual matching exercise on our assets and liabilities, which reduces the net impact of interest rate risk as shown in interest rate sensitivities – To limit exposure to credit spread risk, we tightly control individual asset exposures as shown in spread risk sensitivities – We use risk-reduction techniques, such as hedging foreign currency exposures with forward contracts, and hedging exposure to US interest rates with swap contracts
Credit risk	The risk of loss resulting from default in cash inflows and/or changes in market value of issuers of securities, counterparties and any debtors to which the Group is exposed. This includes the risks associated with inadequately diversified portfolios of assets and/or obligations. See pages 151 to 155	– Credit limits are set for each counterparty and we actively monitor credit exposures – We only purchase reinsurance from reinsurers with at least an A– rating. For liabilities with a relatively long period of time to settlement, this rating will be at least A+ – We have well-defined criteria to determine which customers are offered and granted credit

	Principal risks	Management and mitigation examples
Operational risk	The risk of loss due to inadequate or failed internal processes or systems, human error or from external events. The principal risks within this category are information security, partnership contractual obligations, change, outsourcing and technology and infrastructure risks. See page 156	– We have appropriate operational processes and systems, including detection systems for fraudulent claims and appropriate processes which seek to enable operational resilience – We are continuing to work to improve performance and stability of our IT systems while focusing on developing future systems capability. With significant change underway, we are continuing to monitor risks associated with our IT systems' stability, and resilience, cyber security, and the internal control environment – Our risk management framework is designed to enable us to capture risk information in a robust and consistent way – We monitor how risks are managed in the performance of outsourced and off-shored activities
Regulatory and conduct risk	The risks arising out of changes to laws, regulatory rules, policy or interpretation, or to supervisory expectations or approach, that have an adverse operational and financial impact as a result of reputational damage, regulatory or legal censure, fines or prosecutions, and any other type of non-budgeted operational risk losses, associated with the Group's conduct and activities.	– We maintain a constructive and open relationship with our regulators – We use specific risk management tools and resources to help manage our exposure to regulatory risk – We have a strong culture of delivering on our commitments to our customers – Our conduct risk management framework is designed to deliver fair outcomes to customers and minimise our risk exposure – We carry out planned risk-based monitoring of customer processes as well as more targeted thematic reviews which consider strategic or regulatory projects
Strategic risk	The risk of direct or indirect impact on the earnings, capital, or value of the business as a result of the strategies not being optimally chosen, implemented or adapted to changing conditions.	– We agree, monitor and manage performance against the Board-approved plan and targets – The Board leads an annual strategy and planning process which considers our performance, competitor positioning and strategic opportunities – We identify and manage emerging risks using established governance processes and forums

Potential effects of Brexit

The UK is scheduled to exit from the EU on 29 March 2019. At the date of this report there is considerable uncertainty as to how and even whether there will be a Brexit, or at least as to when it will take effect and on what terms. Accordingly there is corresponding uncertainty as to the effect of Brexit on the Group.

If Brexit takes place smoothly, for example involving a transition period during which work would take place at the government level to agree a future trading agreement between the UK and the EU, and accordingly without significant disruption to the UK economy and to business generally, then any adverse impact on the Group (if any) would also not be expected to be significant, at least until the end of the transition period and the future trading arrangements between the UK and the EU being clarified. If, however, the UK were to leave the EU in such a way as to involve or lead to significant disruption, as has been conjectured in the event of a 'hard' no deal Brexit at the end of March, then the impact on the Group could correspondingly also be disruptive and potentially material.

Following the EU referendum result in 2016, which saw the UK vote to leave the EU, the Group established a Brexit Working Group comprising representatives from across the Group. It was identified that there was a risk that the UK could enter a prolonged period of reduced growth due to Brexit, potentially reducing insurance sales and the value of our investment portfolio. Whilst our operations are based mainly in the UK, Brexit-related issues which could impact adversely on the Group could include: changes to the value of sterling which impact claims and non-claims supplier costs; inflation; impacts on credit spreads which in turn could impact on the Group's investments and capital; recruitment and retention of people; impacts on the speed of delivery and cost of goods and services required by the business including for fulfilling insurance claims made by customers, for example because of delays at borders caused by increased border regulations and by additional costs caused by increased tariffs and devaluation of sterling; availability of reinsurers authorised to write business in the UK; data transfers; the removal of the European Health Insurance Card ("**EHIC**") leading to greater reliance on travel insurance; travel disruption; increased use of Green Cards (internationally recognised certificates that act as proof of insurance, including in the EU); potential changes to direct and indirect tax; and the regulatory impact on our capital position.

The Group has proactively considered a variety of possible implications of a disruptive 'hard' Brexit, including of a financial and operational nature; for example:

The impact on the Group's investment portfolio and in particular credit spreads relating to its debt securities and therefore Group solvency: A sensitivity analysis relating to its credit spread is provided in note 3.3.2 to the financial statements (on page 151). The Group has also considered Brexit in its Investment Committee, and further information is provided on the work of the Investment Committee on page 87. A disruptive Brexit could impact adversely on the Group's investments and therefore capital and the solvency capital ratio and the appropriateness of paying dividends.

Procurement and supply chain: In particular as part of the Group's ability to deal with claims made under insurance policies, the Group needs to acquire a wide range of goods and services. A significant amount and spread of goods, for example such as car parts, are sourced from within the EU. The Group has been in discussion with principal suppliers who have taken some steps to increase stocks within the UK in the event of a 'hard' Brexit leading to disruption at borders. However, the Group's ability to deal with claims in its normal ordinary course of business manner could be adversely impacted and there could be delays and extra costs.

The Group has a small amount of business in the Republic of Ireland, servicing a small Irish part of a UK partner's wider business. The Group is well advanced in establishing a formal third-country branch in the Republic of Ireland in order to be able to continue with this business post a 'hard' Brexit, and expects the branch to be authorised for business by the Central Bank of Ireland by the current deadline of 29 March 2019, should that become necessary.

The Group has also been focusing on Brexit from a potential crisis management perspective, with the objective of maintaining operational resilience in the event of a disruptive Brexit and with a view to being able to react better to events as they unfold.

Emerging risks

Our definition of emerging risks is new or developing risks which are often difficult to quantify; they are also usually highly uncertain and external to the Group. Emerging risks are identified by management and the latest information is maintained within an Emerging Risk Register. Each emerging risk is owned by a business subject matter expert and members of the Second Line of Defence provide challenge and oversight of activity taking place. We report emerging risks to the Board Risk Committee for review and challenge. Our emerging risks processes aim to:

- identify emerging risks on a timely basis;
- manage emerging risks proactively;
- mitigate the impact of emerging risks which could affect the delivery of the strategic plan; and
- reduce the uncertainty and volatility of our business's results.

We consider our main emerging risks to be:

Climate change

Climate change poses a range of financial risks to the Group. These can be divided into three categories:

- Physical risks include many weather-related risks arising directly from climate change. These include changes in the frequency and severity of events, floods, storms, freeze, subsidence or wildfire. The Group's use of catastrophe reinsurance mitigates against many of the worst potential impacts and the Group regularly reassesses its use of external catastrophe models to ensure they fully capture climate-related risk.

- Transitional risks arise from efforts to mitigate or adapt to climate change. These include the strategic and operational risks from the transition towards electric-powered vehicles. Whilst insuring electric vehicles does not fundamentally change the business model, the business seeks to develop the new processes, skills and technical knowledge required to keep pace with these changes in technology.
- Liability risks arise when parties, who have suffered losses from climate change, seek to recover from those they believe may have been responsible. There is some potential exposure to liability risk through commercial liability insurance. However, Pollution and Professional Indemnity covers, which carry the highest risk, are almost fully reinsured.

There are also potential physical, transition and liability risks arising through the investment portfolio. During 2018 a significant new initiative was approved to strengthen further the Group's investment strategy with regard to environmental, social and governance issues. More information can be found in the Investment Committee's report on page 87.

Technological developments change consumer needs for insurance

New car technologies, such as crash-prevention aids, car sharing and driverless cars, could significantly affect the size and nature of the insurance market and the role of insurers. The Group continues to build strong collaborative relationships with key manufacturers, and has established an 'In-Car Technology' programme to help manage the response to developing car technology.

Furthermore, the Group's strategic pillars of being a great retailer, smart and efficient manufacturer and leading disrupter, as well as our aim of multi-channel success, help position us to take advantage of changes in technology and customer behaviours, through the development of new capabilities, new partnership capabilities, and by enabling us to have the flexibility to adapt/react to these changes.

Fairness and pricing practices

The FCA is conducting a market study into Fair Pricing in Financial Services and the Competition and Markets Authority has announced plans to take forward a 'package of reforms' to address the 'loyalty penalty' for long-standing home insurance customers, but has concluded that it will not be conducting its own market study at this time.

The Group remains up-to-date with developments from the FCA and the Competition and Markets Authority work on pricing practices and will keep the review in focus throughout 2019 as well as seeking to ensure that the Group continues to maintain fair pricing principles.

Viability statement

In accordance with provision C.2.2 of the 2016 UK Corporate Governance Code, the Directors have assessed the prospects of the Group for a period longer than the minimum 12 months required by the going concern statement.

The Strategic report, on pages 1 to 59, sets out the Group's financial performance, business environment, outlook and financial management strategies. It covers how the Group measures its regulatory and economic capital needs, and deploys capital. You can find discussion about the Group's principal risks and risk management in this section. Note 3 to the consolidated financial statements starts on page 146 and sets out financial disclosures relating to the Group's principal risks. This covers insurance, market and credit risk, and the Group's approach to monitoring, managing and mitigating exposures to these risks.

Every year, the Board considers the strategic plan and an Own Risk and Solvency Assessment ("ORSA") for the Group. The plan makes certain assumptions in respect of the competitive markets in which the Group operates, and the delivery and implementation of the new customer systems. Appropriate aspects of the strategic plan are stress-tested to understand and help set capital and other requirements.

When reviewing the strategic plan, the Board considered the Group's prospects over the period that the plan covered and the conclusions of the ORSA, based on the Group's anticipated activities as set out in the strategic plan. This review included reviews of solvency, liquidity, assessment of principal risks, and risk management over a three-year period, with a further two years of indicative planning. The first year following approval of the strategic plan has greater certainty, so it was used to set detailed budgets across the Group. Outcomes for the subsequent years in the plan are less certain. However, the plan provides a robust planning tool for strategic decisions. The Board recognises that, in a strategic plan, uncertainty increases over time and, therefore, future outcomes cannot be guaranteed or accurately predicted.

Based on the results of these reviews, the Board has a reasonable expectation that the Company and the Group can continue in operation, and provide the appropriate degree of protection to those who are, or may become, policyholders or claimants in the period to 31 December 2022.

ESG – our approach

We aim to drive sustainable outcomes for our stakeholders and in order to deliver this we have developed a five pillar strategy which resonates with our collaborative culture and values. Our approach to environmental, social and governance matters is delivered through our five pillars and the table below shows where information can be found in this annual report and accounts.

Pillars	**Our customers** **Making insurance much easier and better value**	**Our society** **Playing an active role in issues that affect our society**	**Our planet** **Reducing, reusing and recycling to build a sustainable future**
Initiatives	Tailored brands p.5 Routes to market p.9 & 19 Renewal pricing principles p.18 & 21 Customer focus p.22, 52 & 81 Propositions p.39, 41, 42 & 43	Autonomous vehicles p.21 Young drivers p.54 & 85 Road safety p.53 & 85 Women in Finance p.58 Supporting charities p.53, 54, 85 & 86	Recycling coffee cups p.55 Environmental Champions p.55 Investment in green bonds p.54 & 87 Travel free weeks p.55
Disclosures	Net promoter score p.25 & 52 Customer complaints p.25 & 52 Non-financial KPIs p.25	Paying tax p.37 & 54 Recycling p.55	Emissions p.20, 55, 85 & 120 Waste p.55 Climate change p.48, 49 & 55
Policies	Connect training p.20 Customer approach p.61 Data protection p.81	Prompt payment code p.54 Ethical investment p.54 & 87	Upgrading our buildings p.20 Diverting 100% of office waste p.55 Commitment to 100% electricity from renewable sources p.55

Our stakeholders

The Board believes that adopting a business model that is sustainable in the long term and based on high ESG standards is important for promoting the success of the Company. In discussing and approving the Group's strategic and financial plan, the Board considers the potential impact on all stakeholders in the business, including employees, customers, suppliers, the communities with which we interact and the environment, as well as the shareholders for whom we aim to continue generating returns on investment. You can find more detail about the stakeholder matters discussed by the Board when considering the strategic plan on page 66.

Our culture as a business flows from the beliefs underpinning the five pillars of our approach to Responsibility, which are set out in this section.

Our people

Investing in our talented people, encouraging everyone to aim higher

Diversity and inclusion p.58

Employee Representative Body p.56 & 61

Employee ideas forum p.57

Mental health/wellbeing p.59

Women in Finance Charter p.58

Values p.60

Employee surveys p.17 & 56

Gender pay gap p.58 & 59

Living wage p.58

Diversity and inclusion p.73 & 85

Annual Incentive Plan p.58

Employee share ownership p.16 & 58

Development and training p.20 & 59

Parental leave and flexible working p.57

Our governance

Creating a long-term business that serves all of our stakeholders

Culture and values p.60 & 61

Board (leadership and diversity) p.66, 67 & 73

Risk governance p.44 & 45

ESG p.85 & 86

Strategic planning p.68

Remuneration p.61 & 88

Board effectiveness p.70

Auditor fees p.79

Committee structures p.68 & 69

UK Corporate Governance Code p.66

Stakeholder interests p.66

Whistleblowing p.82

Modern Slavery Act p.86

Anti-bribery and corruption policy p.82

Risk governance p.82

Code of business conduct p.61

ESG Oversight

Board

The Direct Line Group Board oversees all of the Group's ESG activity. It has delegated particular aspects of this supervision to its Committees.

The **Remuneration Committee** determines remuneration for senior management and reviews workforce remuneration.

The **Corporate Social Responsibility Committee** focuses on the Group's responsibility for the environment, the community and the wellbeing and engagement of its people.

The **Investment Committee** considers the strategy for incorporating ESG factors into the Group's investment management.

The **Board Risk Committee** oversees all aspects of financial, regulatory and operational risk, including the long-term risk to the Group of climate change.

The **Audit Committee** focuses on sustainability in the Group's financial disclosures.

The **Nomination Committee** monitors developments in governance and investor ESG expectations, as well as being responsible for Board succession planning.

More information about the activities of each of the Committees can be found in the Committees' reports on pages 76 to 87.

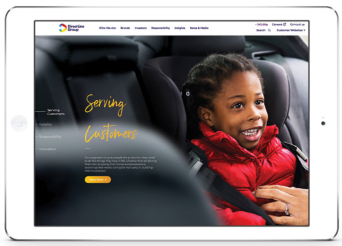
Non-financial information statement

This diagram sets out where stakeholders can find information in our Strategic report that relates to non-financial matters, as required under the new regulations[1] on reporting non-financial information.

Our business model, pages 22 & 23

Principal risks and impact on business activity pages 44 to 49

1. The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016, SI 2016 No 1245.



Further information on our ESG pillars, strategy and full disclosure can be found online at www.directlinegroup.co.uk/en/investors/esg.html

Long-term sustainability for our stakeholders

Under the leadership of our Board, responsibility is at the heart of how we think about our business. Our five pillar ESG strategy ensures that we target delivering long-term sustainability for our customers, our people and our shareholders and that we consider the impact we have on our society and our planet.

Our approach to responsibility is structured around five pillars:

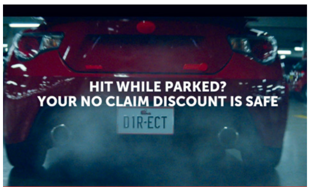
Our customers	Our society	Our planet	Our people	Our governance
Making insurance much easier and better value	Playing an active role in issues that affect our society	Reducing, reusing and recycling to build a sustainable future	Investing in our talented people, encouraging everyone to aim higher	Creating a long-term business that serves all of our stakeholders
See page 52	See pages 53 – 54	See page 55	See pages 56 – 59	See pages 60 – 121

Our customers

Customers are at the heart of everything we do, and as such our work in pursuit of making insurance much easier and better value for our customers is highlighted throughout this report. You can read about our brands, products and channels on the following pages. Our latest customer propositions can be found on pages 39 and pages 41 to 43 and our strategy in action on pages 20 and 21 outlines how we are delivering outcomes for our customers.

We've built a reputation for delivering for our customers by regularly developing new and different ways to make our products easier and better value for our customers. Propositions such as our Churchill Vandalism Promise, Direct Line's Fair Claim Commitment or Fast Response are ways of making insurance easier and we've used training to help our people have far more empathetic and powerful conversations with our customers.

We recognise that our customers are always raising their expectations and one of our values is to "aim higher". The relationship between NPS and customer retention shows there's a direct link between customer experience and our success as a business and that's why this year we launched an initiative designed to help us identify, meet and exceed customer expectations when we make decisions and choices about how we run our business.



See Motor on page 38

See Rescue and other personal lines on page 42

See Home on page 40

See Commercial on page 43

One claim every single minute of every single hour, every day of the year

Our society

Brake and PACTS

We continue to engage with important partners in the road safety debate, including road safety charity Brake, the Parliamentary Advisory Council for Transport Safety ("**PACTS**") and the Department for Transport.

We remain a committed partner to the road safety charity Brake, campaigning throughout the year to make our streets safer.

Working with politicians, our partnership has raised the profile of local campaigns leading to meaningful change in constituencies throughout the UK. Highlights this year have included the introduction of 20 mph zones near schools, reducing the speed limit on major A roads and tackling speeding on rural roads through greater law enforcement.

We celebrated the successes at Brake's annual parliamentary reception with hundreds of Brake supporters, volunteers and parliamentarians.

Sprintathon

422 of our people took part in a Sprintathon this year, where they ran 100m sprints to cover the marathon distance of 26.2 miles. Our aim was to complete a marathon in the shortest possible time and, more importantly, raise money for Stand Up to Cancer.

An astounding £60,000 was raised for Cancer Research UK, who carry out work that accelerates new cancer treatments and tests for UK patients, and patients across the world, to ultimately save more lives.

Our people pulled together to get involved in this great cause and it was an engaging and rewarding group experience where each individual effort combined to fight cancer. This was a fun and collaborative way to really live our value of 'Working Together'. The marathon was completed in under two hours and there's not many people in the world who can say they achieved that!

Steve Maddock, our Chief Operating Officer, and Judith Cummins MP, who was awarded Brake and Direct Line Group's Parliamentarian of the Year Award and who campaigned for tougher sentences for dangerous drivers.

422
of our people took part

£60,000
raised for Cancer Research UK

Shotgun

As Britain's leading personal motor insurer we want, for both our customers and society, to keep Britain's roads safe. This is particularly true for young drivers where inexperience often leads to more accidents.

The facts are stark:

- The part of the brain that helps assess risk is not fully developed until we reach our mid 20s
- 17 to 19 year olds are involved in 9% of all fatal and serious crashes, despite representing just 1.5% of all drivers
- One in four 18 to 24 year olds crash within two years of passing their driving test

That's why we developed our driving app called Shotgun with the aim of cutting the number of young driver deaths to zero in the first 1,000 miles after passing their test, even if they insure their car with someone else.

Shotgun's real-time feedback after every journey has already led to driver improvement on important safety metrics such as speeding, braking and smoothness.

There is clearly demand for Shotgun, which rewards drivers for good driving. With over 27,000 downloads since launch, we've analysed 3.6 million car journeys covering 32.8 million miles, helping young drivers to be safer on our roads.

One Day

We give every colleague the opportunity to do a full day each year out of the office either individually or as a team, to volunteer for a charity or a community group day.

Our One Day initiative is hugely popular, giving everyone the time to support causes they are personally dedicated to.

This year several of our people supported our national charity Mind, by taking part in a Retail Challenge, where teams competed against each other to raise the most money for the Mind shop they worked in.

One of Direct Line Group's teams competing in Mind's Retail Challenge.

Financial responsibility

Responsible investing

As the Group's investment strategy evolves, it is constantly looking for ways to enhance its investment practices with regard to ESG issues.

To date, the Group's investment strategy has reflected the following initiatives:

- Approximately 95% of externally managed assets are run by managers who are currently signatories to the United Nations-supported Principles for Responsible Investment
- Almost 90% of the investments in the infrastructure debt portfolio are in schools, hospitals and other social infrastructure assets
- The commercial property portfolio invests only in assets with an energy efficiency level of D or higher (or with apportioned funds to achieve this level), exceeding the government minimum requirement of an E rating

During 2018 a significant new initiative was approved to strengthen further the Group's ESG credentials:

- In the first half of 2019, the majority of investment grade bond mandates will transition to be managed against ESG weighted indexes
- Investment guideline amendments now instruct the portfolio managers to prefer investment in green bonds where they offer a similar risk-reward profile to other issues

The Investment Committee's section of the Annual Report can be found on page 87.

Tax

As part of our contribution to society we believe that it is important to pay the appropriate amount of tax and manage our tax obligations responsibly. For the first time, this year we are publishing the Group's total tax contribution of £961.7 million, which includes the Group's direct and indirect tax contribution as well as amounts collected on behalf of the UK Exchequer. See the full tax contribution note and tax strategy on page 37.

Suppliers

The Prompt Payment Code sets out standards for payment practices for the benefit of suppliers. The Group is committed to maintaining the highest possible standards of integrity with suppliers and partners and is a long-standing signatory of the Prompt Payment Code. During the financial year, the Group remained committed to prompt payment terms to ensure fair payment practices.

Our diversity and inclusion practices are in line with the Universal Declaration of Human Rights. Our Ethical Code for Suppliers requires that all our suppliers adhere to the core International Labour Organisation standards. We support the aims of the Modern Slavery Act 2015 and are committed to ensuring that modern slavery is not present in our supply chain.

Our planet

Environmental credentials

Our 'Reduce, Reuse, Recycle' strategy guides the Group in meeting its environmental objectives. Simple changes have proven successful:

- Targeting a 30% reduction in energy consumption by 2020 against a 2013 baseline
- Introducing 'travel free weeks' reducing our CO_2 emissions
- Diverting 100% of office waste from landfill
- Maintaining our commitment to source 100% of our electricity from renewable sources

This year we have taken further steps to build a sustainable future.

Recycling coffee cups

The popularity of coffee presents a recycling challenge for a company our size.

That's why we have partnered with a company called Simply Cups, which works with companies to help them separate the plastic film that can make recycling difficult. We have successfully introduced a pilot in our Bromley office where dedicated recycling points are encouraging our people to use them throughout the building. Simply Cups collects our cups and sends them to a specialist processor which enables us to recycle 20,000 cups per month.

Environmental Champions

To further entrench the importance of sustainability across the Group we have appointed 10 'Environmental Champions' in our core sites. Working with the Institute for Environmental Management they have received accredited training, increasing their awareness of how sustainability issues affect the workplace. They are using this knowledge to discuss a range of environmental issues and drive change across the Group.

Emissions

You can find information on Group-wide greenhouse gas ("**GHG**") emissions in the chart below – and more details of our emissions in the Directors' report on page 120.

In absolute terms, we have reduced our emissions significantly after rationalising and implementing an energy-savings plan across our estate over the last six years, resulting in a 46% reduction in GHG emissions.

We communicate the details of a carbon management programme through the Carbon Disclosure Project and this year achieved a rating of 'B'.

Waste

We remain focused on improving our waste management systems. In 2018, 98% of total waste produced across the Group was recycled or recovered for energy use. This compares with 72% last year.

Climate change

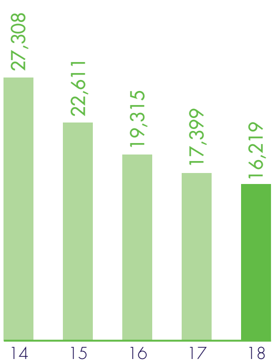
The Group's use of catastrophe reinsurance mitigates against many of the worst potential physical risks from climate change, and the Group regularly reassesses its use of catastrophe models with the objective of ensuring they fully capture climate-related risks.

Efforts to mitigate against climate change are driving a de-carbonisation of the economy, including a transition towards electric vehicles. While this does not fundamentally change the business model, the Group continues to develop the new processes, skills and technical knowledge required to keep pace with changes in vehicle technology.

The Group has reviewed its investment strategy, deciding that a greater weighting should be given towards issuers with stronger ESG credentials (including climate change). More information can be found in the Investment Committee's section of the Annual Report on page 87.

Our Head Office in Bromley is successfully recycling 20,000 coffee cups per month.

Greenhouse gas emissions (tonnes)



Our people

We are nothing without our people. We employ thousands of people throughout the UK who use their skills and expertise to help make insurance much easier and better value for our customers.

We know that to remain a successful business we must reflect the customers we serve on a daily basis. We are proud of our diversity and actively encourage people to celebrate the different personalities that make up the Group. It is central to our values and our identity.

We have an open culture of dialogue between management and staff at all levels. This is underpinned by an Employee Representative Body ("**ERB**") which is made up of colleagues elected by their peers to represent their views at divisional and company-wide level. As of October 2018 our gross staff turnover rate was 16.5%.

It is one of the reasons why we have such an engaged and motivated workforce, with 90% of employees taking part in our employee opinion survey this year.

Yet again we saw positive results, with an increase in our full engagement score from 78% to 81% – 36 percentage points higher than when we first ran the survey in 2014.

The percentage of employees who are proud to work for the Group also increased from 91% in 2017 to 92%, while 87% tell others that the Group is a great place to work (85% in 2017).

92%

of employees are proud to work for the Group

I'm shaping the way we deliver our future recruitment programme. The fantastic technology we can use for video interviews will really move us into the digital era.

CHRISTINE SWIFT
RECRUITMENT TEAM MANAGER, LEEDS

I love how customer focused the business is. It is very open to feedback, encouraging everyone to put forward ideas to improve the customer journey.

DIPIKA BAJWA
CUSTOMER SERVICE ADVISOR, LEEDS

When we receive damaged cars I prepare, paint and polish vehicles to the manufacturer's standard. We have a great working environment here, being part of a team that cares for its customers and employees.

JASON HODGSON
PAINT TECHNICIAN, DLG AUTO SERVICES, WELWYN GARDEN CITY

Best Companies results

We came third in the 'Best Big Companies to Work For' award in the prestigious Sunday Times list 2019. This has come from a collective belief that having a great team of highly engaged people pulling in the same direction will deliver better results for customers, and in turn, great results for shareholders. For more information see www.b.co.uk/the-lists/big-companies.

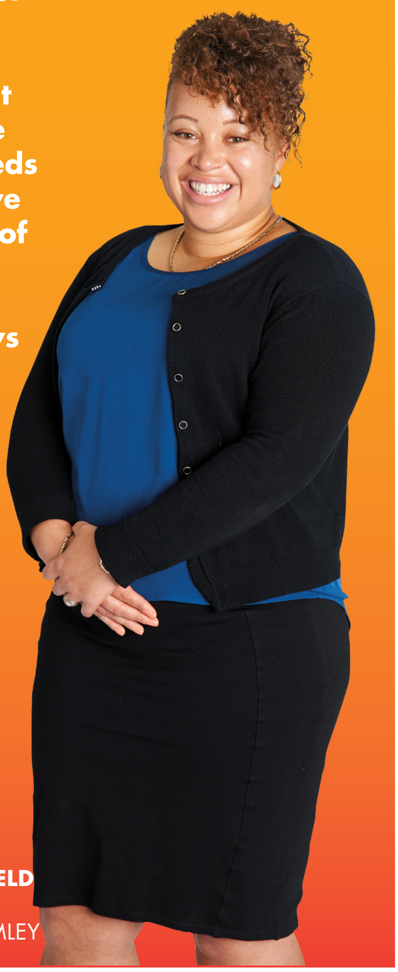
My life

We understand that work doesn't always come first. We're all human beings with our own families, people we care for, other responsibilities and dreams to follow. We launched a new set of policies, designed to be simple and flexible, to help our people focus on what matters to them.

- Employees with at least one year's service receive full pay during the first 20 weeks of maternity and adoption leave
- Shared parental leave and pay mirrors our maternity and adoption benefits; our employees can ask to split their leave into shorter periods with periods of work in between, to help settle back in as easily as possible
- Up to 12 weeks' full pay as part of a phased return to work following a period of maternity/adoption/shared parental leave for all employees
- Two weeks' paid paternity leave for all employees
- Up to four weeks' unpaid parental leave each year is also available to all parents, carers and grandparents
- A period of paid compassionate leave can be agreed for anyone
- Paid time off and/or flexible working arrangements can be agreed during IVF investigations and treatment
- Up to 12 months unpaid lifestyle break for anyone wishing to pursue something that really matters to them

We know that successful businesses are the ones that offer greater flexibility and take meaningful steps to help people achieve this. We are proud of being one of the first 10 companies to back a campaign calling for large firms to publish policies on their external websites.

"I help monitor and oversee the risk management decisions the business needs to take. I love the breadth of what we do as a team, we're always thinking differently.



LAURA BROMFIELD
INSURANCE RISK MANAGER, BROMLEY

Idea Lab

The Group runs Idea Lab, rewarding employees who generate solutions to improve our customers' experience and make the business more efficient. This has empowered people to think differently and share their creativity.

Some of the highlights include:

- Giving our drivers tool kits when returning vehicles to customers in case any further minor damage arises on the delivery which can be instantly fixed
- Improving efficiency with extra vehicle checks for our Green Flag business
- Using dedicated social media pages to alert customers to fraud trends

#thinkdifferently idea lab

This year we celebrated three years of success with over 5,900 ideas.

£3.25 million
Saved for the business

£137,000
Awarded to our people

£27,300
Donated to charity

Diversity and inclusion

Building a diverse and inclusive culture takes multiple initiatives to work together. We remain focused on bringing in new methods to improve our performance, ensuring that all employees take ownership in communicating the importance of inclusive behaviour.

To challenge ourselves, we took the step this year to sign an industry-wide pledge that sets out expected minimum standards of inclusive behaviour. It commits us to speak up and call out inappropriate or discriminatory behaviour, even when it is uncomfortable to do so.

Diversity

The Group is proud of its Diversity Network Alliance ("**DNA**"), the employee network which champions diversity and inclusion in our business.

We are building inclusive leadership programmes for all managers to assist them in managing their teams. Senior leadership teams are also setting specific diversity commitments aligned to their function's needs, including, but not limited to, recruitment and performance decisions.

This year our recruitment team has received training on removing gender-biased language when advertising for roles, including how to use tools which identify gender specific wording.

Pay

In April the Group reviewed its pay structure and introduced a new company-wide minimum base salary of £18,000 for full-time colleagues, 6% higher than the Living Wage and 18% higher than the National Minimum Wage.

As of April 2018, our median gender pay gap was 15.4% compared to the financial services industry average of 22%.

Annual Incentive Plan

The Group's AIP ensures that all our people are judged on the basis of delivering against our Customer Experience and People agendas. We know that a good customer experience means that people are more likely to recommend us to others. This is why the Group's Customer Experience agenda is focused on making it easy for customers when they take out cover, need to make a claim or require complaints to be resolved swiftly. We are only able to deliver this due to our people, which is why we place a sharp focus on diversity and inclusion and regularly engage with our people throughout the year. The AIP therefore ensures a strong link between pay and the Group's performance on these specific metrics.

Employee share incentive scheme

All colleagues are able to benefit from an attractive Buy As You Earn scheme. Our people are rewarded with a top up share for every two they purchase, incentivising people to benefit from the Group's success.

Colleagues have also benefited from free share awards. In March 2018 colleagues received a £500 free share award to celebrate the Group's anniversary of its launch on the London Stock Exchange; this is in addition to three separate share awards made in previous years. These schemes are equivalent to an Employee Stock Purchase Plan and Employee Stock Ownership Plan in the US.

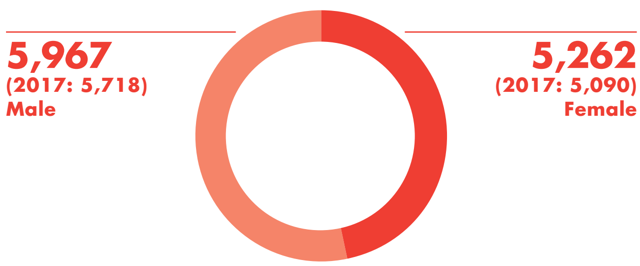
Women in Finance Charter

The Group made significant progress against the Women in Finance Charter commitment of 30% females in senior leadership positions by 2019, and in 2018 we achieved 28%. This improvement has come from a combination of external hires (utilising methods such as gender balanced shortlists), and internal promotions, which will continue by utilising the Group's new cross functional talent mobility forum.

Hampton Alexander Review

The Hampton Alexander Review set targets for FTSE 350 companies to have at least 33% women on their Board and in leadership positions by 2020. The Group is ranked 13th in the FTSE 100 for female Board representation, with 42% of the Board being female. This exceeds the target ahead of time. Within the FTSE 350 Non-Life Insurance sector, we are ranked 1st for female Board representation and 4th for combined Executive Committee and direct reports to the Board.

Gender diversity of all employees



Gender diversity of senior managers

Mental health and wellbeing

Stress, depression and mental health issues are unfortunately increasingly common in the UK. Mental health is central to the Group's Wellbeing Strategy. We give our people immediate access to free and confidential support, with professional, independent and impartial information and counselling. Staff can also talk to our external provider about any issue including stress, work issues, finances, family or personal crises or anything else that is on their mind.

There are a number of steps we have put in place to help us all feel comfortable discussing mental health and raise awareness:

- Our Mental Health First Aider's programme, training over 135 mental health first aiders, meaning we now have at least one on every floor, in every site. This has been supported by training our people managers on mental health and resilience through our 'Engage' programme
- Formed a partnership with the charity Mind in England and their partner charity the Scottish Association for Mental Health with the ambition of raising £100,000, which has the potential to fund 13,000 people in a time of need via Mind's national helpline
- Became a gold partner of This Can Happen, a charity focused specifically on tackling mental health issues in the workplace
- Backed the 'Where's Your Head At?' campaign calling for mental health provision in the workplace to be put on an equal footing with physical first aid
- Our #ThisIsMe campaign has encouraged open and honest discussion about challenges some of our people face daily
- Ran successful lunchtime sessions, exercise classes, holistic treatments and mindfulness sessions during Mental Health Awareness Week
- Ran our first Mental Health First Aider's conference allowing 650 colleagues to come together and collaborate with renowned mental health campaigners

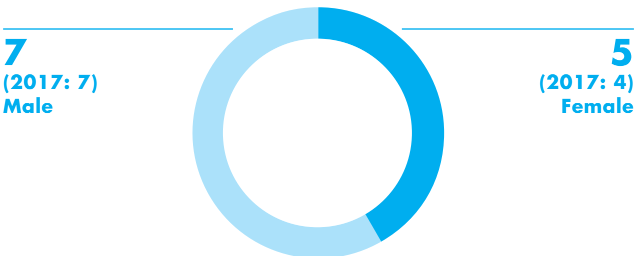
Find out more at https://www.directlinegroup.co.uk/en/responsibility/people/mental-health-and-wellbeing.html

Graduate and apprenticeship programmes

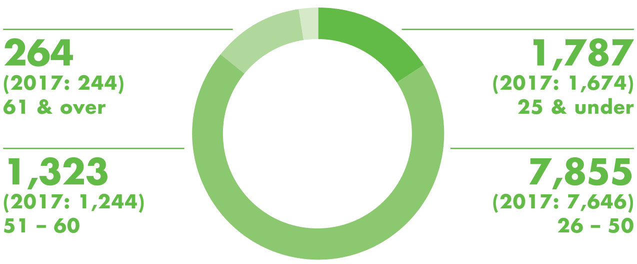
Our graduate programme continues to develop the next generation of leaders. We currently have over 100 graduates placed across the business, gaining first hand experience in areas such as Underwriting, Risk, Claims and customer facing roles. Regular rotation gives them deep insight into the Group's overall business strategy and changing consumer needs.

We also have 285 apprentices gaining technical expertise across various functions including Pricing, Auto Services and Human Resources. Their development is supported by the opportunity to study for vocational qualifications, allowing our apprentices to become established in the business.

Gender diversity of Board of Directors



Age range of employees



Statement of the Directors in respect of the Strategic report

The Board reviewed and approved the Strategic report on pages 1 to 59 on 4 March 2019.

By order of the Board

PAUL GEDDES
CHIEF EXECUTIVE OFFICER
4 March 2019

PENNY JAMES
CHIEF FINANCIAL OFFICER
4 March 2019