Direct Line Group

IFRS 17 & IFRS 9

12 December 2022

The fundamentals of our business are unchanged

1. IFRS 17 does not change the economics of the business and dividend paying capacity
2. Presentational changes aimed at aiding comparability between insurers
3. Accounting policy choices brings IFRS 17 earnings recognition closer to Solvency II capital generation
4. Modest impact on total equity at transition with reserve strength expected to be similar at c. 75% confidence level
5. Moving to net insurance margin as a key performance indicator as it more closely resembles how we run the business; updated targets to be disclosed at FY 2022 results

Implementation on track

Report under IFRS 17 & 9 with 2022 comparatives restated

12 December 2022
IFRS 17 & 9
teach-in

1 January 2023
IFRS 17 & 9
go live

7 March 2023
FY 2022 results
and IFRS 17
targets published

Transition guide to be included in 2022 annual report

2 August 2023
HY 2023 results
published

5 March 2024
FY 2023 results
published

IFRS 17 & 9 overview

IFRS 17 Insurance contracts

IFRS 17 is a comprehensive accounting standard for insurance contracts and replaces IFRS 4 and is effective from 1 January 2023

The standard establishes new principles for the recognition, measurement, presentation, and disclosure of insurance and reinsurance contracts

- The new standard aims to:
  - Ensure consistent accounting for all insurance contracts
  - Increase transparency in financial reports
  - Improve alignment with accounting across different industries
- The key principles are:
  - Best estimate of expected future cash flows discounted for time value of money
  - Allowance for risk associated with those cashflows
  - No recognition of profit until services provided
  - Timely recognition of expected losses on onerous contracts

IFRS 9 Financial instruments

IFRS 9 is a new accounting standard covering the classification and measurement of financial assets after initial recognition and replaces IAS 39

The standard includes requirements:

- Recognition and measurement
- Impairment derecognition
- General hedge accounting

IFRS 9 requires entities to recognise credit losses long before a default occurs, in contrast to IAS 39 which permitted the recognition of losses post a default event.

The adoption date is consistent with IFRS 17, due to interrelationships between the two standards

IFRS 17 changes the way results are presented in the income statement

IFRS 17 income statement (management view) - key line items	
Net insurance contract revenues	Replaces net earned premium and includes elements of other income
Net insurance contract claims	
Other insurance service expenses	
Insurance service result	Replaces underwriting result and includes some other income and becomes the numerator for KPIs
Investment income, other non insurance income and expenses	
Operating profit	
Finance income / expenses from insurance contracts, fair value movements and impairments	New elements capture changes in fair value of assets and movements of discounting on liabilities in one place
Restructuring and one-off costs	
Finance costs	
Profit before tax	

All numbers in this presentation are unaudited
See glossary on slide 15

Key accounting policy choices will improve comparability with SII

Topic	IFRS 4 & IAS 39 policy	IFRS 17 & 9 policy	Alignment with Solvency II
Premiums	• Unearned premium reserve held on the balance sheet with premiums earned on a straight-line basis	• Premiums will continue to be earned on a straight-line basis and qualify for the **Premium Allocation Approach** (PAA)	• **Partial alignment:** Similar premium recognition and earning but different underlying principles with respect to profit recognition of unearned business
Acquisition costs	• Current standard requires the deferral of acquisition costs over the coverage period with DAC asset held on balance sheet	• Acquisition **costs will be expensed as incurred**, not capitalised in the balance sheet	✓ **Full alignment:** Deferral of acquisition costs is not admissible
Discounting of claims	• Only PPO reserves are discounted • The unwind of the discount is recognised as a prior year claims expense	• **All claims will be discounted** using PRA risk free yield curve plus an illiquidity premium • The unwind of the discount and any change in the discount rate is recognised within finance income / expense	• **Close alignment:** All claims are discounted using the PRA risk free yield curve with / without volatility adjustment depending on the line of business
Debt securities	• Unrealised gains and losses are recognised in other comprehensive income	• **Unrealised gains and losses will be recognised in the income statement** within finance income / expenses	✓ **Full alignment:** Debt securities continue to be measured at Fair value with unrealised gains and losses impacting own funds

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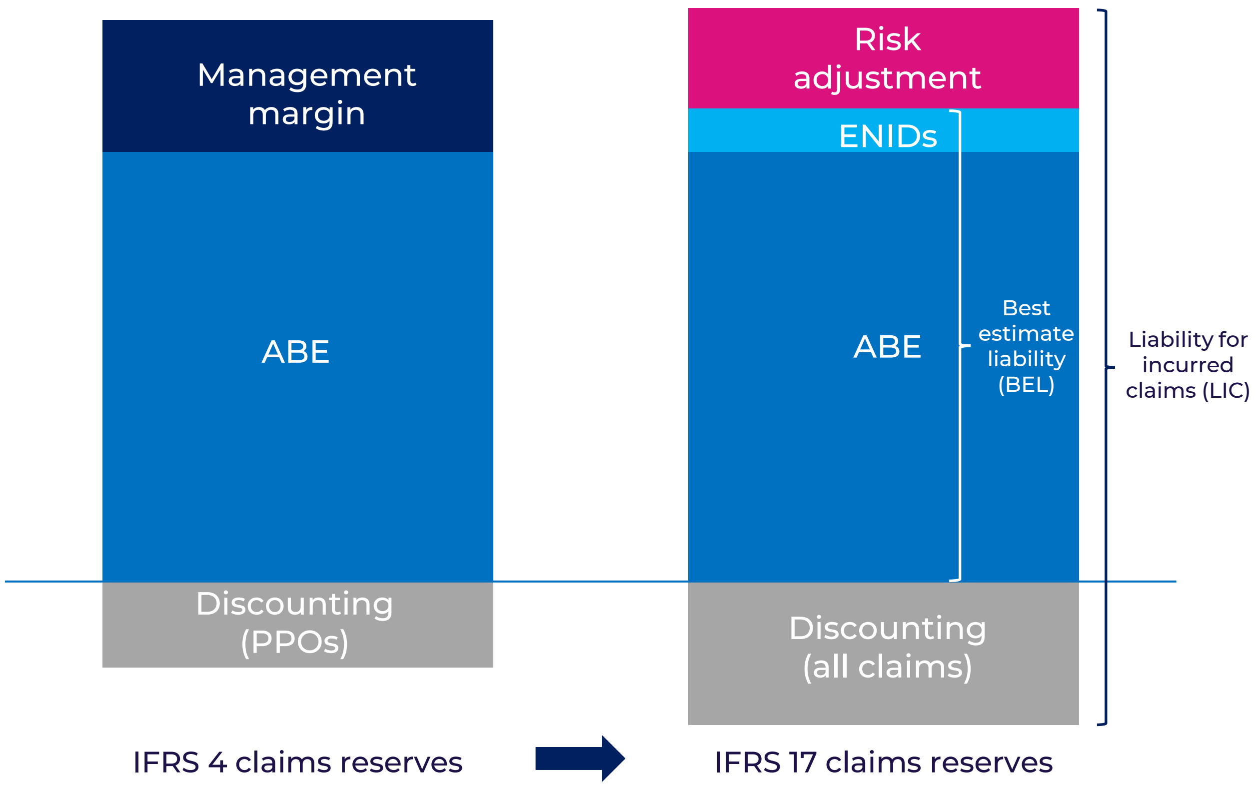
Similar level of reserve confidence as management margin is removed and events not in data are added



Management margin is removed and events not in data (ENIDs) are added

A risk adjustment (RA) is applied at the c. 75% confidence level and all claims liabilities are discounted

IFRS 17 income statement by line item

IFRS 17 & IFRS 9 income statement (management view)	
Insurance contract revenue	1
Expenses from reinsurance contracts held	
Net insurance contract revenues	
Insurance claims	
Insurance claims recoverable from reinsurers	
Net insurance contract claims	2
Acquisition costs	3
Operating expenses	
Insurance service result	4
Investment income	5
Other operating income	6
Other operating expenses	
Operating profit	7
Investment unrealised fair value gains / (losses)	
Investment impairments to financial instruments	
Net finance expenses from insurance contracts	
Net finance income from reinsurance contracts	
Net finance expenses and FV and impairments	8
Restructuring and one-off costs	
Finance costs	
Profit before tax	9

1. Revenue recognition materially unchanged but inclusion of instalment income and elements of other income **increases** this compared with NEP
2. Reserve philosophy unchanged but **claims reduce** primarily due to greater discounting effect. Also includes majority of other income that is claims related
3. **Acquisition costs expensed as incurred** and other operating expenses directly attributable will form part of the Insurance service result
4. **Insurance service result** is similar to existing underwriting result plus the majority of other income
5. **No material change**; income earned from invested assets and realised gains and losses. Unrealised FV gains, losses and impairments reported below operating profit
6. Revenue from non-insurance activities such as intermediary services and expenses not attributable to the fulfillment of insurance contracts, will **sit outside of the Insurance service result**
7. Similar to existing operating profit but **benefits from** greater discounting effect with the unwind of discount rate included in net finance expenses
8. Movements previously captured in OCI and new discounting effect thus **increasing volatility**
9. **More closely resembles pre-tax capital generation under SII**

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IFRS 4 income statement to IFRS 17 income statement

Direct Line Group

IFRS 4 income statement (management view)	
A	Gross earned premium
B	Reinsurance premium
	Net earned premium
C	Insurance claims
D	Insurance claims recoverable from reinsurers
	Net insurance claims
E	Commission expenses
F	Operating expenses
	Total expenses
	Underwriting result
G	Investment return
H	Instalment income
I	Other income
	Operating profit
J	Restructuring and one-off costs
K	Finance costs
	Profit before tax

Income relating to claims

Insurance expenses

Income from intermediary services

Non-insurance expenses

IFRS 17 & IFRS 9 income statement (management view)	
A + H + I	**Insurance contract revenue**
B	Expenses from reinsurance contracts held
	Net insurance contract revenues
C + I + L + M	Insurance claims
D + L + M	Insurance claims recoverable from reinsurers
	Net insurance contract claims
E	Acquisition costs
F	Operating expenses
	Insurance service result
G	Investment income
I	Other operating income
F	Other operating expenses
	Operating profit[1]
G + P	*Investment unrealised fair value gains / (losses)*
G	*Investment impairments to financial instruments*
N	*Net finance expenses from insurance contracts*
O	*Net finance income from reinsurance contracts*
	Net finance expenses and FV and impairments
J	Restructuring and one-off costs
K	Finance costs
	Profit before tax

We'll continue to report GWP

New IFRS 17 elements

- L Loss component (onerous contract)
- M Removal of management prudence and inclusion of ENIDs / risk adjustment
- N Unwind of discounting on gross claims +/- rate change
- O Unwind of discounting on reinsurance recoveries +/- rate change
- P Unrealised gains and losses on debt securities

No change

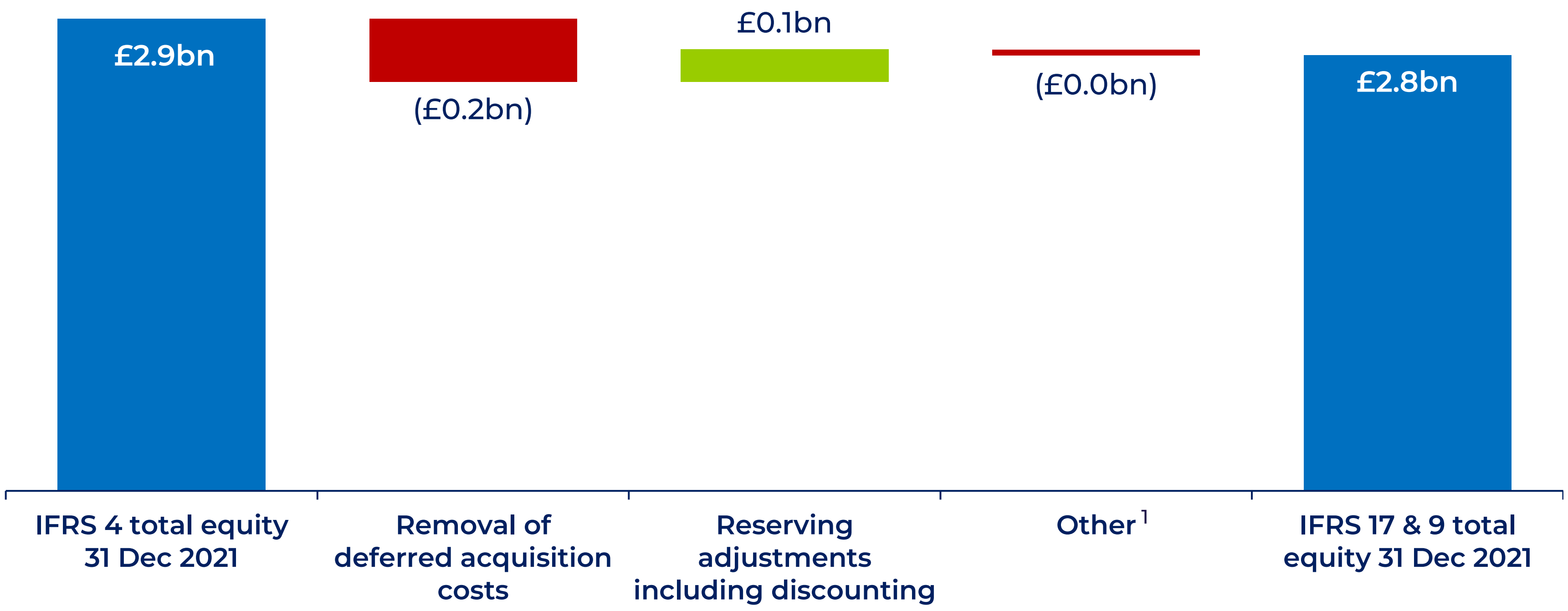
1. Alternative performance measure

All numbers in this presentation are unaudited

See glossary on slide 15

Modest impact of transition on total equity primarily due to treatment of acquisition costs

- **Total IFRS equity (pre-tax) expected to reduce by c. 4% with adjustment recognised in retained earnings**
- **No impact on Solvency II own funds with the exception of anticipated current / deferred tax**



1. Includes instalment income adjustment and expected credit losses under IFRS 9

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See glossary on slide 15

KPIs: Net insurance margin to become key ratio

IFRS 17 & IFRS 9 (management view)	
Insurance contract revenue	
Expenses from reinsurance contracts held	
Net insurance contract revenues	
Insurance claims	
Insurance claims recoverable from reinsurers	
Net insurance contract claims	A
Acquisition costs	B
Operating expenses	C
Insurance service result	
Investment income	
Other operating income	
Other operating expenses	
Operating profit[1]	
Net finance expenses and FV and impairments	
Restructuring and one-off costs	
Finance costs	
Profit before tax	

Net insurance contract revenues becomes the denominator replacing net earned premiums

$$\text{Net insurance margin} = \frac{\text{Insurance service result}}{\text{Net insurance contract revenues}}$$

A **Net insurance claims ratio[1]**

Net insurance contract claims / Net insurance contract revenue

B **Acquisition ratio**

Acquisition costs / Net insurance contract revenue

C **Expense ratio**

Operating expenses / Net insurance contract revenue

Targets for KPIs under IFRS 17 to be disclosed alongside FY 2022 results

1. Current year loss ratio, weather and prior year loss ratio will continue to be reported
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Appendix

Statutory consolidated income statement presentation

IFRS 4 consolidated income statement
Gross earned premium
Reinsurance premium
Net earned premium
Investment return
Instalment income
Other operating income
Total income
Insurance claims
Insurance claims recoverable from reinsurers
Net insurance claims
Commission expenses
Operating expenses (incl. restructuring and one-off costs)
Total expenses
Finance costs
Profit before tax
Tax charge
Profit for the year

IFRS 17 & IFRS 9 consolidated income statement
Insurance revenue
Insurance claims and other insurance service expenses
Expenses from reinsurance contracts held
Insurance claims recoverable from reinsurers
Insurance service result
Investment result
Net finance expenses from insurance contracts
Net finance income from insurance contracts
Investment result and net finance expenses
Other operating income
Operating expenses (incl. restructuring and one-off costs)
Finance costs
Profit before tax
Tax charge
Profit for the year

Balance sheet presentation

IFRS 4 Consolidated Balance sheet	
Assets	Goodwill and other intangible assets
	Property plant and equipment
	Right-of-use assets
	Investment property
	Reinsurance assets
	Current tax assets
	Deferred acquisition costs
	Insurance and other receivables
	Prepayments, accrued income and other assets
	Derivative financial instruments
	Retirement benefit asset
	Financial investments
	Cash and cash equivalents
	Assets held for sale
Equity	Shareholders' equity
	Tier 1 notes
Liabilities	Subordinated liabilities
	Insurance liabilities
	Unearned premium reserve
	Borrowings
	Derivative financial instruments
	Provisions
	Trade and other payables
	Lease liabilities
	Deferred tax liabilities
	Current tax liabilities

Deleted or amended lines

IFRS 17 Consolidated Balance sheet	
Assets	Goodwill and other intangible assets
	Property plant and equipment
	Right-of-use assets
	Investment property
	Insurance contract assets
	Reinsurance contract assets
	Current tax assets
	Other receivables
	Prepayments, accrued income and other assets
	Derivative financial instruments
	Retirement benefit asset
	Financial investments
	Cash and cash equivalents
	Assets held for sale
Equity	Shareholders' equity
	Tier 1 notes
Liabilities	Subordinated liabilities
	Insurance contract liabilities
	Reinsurance contract liabilities
	Borrowings
	Derivative financial instruments
	Provisions
	Other payables
	Lease liabilities
	Deferred tax liabilities
	Current tax liabilities

New line items

Amended line items

Key changes

- Deferred acquisition cost asset is removed
- All insurance balances (liability for remaining coverage and premium receivables) presented net
- All reinsurances balances presented net
- Closer alignment to SII balance sheet (IFRS 17 policy choices/assumptions more consistent with SII requirements)

Glossary of terms

Acronym	Stands for
ABE	Actuarial best estimate
APM	Alternative performance measure
COR	Combined operating ratio
DAC	Deferred acquisition cost
ENIDs	Events not in data
FV	Fair value
GWP	Gross written premium
IFRS	International financial reporting standard
LIC	Liability for incurred claims
NEP	Net earned premium
PAA	Premium allocation approach
PPO	Periodic payment order
OCI	Other comprehensive income
RA	Risk adjustment
SII	Solvency II
UPR	Unearned premium reserve

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Certain information contained in this document, including any information as to the Group's strategy, plans or future financial or operating performance, constitutes "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "aims", "ambition", "anticipates", "aspire", "believes", "continue", "could", "estimates", "expects", "guidance", "intends", "may", "mission", "outlook", "over the medium term", "plans", "predicts", "projects", "propositions", "seeks", "should", "strategy", "targets", "will" or "would" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in several places throughout this document and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, among other things: the Group's results of operations, financial condition, prospects, growth, strategies, the industry in which the Group operates and the Group's approach to climate-related matters. Examples of forward-looking statements include financial targets which are contained in this document including with respect to; return on tangible equity, solvency capital ratio, combined operating ratio, percentage targets for current-year contribution to operating profit, prior-year reserve releases, cost reductions, reduction in expense ratio, investment income yield, net realised and unrealised gains, capital expenditure and risk appetite range; and targets, goals and plans relating to climate and the Group's approach and strategy in connection with climate-related risks and opportunities. By their nature, all forward-looking statements involve risk and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future and/or are beyond the Group's control and/or they rely on assumptions that may or may not transpire to be correct. Forward-looking statements are not guaranteeing future performance.

The Group's actual results of operations, financial condition and the development of the business sector in which the Group operates may differ materially from those suggested by the forward-looking statements contained in this document, for example directly or indirectly as a result of, but not limited to:

- United Kingdom **("UK")** domestic and global economic business conditions;
- the direct and indirect impacts and implications of the coronavirus Covid-19 pandemic on the economy, nationally and internationally, on the Group, its operations and prospects, and on the Group’s customers and their behaviours and expectations;
- the Trade and Cooperation Agreement between the UK and the European Union **("EU")** regarding the terms, following the end of the Brexit transition period, of the trading relationships between the UK and the EU and its implementation, and any subsequent trading and other relationship arrangements between the UK and the EU and their implementation;
- the terms of trading and other relationships between the UK and other countries following Brexit;
- the impact of the FCA pricing practices report and any new rules and regulations arising as a result of that report and of responses by insurers, customers and other third parties and of interpretations of such rules by any relevant regulatory authority;
- market-related risks such as fluctuations in interest rates, exchange rates and credit spreads, including those created or exacerbated by the Russian invasion of Ukraine;
- the policies and actions and/or new principles, rules and/or regulations, of regulatory authorities and bodies, and of changes to, or changes to interpretations of, existing principles, rules and/or regulations (including changes made directly or indirectly as a result of Brexit or related to capital and solvency requirements or related to the Ogden discount rates or made in response to the Covid-19 pandemic and its impact on the economy and customers) and of changes to law and/or understandings of law and/or legal interpretation following the decisions and judgements of courts;
- the impact of competition, currency changes, inflation and deflation;
- the timing, impact and other uncertainties of future acquisitions, disposals, partnership arrangements, joint ventures or combinations within relevant industries; and
- the impact of tax and other legislation and other regulation and of regulator expectations, interventions, enforcements, fines and requirements and of court, arbitration, regulatory or ombudsman decisions, judgements and awards (including in any of the foregoing in connection with the Covid-19 pandemic) in the jurisdictions in which the Group and its affiliates operate.

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