

# Navigating an extraordinary year



**Penny James**  
Chief Executive Officer

**Despite the many challenges we faced in the year as a result of the Covid-19 pandemic, we traded well and prioritised support for our customers, our people and local communities. I am proud that our people, even when working remotely, have continued both to care for our customers and to help us build an insurance company of the future.**

I am proud of what the Group has achieved during 2020. Once again, we have demonstrated financial resilience by delivering another good set of results, whilst supporting our customers, our people and local communities through the challenges of the pandemic. Despite the disruption and uncertainty that 2020 has brought, we have made real progress towards becoming a technology-driven business which can adapt quickly to the changing world around us and deliver more for our customers at speed. We could not have done this without our highly engaged people, who have demonstrated the commitment and flexibility needed to do what it takes for our customers and to drive forward our business plans regardless of their personal circumstances. I am grateful to them for their dedication, skill and support.

## **Business performance and the impact of Covid-19**

In 2020, we delivered another year of strong profitability at the same time as growing our direct own brand policy count. The investments we have made in systems and capability over the last few years are showing through in this growth and are contributing to underlying improvements in current-year underwriting profitability. Overall Covid-19 led to a modest net benefit to the result. Despite the impact of the pandemic, we made further progress in delivering the change required to implement the Group's transformation plans.

**"In 2020, we delivered another year of strong profitability at the same time as growing our direct own brand policy count."**

We traded well through the year, delivering growth in our Home, Commercial and Green Flag Rescue businesses despite prolonged periods of lockdown when new business shopping dropped significantly. Retention has held up well. In contrast average premiums have fallen as risk mix has reduced, with fewer new drivers on the road as no driving tests have been conducted for parts of the year and fewer new cars have been purchased. In the midst of these trends we are happy to see direct own brand policy growth of 2.2% and gross written premium broadly flat.

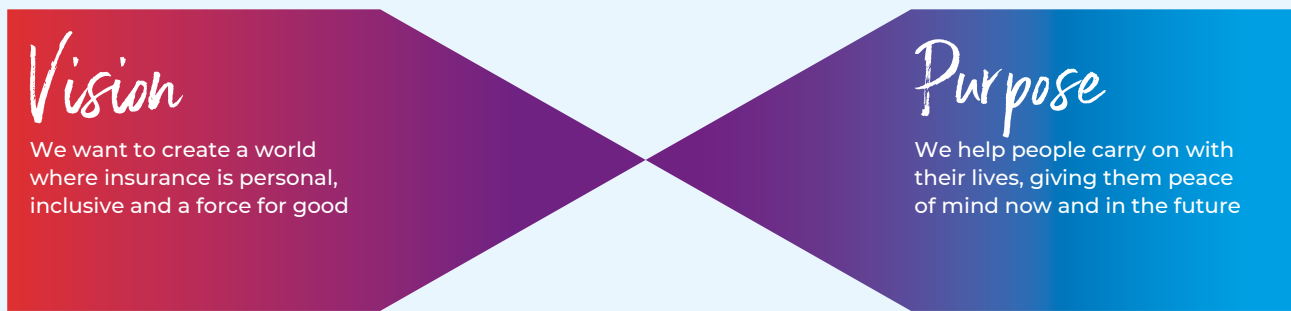
At a headline level we delivered operating profit of £522.1 million, a combined operating ratio of 91.0% and a return on tangible equity of 19.9%, well ahead of our target of at least 15% over the long term. Operating profit of £522.1 million was £24.8 million lower than 2019 (£546.9 million) due to higher major weather costs of £43.0 million (2019: £6.0 million) and reduced prior-year reserve releases, partially offset by improved current-year profitability.

## Forging ahead with our strategy

### Our values

<b>Do the right thing</b>	<b>Aim higher</b>	<b>Take ownership</b>	<b>Say it like it is</b>	<b>Work together</b>	<b>Bring all of yourself to work</b>
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### Our vision and purpose



### Performance against strategic objectives

<b>Best at direct</b>	<b>Win on price comparison websites</b>	<b>Extend our reach</b>
<ul style="list-style-type: none"> <li>– Superhero branding campaign launched</li> <li>– New Motor “Mileage MoneyBack” proposition</li> <li>– Launched Van and Tradesperson products on new Direct Line for Business platform</li> <li>– Green Flag awarded “Superbrand” status</li> </ul>	<ul style="list-style-type: none"> <li>– Privilege Motor new business and renewals now live on the new platform</li> <li>– Increased PCW focus including Churchill Home</li> <li>– Darwin brand launched on two more PCWs</li> <li>– Churchill Motor started roll-out to new platform in Q1 2021</li> </ul>	<ul style="list-style-type: none"> <li>– Agreed a two-year extension with NatWest Group for Home</li> <li>– Enhanced API capabilities to enable potential Home partners to link and test</li> <li>– Increased our presence in the on-demand mobility market</li> </ul>
<b>Technical edge</b>	<b>Nimble and cost efficient</b>	<b>Great people</b>
<ul style="list-style-type: none"> <li>– Launched new market-leading Motor counter-fraud system</li> <li>– Expanded electric vehicle repair capabilities</li> <li>– Launched a free on-line risk management portal for every NIG policyholder</li> <li>– Green Flag launched a new cloud-based claims system</li> </ul>	<ul style="list-style-type: none"> <li>– New agile operating model embedded across digital, data and pricing</li> <li>– Increased proportion of service interactions through digital channels</li> <li>– Launched new property strategy following success of remote working</li> </ul>	<ul style="list-style-type: none"> <li>– Our people continued to deliver our transformation agenda while working remotely</li> <li>– Our engagement scores remained high as we focused on the security and wellbeing of our people</li> <li>– Awarding free shares and ensuring all eligible employees receive a bonus for the year</li> </ul>

### Sustainability pillars *See page 44 for more information*

<b>Customers</b>	<b>People</b>	<b>Society</b>	<b>Planet</b>	<b>Governance</b>
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Overall, the impact of the pandemic led to a modest net benefit to our financial result, with the effects concentrated in four main areas:

- Reduction in motor claims frequency falling to below normal levels from Q2
- Increase in Travel claims, relating to both claims volumes and claims handling costs as well as additional commission payments
- An estimated £6 million in Covid-19 related business interruption claims
- Investments to support our customers, people and society totalling £93 million

Motor claims frequency levels were significantly lower than normal due predominantly to lockdown restrictions leading to claims frequency falling to around half normal levels during Q2. Whilst it increased during the second half of the year, claims frequency did not return to pre-Covid-19 levels during 2020. However, severity costs have increased due to the costs of making accident repair centres Covid-19 safe, longer repair times and consequently higher credit hire costs. We have seen an increase in the volume of claims within our Travel business and so have also incurred additional claims handling costs supporting our customers. In terms of business interruption, our standard wordings were clear from the outset and we were not party to the FCA's test case nor the appeal to the Supreme Court, which has been relevant to many commercial insurers, and our overall Covid-19 related business interruption claims are estimated at £6 million.

Consistent with our "Force for Good" vision, we have invested extensively in our customers in the form of premium refunds, waived fees and reduced premiums, and also in our people by protecting jobs at the most critical points in lockdown, preserving salaries and incentives in return for flexibility and investing in strengthening home working capability. And finally we have invested in society: we have helped local communities with over £7 million of donations helping 100,000s of households and contributing to the ABI Covid-19 Support Fund. In total these initiatives represent an impact of around £93 million, of which £34 million is within our operating expenses and £59 million is within our loss ratio.

**"As we transform the business both in terms of the technology we use and our agility, we are changing the way the organisation works."**

A further effect was felt in our investment portfolio where we saw investment return fall from £134.6 million in 2019 to £95.1 million in 2020, reflecting the dual impact of lower reinvestment rates and a small number of writedowns in the investment portfolio. When we look at some of the volatility in the market over the period we are pleased with the overall performance of the portfolio.

Prior to the pandemic we had set out to achieve improvements in our current-year loss ratio and therefore to improve the profitability of the business we write. Offsetting this we had expected to see the level of releases from prior year business reduce, reflecting changes in the level of Motor excess of loss reinsurance some years ago. During 2020, prior-year reserve releases reduced to £173.8 million (2019: £294.5 million). Although the improvements in our loss ratio undoubtedly benefited from the impact of the Covid-19 pandemic, we are confident we have made progress in increasing the current-year contribution to operating profit.

Overall we have sought to do the right thing by all our stakeholders throughout 2020, and believe the underlying performance and quality of change delivery in the year indicate we are on track to deliver on our targets.

## Strategic update

2020 was always a critical change delivery year on our path to building the insurance company of the future – technology and data led but with the customer at its heart. I have been very pleased by our ability to continue delivering major transformational change, even from our homes. The table opposite outlines some of our key achievements.

Many of the foundation blocks are now in place and we are increasingly moving to extracting benefits from the technology we have implemented rather than focusing purely on technology delivery.

As we transform the business both in terms of the technology we use and our agility, we are changing the way the organisation works. We have found through 2020 that we can create and protect the culture of the Group, even with almost everyone working from home, and our regular people surveys tell us that our people want the personal flexibility that homeworking offers. Our intention, therefore, is to take this opportunity to change the way we use our premises in future so they support collaboration, training and teamwork rather than being an everyday place of work for most people.

We will remain focused around our core hub sites so our people can get together, but believe our approach gives both cost savings and advantages for our people, allowing us to support greater social mobility and assist us in identifying top talent. To this end we are reviewing our office site property strategy and have chosen to buy out our Bromley lease, the run costs of which were above market rate. This will accelerate the costs from the future 17 years of the lease and so we will take a charge to Solvency II own funds in 2021 of £85 million as we effectively de-leverage the business and, in return, make savings in excess of £10 million per annum from 2022, incremental to our original cost target plans. We will then have greater freedom to create the nature of property usage this business needs.

With the potential impact of the FCA Pricing Practices report, discussed in the Market Overview section later, combined with whiplash reform, currently due to be effective from May 2021, a mixed picture is emerging in terms of lockdowns in H1 and uncertainty over the long-term level of driving in our new "normal", and there are clearly many moving parts.

That said, capital generation has been strong and our perception is that the level of risk in the system, with vaccines rolling out and a Brexit deal in place, is beginning to reduce. As a result we are declaring a final dividend of 14.7 pence per share and announcing a share buyback programme, as we reiterate our target of operating around the middle of our risk appetite range of 140% to 180% in normal circumstances. The share buyback will be for up to £100 million, with an initial tranche of up to £50 million expected to be completed by the time of the half-year results.

As you move through the Strategic report we will seek not only to guide you through understanding our financial performance and how that positions us for the future but also to bring to life examples of the technology development and the benefit we believe it will bring. I hope it will allow you to feel why we are so excited about the progress we have made and the opportunity ahead.

Looking into 2021 we will be continuing the roll-out of our technology transformation and increasingly turning our attention to utilising these new platforms to deliver benefits for our customers.

Our plans include:

- Continuing the migration of Direct Line and Churchill Motor policies onto our new platform, enabling us to improve customers' online journey and extend our product range even further.
- Continuing the journey towards greater digitalisation, applying advanced analytical techniques to enhance the customer experience.
- Rolling out a new policy and pricing system for Green Flag enabling it to grow beyond traditional breakdown services and look after customers' motoring needs in and out of an emergency.

- Being well placed for customers and at a competitive advantage to other players in a post FCA pricing practices market.

We are also heavily focused on improving efficiency in order to meet our cost targets by:

- Continuing organisational transformation to further digitalise customer journeys, automate business processes and adopt new ways of working, as we aim to step change both customer experience and the efficiency of our cost base.
- Realising the benefits of agile ways of working throughout the organisation with the aim of reducing the cost and increasing the pace of change.

These plans are designed with fantastic customer experience and propositions at their heart. Supporting our activities and central to the long-term sustainability of the business, we have deeply embedded and fundamental principles:

- Our values sit at the very heart of our everyday behaviours.
- Our sustainability pillars bring environmental, social and governance ("ESG") factors into the heart of our strategic thinking, whether that's our customers, our people, our society, our planet, or the importance of strong governance – they all play central roles in helping deliver our business in a sustainable way.

'Bring all of yourself to work' is a value lived vibrantly across the Group but after extensive discussions with our people, we launched a new diversity and inclusion strategy and set ourselves stretching targets around ethnicity and gender in our leadership so that we are truly inclusive and reflect the customers we serve.



## 2020 - a year like no other

### Supporting our customers

# 450k+

Over 450,000 customers supported through payment deferrals, waiving cancellation fees and mileage refunds

# 26k+

More than 26,000 customer travel claims settled and over 900 customers repatriated



# Free

Free Rescue cover, fast-track claims and free home emergencies cover for NHS staff

### Supporting our people



# 9,000

Moved 9,000 people to home working and supported our motor accident repair centres to open safely and keep Britain moving

# Protected

Protected roles and salaries during initial lockdown, without government support, and offered maximum flexibility to help our people manage home and work

# Free shares

£3.8 million distributed as a thank you to our people

### Supporting our communities

# £3.5m

Established our first Community Fund which distributed £3.5 million to 250 charities, helping over 200,000 people

# £1.5m

Extended our Community Fund into 2021 with £1.5 million to support charities dealing with the impact of the Covid-19 pandemic

# £3.6m

Contributed £3.6 million to the Association of British Insurers Covid-19 Support Fund



### Supporting a greener future

# Reduce

Committed to setting Science-Based Targets<sup>1</sup> for Scope<sup>1</sup>, 2 and 3 to help the Group reduce its carbon footprint

# Carbon neutral

Became a 100% carbon-neutral business by investing in high social impact projects to offset our Scope<sup>1</sup>, 2 and 3<sup>2</sup> emissions

# Report

Published our first Task Force on Climate-related Financial Disclosures ("TCFD") Report<sup>3</sup>

#### Notes:

1. See glossary on pages 224 to 226 for definitions.
2. Scope 3 emissions which are under our direct control.
3. For more information please see our published 2020 TCFD Report on the Group's website at [www.directlinegroup.co.uk/2020\\_TCFD](http://www.directlinegroup.co.uk/2020_TCFD).

## Market overview

### Consumer trends

In 2020 we saw a number of trends emerging through the year. Ultimately these tell us that our strategy is the right one. Those trends are:

- Consumers' willingness to interact digitally has been transformed. Digitalisation is at the heart of our technology transformation so this trend is entirely aligned with our plans.
- Agility is a must. We need to be quicker at implementing changes to fulfil changing customer needs.
- The working model has changed. Knowing our people can deliver from home has provided an opportunity to change how we use our offices in a way that supports what our people tell us they want and offers opportunities to recruit people irrespective of geography.
- Car technology continues to evolve rapidly. Having the largest owned repair network of any UK insurer gives us the opportunity to develop further commercial insights.
- Cross collaboration is a must. We can achieve more by working together; co-operation across industries is essential to tackling climate change and ensuring greater diversity.

### Financial Conduct Authority Pricing Practices

In September 2020 the FCA released its General Insurance Pricing Practices Final Report, which remains a key focus for us. It included the FCA's proposed remedy package aiming to ensure retail home and motor insurance products offer fair value to customers. The FCA recognised that insurers do not make excessive profits and their key proposal was that firms should offer renewal prices no higher than the equivalent new business price through the same sales channel. The consultation period ended on 25 January 2021 and we look forward to understanding the final details some time in Q2 2021.

This is an area where we have already been proactive for several years by implementing a range of measures to reduce the differential in pricing between our new business and renewal customers. We are supportive of the aims of the FCA and believe that, in a world where prices become less of a differentiator, our strong brands, diversified business model and the capabilities we are building will enable us to win in the future market. On the way there is uncertainty around the detailed application of the rules, the timelines for implementation and the nature of short-term volatility as the market rebalances. We have prepared for a range of outcomes and we continue

to work with the FCA to assist it in navigating some of the issues and are seeking to help shape the right outcome for our customers and shareholders.

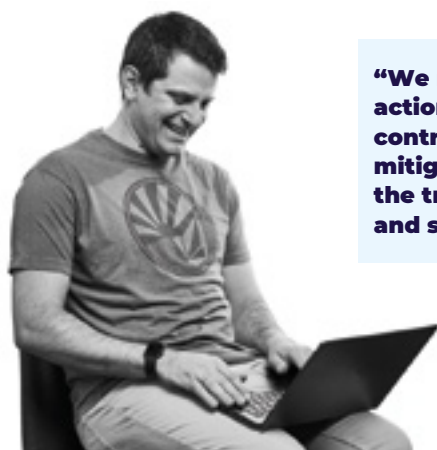
### Climate

The impact of climate change has far reaching implications for economies around the world. Our Planet pillar, which aims to protect our business from the impact of climate change and give back to the planet more than we take out, drives our approach. We recognise that our actions as a business can contribute to climate risk mitigation and help accelerate the transition to a low carbon and sustainable future. We take this seriously and have continued to challenge ourselves to reduce emissions and energy consumption through greater transparency.

We have previously published our Scope 1 and 2 emissions<sup>1</sup>, but this year we wanted to go further. For the first time we broke down our emissions across our offices and our accident repair centres to help us to focus our plans on where we can have the most impact. Alongside this we evaluated our Scope 3 emissions<sup>1</sup> starting with those under our direct control and purchased goods and services which make a substantial contribution to our overall emissions. Our first comprehensive TCFD report (see page 62) provides us with a roadmap to strengthen our strategic response in tackling climate change and we see the Bank of England's Climate Biennial Exploratory Scenario ("CBES"), in which the Group has been invited to participate, as a way to help enhance our climate change scenario analysis capability.

The Group's focus in 2021 is to evaluate the Scope 3 emissions<sup>1</sup> arising out of our investment portfolio and we will begin to scope out Science-Based Targets, which are a set of goals to provide a clear route

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to reduce emissions, to submit to the Science Based Target Initiative (“SBTi”) for approval. Finally, we know that we are on a journey and cannot reduce our emissions overnight, therefore we became carbon neutral through offsetting, as we work to reduce our emissions over time.

Note:

1. See glossary on pages 224 to 226 for definitions.

## UK economy and Brexit

Following the recession in 2020, economic uncertainty is expected to remain high throughout H1 2021 as a result of the Covid-19 pandemic, although the UK Government has acted to support UK businesses and employees and prevent lasting damage to the economy. However, the uncertainty surrounding the pandemic makes the overall impact and recovery progress unclear.

The disruption to global trade and supply chains caused by the pandemic could increase the risk of inflation in the long term. The Group’s investment portfolio is positioned defensively and additional steps could be taken, such as further shifting the portfolio towards ‘defensive’ sectors or increasing more allocation to cash. The portfolio also contains a proportion of short-maturity bonds which could be sold relatively quickly if necessary.

As a UK-based business with UK customers, we identified that the biggest potential financial exposure for the Group, from a disruptive or disorderly Brexit, would be to market volatility. We continue to work through the operational effects of Brexit for customers and supply chains but the potential effects have been helped by a trade deal which has avoided otherwise expected tariffs on EU goods needed to serve our customers.

**“Given the progress we are making on our transformation, we enter 2021 with real momentum and are confident in delivering our vision of being a technology and data led insurance company of the future with our customers at its heart.”**

## Outlook

The capability delivered as the Group looks to transition from technology transformation into business transformation underpins the improvement in the current-year profitability and provides a platform for growth, underwriting improvements and cost efficiency. Through increased digitalisation and self-serve, enabled by new ways of working, we aim to deliver significant customer and efficiency improvements and underpin our target of an operating expense ratio of 20% by 2023. The new ways of working during 2020 have enabled us to think more ambitiously about how we use our office space and we have therefore launched a property strategy which aims to help deliver incremental savings to this target. In addition, greater pricing sophistication and counter-fraud initiatives aim to continue the improvement in the current-year loss ratio. The Group remains on track to maintain the contribution from current-year operating profit at more than half of the Group’s total operating profit and we reiterate our ongoing target of achieving at least a 15% return on tangible equity per annum.

The Group targets a combined operating ratio of 93-95% for 2021 and over the medium term, normalised for weather, although we acknowledge there will be increased uncertainty for a period as we progress through the implementation of the FCA pricing practices proposals and as the market reacts to the ongoing Covid-19 pandemic.

2020 has been a testing year for everyone and I am proud of how we have responded as a Group, demonstrating throughout the resilience of our business model. We had strong momentum coming into the Covid-19 crisis and have delivered a good financial result whilst simultaneously navigating the Covid-19 pandemic, supporting our various stakeholders and staying true to our vision and purpose throughout. Given the progress we are making on our transformation, we enter 2021 with real momentum and are confident in delivering our vision of being a technology and data led insurance company of the future with our customers at its heart.



**Penny James**

Chief Executive Officer