

An exciting point for The business

As I reflect on 2021, I am delighted by the Group's strong performance. I feel proud of the way we have navigated the complexities and uncertainties of a challenging market, impacted by the pandemic. Commercial, Home own brands and Rescue have grown, benefiting from the investments we have made in recent years in technology and pricing, whilst in Motor we have prepared for future growth while steering a smart path through a period of falling premium and uncertain claims frequency as the market seeks to predict the shape of the pandemic and its effect on customer driving behaviour.

Penny James
Chief Executive Officer



At the same time we have made brilliant strategic progress. After several years replacing the technology across the business, introducing agile ways of working and building our data foundations, we are nearing the completion of our technology transformation phase.

Through that transformation we have improved the profitability of the business we write, with releases from older reserve years no longer such a significant part of our annual profits. We have delivered performance across the business, including the quality of claims management, pricing and improvements in our cost efficiency. We anticipate further progress in all these areas through 2022 and 2023.

So, as I look ahead, I see 2022 as the year we pivot to focusing on driving the business forward. 2021 has been dominated by delivering the transformation to enable future growth and preparing for one of the biggest changes the market has seen with the introduction of the FCA's new Pricing Practices Review regulations. As we tune and embed the systems we have built and plan for Home to join Motor on them, we also look ahead with excitement as we are able to focus on driving our performance in this new market.

As we look to make this shift, I have focused on making sure we have the right leadership to make us successful. Several members of our executive team have changed and we now have a team brimming with the customer and insurance experience that has driven our past success, but also the technology, digital and data skills we want to become the data- and technology-driven insurance company of the future.

We start from a position of strength, of course, with a track record of strong returns, having delivered a return on tangible equity of over 19% for each of the last five years and having returned over £2.1 billion of capital to shareholders over the same period, including the final dividend and share buyback programme announced today. This is possible due to our scale and expertise across our diversified business model, with market-leading brands across multi-products and multi-channels. These sustained returns, combined with our new tech capability, give us a platform for future success.

Chief Executive Officer's review *continued*

Our customer-obsessive mindset is intent on delivering long-term sustainable growth. We are a business that puts data at the heart of what it does and we are working to have it at everyone's fingertips – with the agility to create and tailor innovative solutions and give customers the flexible, modular and on-demand insurance products that give them control. It is why I am so excited by the progress we have made, having now rolled out our largest brands, Direct Line and Churchill, onto our new Motor platform.

This transformation builds on our existing core strengths of great customer service, strong brands and expert claims capability which look to harness the best of technology to make every customer interaction effortless, instant and transparent, however customers come to us. Our diversified business model gives us the platform to be the best at direct and win through price comparison websites ("PCWs"), partners and brokers. The technology transformation enables a step change in our pricing capability and operational efficiency which is designed to further increase our competitiveness.

As we move to embed and leverage what we have built, we believe there is plenty more to come:

- Step changes in our use of pricing and data, which are already beginning to improve our competitiveness in Motor, and we will continue to refine and enhance our pricing models and capabilities as we move through the year.
- The next sweep of our brand advertising, building on the success of the 'superheroes' and Churchill campaigns.
- Improvements in our customer service and costs efficiency through material increases in straight-through processing.
- Over 640,000 Motability Operations customers who are scheduled to join us in 2023 in a deal focused on providing brilliant customer service and claims in a capital-efficient manner with 80% reinsured.
- And we are delighted to have extended our contract with NatWest Group to continue looking after their customers' Home insurance needs, a contract built on our ability to deliver great service for their customers through brilliant use of digital and data capability.

So, as we enter 2022, we are initially focused on understanding the new dynamics in the marketplace, where renewal and new business pricing are linked. It's early days but the market appears to be responding rationally and we are taking time to understand how customers will behave in the new pricing practices world and how to balance product, pricing and distribution to the best effect. The next phase is optimising for growth as we embed and tune the technology we've built.

We believe passionately that delivering sustainable growth in the long run means our customers, society and the planet need to thrive and we have a role to play in helping to ensure that is the case. In essence we need to do the right thing for our customers, our people and the planet. We are making our business an inclusive and rewarding place to work, where brilliant, skilled people can deliver in a high-performance culture. We are investing in the skills that our business will need for its future success and are offering training programmes to enable people who want to reskill to do so.

We have also made further strides to embed sustainability initiatives by prioritising actions which are good for the long-term interests of the business and which bring wider societal benefits. You can see this most strongly in the steps we are taking to protect our business from the impact of climate change and to give back more to the planet than we take out. Our decision this year to join the Race to Zero – committing to set Science-Based Targets to reduce emissions based on a 1.5°C pathway – reflects that ambition. But we also recognise our role in supporting customers to go green and delivering our new Direct Line electric vehicle proposition is another sign of our ability to innovate in an agile way.

This is a business I love, brimming with people who share my view and go the extra mile to support customers and one another. 2021 has been far from an easy year. Change is never comfortable and is rarely predictable. The results and progress are the outcome of the sheer dedication of our amazing people and their determination to succeed despite the challenges and strains of a pandemic. So, the most important thing I can do here is thank each one of them for sharing this journey with me.

Forging ahead with our strategy

Our vision and purpose

Vision

We want to create a world where insurance is personal, inclusive and a force for good

Purpose

We help people carry on with their lives, giving them peace of mind now and in the future

Our values

Do the right thing

Aim higher

Take ownership

Say it like it is

Work together

Bring all of yourself to work

Our strategic objectives

Best at direct

Win on price comparison websites

Extend our reach

Technical edge

Nimble and cost efficient

Great people

> See pages 15 and 26 for further information

Our sustainability pillars

Customers

People

Society

Planet

Governance

> See page 54 for further information

Our brands

 Direct Line®

Darwin®

Privilege®



 churchill™

GREEN FLAG
COMMON SENSE TO THE RESCUE

 DLG PARTNERSHIPS

Chief Executive Officer's review *continued*

Preparing for the future

As one of the largest motor insurers in the UK we have 22 garages. As car technology rapidly changes, we are continuing to invest in our repair capability so we can meet future customer needs with the aim of achieving efficient repair.

This is why we possess the ability to test and calibrate ADAS (Advanced Driver Assistance Systems) and are training more of our technicians in electric vehicle repair, as this is expected to be a growing market and we need to be ready. Our new technology centre is a further sign of our repair capability and is designed to help build in-house knowledge and inspire the next generation.

New Motor insight

We are delighted to announce a new 10-year Motor partnership with Motability Operations from 2023.

It is expected to give the Group further insight on a fleet of modern vehicles as the scheme serves some 640,000 people, and is further evidence of the quality of our customer service, vehicle repair expertise and digital claims capability.

New car technology centre

As the largest insurer-owned garage networks in the UK we pride ourselves in efficient repair. To strengthen the Group's repair capability further we have invested in a new car technology centre in Birmingham.

£2m

investment in new car technology centre



Business performance

We are already beginning to see some financial benefits of our transformation, with another strong financial performance in 2021, growing our own brand policy count, delivering a combined operating ratio of 90.1% and increasing operating profit year on year by 11.4% to £581.8 million. This has enabled us to declare a final dividend of 15.1 pence, a 2.7% increase over 2020, and announce a share buyback programme of up to £100 million.

We grew direct own brand in-force policies by 1.0% driven by Commercial direct and Green Flag Rescue, our two divisions furthest through their transformation, and Home where we traded well in a buoyant new business market.

We continued to make progress on our cost agenda, with operating expenses reducing £18 million to £706 million and the expense ratio falling 0.6 percentage points to 23.9%. Whilst we saw levies increase by 11% during 2021, alongside heightened inflation in wage costs, these impacts were more than offset by lower technology costs, savings from our property strategy and a 9% reduction in headcount. We also incurred lower Covid-19 related costs.

The combined operating ratio at 90.1%, normalised for weather at 91.1%, was better than our medium-term target of 93% to 95% and in line with our mid-year stated revised expectation of between 90% and 92%. We achieved an excellent underwriting profit for the year with increased prior-year reserve releases and Motor claims frequency remaining below pre-pandemic levels in H1 2021.

This, together with a strong investment result, meant operating profit increased from £522.1 million in 2020 to £581.8 million in 2021. We have been focusing on improving the amount of our operating profit that comes from the current year and in 2021 met our target of at least 50%.

Impact of Covid-19

Whilst in 2020 we saw a modest indirect economic benefit from the Covid-19 pandemic in our results, during 2021 the impact was less marked. Within Motor we saw similarly low levels of claims frequency across the first half of 2020 and 2021 and with restrictions easing across H2 2021 we saw claims frequency increase back to expected levels. Throughout 2021 motor market premiums reduced, in part reflecting this trend and offsetting the financial impact.

Outside of Motor the impact of Covid-19 was even less significant. Rescue saw lower new business shopping during lockdown restrictions, whilst claims experience in Home and Commercial was not significantly affected.

In our Travel business, lower customer travel levels continued to reduce gross written premium below pre-pandemic levels and claims volumes reduced in 2021 following the non-repeat of Covid-19 related claims in 2020.

Strategy update

Valuable customer relationships

Following the implementation of the FCA Pricing Practices regulatory changes at the start of 2022, the importance of strong customer relationships has never been higher.

Strong brands and great customer service have always been core strengths of our business and that has been consistently demonstrated by our high Net Promoter Scores and retention rates across both Home and Motor.

Throughout our technology transformation, we have always started with the customer. Our new technology architecture has delivered a step change in our digital capabilities, enabling our customers to deal with us however they wish. We have seen customer use of our digital channels increasing month on month throughout 2021, with 100% of Motor and Home claims now able to be registered online.

Our diversified business model also means that customers can deal with us through a range of recognised brands across a number of products. This enables us to support a real breadth of different customers.

Darwin, a new brand we set up in 2019, is a great example of our diversified approach. It uses machine learning to leverage our existing data resource and counter-fraud expertise to offer customers a low-cost digital product. In just two years it has increased to over 135,000 policies, is ranked in the top 10 on TrustPilot and provides us another powerful brand in the PCW channel.

Finally, our transformation has enabled us to improve our competitiveness through increased accuracy and agility in our pricing, as well as increasing the breadth of propositions that we can offer. During 2021 we rolled out our new electric vehicle proposition, building on our expertise in this growing market and helping our customers make the switch to electric vehicles.

“Our diversified business model also means that customers can not only deal with us through whichever channel they wish, but also via a range of recognised brands across a number of products.”

Growing the portfolio

Commercial and Green Flag Rescue are the areas of our business that are furthest through their transformation and they demonstrate what can be achieved when we combine our existing strengths in claims management, customer service and strong brands, with a new technology infrastructure and agile ways of working.

Between them they drove strong gross written premium growth of 13.9% in 2021 and gained share in their respective markets. We are adopting similar approaches in Motor and Home and are seeking to grow our share over time.

Longer term, we believe our brand strength enables us to extend into broader products and services to meet customers' needs. Direct Line has recently launched a standalone cyclist product to take advantage of this growing market and to attract new customers to other more established products; our electric vehicle proposition is designed to help customers transition to electric vehicles and is only one part of a wider ecosystem; and Green Flag, by changing its operating model, can now offer more assistance to customers during a vehicle recovery. These are all examples of how we are broadening our propositions and products to deliver for more customers.

Chief Executive Officer's review *continued*

Strategic objectives

Overall, in 2021, we made great progress on our path to building the insurance company of the future – technology and data led but with a customer-obsessive mindset. We not only completed the main elements of our technology build but have also made great progress against our six strategic objectives;

Objective	Progress to date
Best at direct	<ul style="list-style-type: none"> – Launched a new Direct Line proposition helping to make the transition to electric vehicles easier for customers by providing free access to a bundle of electric vehicle-related services, including discounted home charging installation. – Green Flag delivered a new cloud-based policy platform for online sales and relaunched the way it operates, enabling it to offer more services alongside roadside recovery. – Launch of Direct Line cyclist product as we extend our products and services in order to meet broader customer needs.
Win on PCWs	<ul style="list-style-type: none"> – Successfully rolled out our new Motor platform, which delivers greater pricing sophistication using third-party data and speed to market. We saw the benefits of this in improved Motor competitiveness in the second half of the year. – Continued to deliver strong growth in Darwin as we enhanced pricing across the four main PCWs, growing policy count to over 135,000, an increase of over 150% compared to the end of 2020. – Churchill business delivered 64% growth in gross written premiums in 2021.
Extend our reach	<ul style="list-style-type: none"> – We announced our new partnership with Motability Operations, demonstrating our core strengths in delivering great customer service and efficient car repairs. The partnership is anticipated to increase Motor gross written premiums by around £500 million each year from H2 2023. – Agreed a long-term extension to our Home partnership with NatWest Group. – U K Insurance Business Services Limited expanded into subscription insurance with a new partnership with Cazoo. – Green Flag renewed partnerships with Caravan and Motorhome Club, Zurich and Virgin Money.
Nimble and cost efficient	<ul style="list-style-type: none"> – Progressed our site strategy, purchasing our head office and rationalising our footprint at two regional offices, overall reducing our site footprint by 30% since 2019 and delivering savings in excess of £10 million per year. – Expanded digital customer journeys, including 100% of all Home and Motor claims now able to be registered online and with end-to-end digital journeys for certain claims types, delivering reduced demand into our contact centres. – Technology transformation reducing ongoing run costs through rationalisation of legacy systems, including the decommissioning of two data centres and reducing system support costs.
Technical edge	<ul style="list-style-type: none"> – We continued to expand our claims capabilities through the acquisition of our 22nd DLG Auto Services accident repair centre. This acquisition supports our competitive advantage in vehicle repairs and we continued to invest in capability to repair more advanced and electric vehicles. – Commercial continued the rollout of its new pricing and underwriting system across Commercial combined and Fleet, alongside the launch of machine learning pricing models, dramatically improving pricing accuracy. – Integration of digital journeys into our new fraud decision engine.
Great people	<ul style="list-style-type: none"> – We have refreshed our leadership, with an Executive Committee team which has the brilliant mix of digital, customer, data, insurance and agile skills we need to grow our business, leveraging the technology we have built. – The Group ranked 13th in The Inclusive Top 50 UK Employers list for 2021/22. – Published our Black Inclusion report and signed up to 10,000 Black interns programme. – Continued to embed Agile operating models across our trading and technology teams, enabling increased pace and efficiency of change.

“We take our environmental obligations seriously and this year joined the Race to Zero – committing to set Science-Based Targets to reduce emissions based on a 1.5°C pathway.”

Sustainability strategy progress

We have continued to make progress on our sustainability strategy this year, improving our MSCI ESG rating from an ‘A’ to ‘AA’, and have published our second Task Force on Climate-related Financial Disclosures (“TCFD”) report outlining our strategic response to climate change in this Annual Report. We have also participated in the Bank of England’s Climate Biennial Exploratory Scenario (“CBES”), providing a clearer assessment of climate-related implications for the Group. We take our environmental targets seriously and this year joined the Race to Zero – committing to set Science-Based Targets to reduce emissions based on a 1.5°C pathway. While we finalise our submission to the Science Based Target Initiative (“SBTi”) for approval, we are clear-sighted that setting ambitious targets requires practical measures to help reduce our emissions.

Colleagues have been innovating and trialling solutions to guide our emission reduction strategy, including launching a Supply Chain Sustainability Programme and piloting measures in our garage network because these are some of our most carbon-intensive operations. Part of our strategic response also means helping to make it easy for our customers to go green so that we can both contribute to and benefit from accelerating the transition. As a major motor insurer we are determined to make it easy for customers to insure electric vehicles, while aiming to fix them in the most energy-efficient repair network in the UK. That’s why our new electric vehicle proposition for Direct Line customers is such an exciting development and a sign of how we can take long-term sustainable decisions which are good for the planet and our business.

UK weather

During February 2022, the UK experienced three significant storms: Dudley, Eunice and Franklin. To date, we have already helped over 10,000 customers across Home and Commercial and estimate claims to be between £30 million and £40 million. This is an early estimate and is within our annual weather budget assumption for 2022.

Ukraine conflict

We are deeply saddened and shocked by the conflict in Ukraine and have made an immediate donation from the Group’s Community Fund to the UK’s DEC Ukraine Humanitarian Appeal. As a UK-based business, there has been no direct impact from the conflict in Ukraine that started in February 2022. The investment portfolio has no direct exposure to Russia or Ukraine.

Outlook

Our strong strategic progress and disciplined approach to trading throughout 2021 meant we were well placed as we entered 2022 and began the implementation of the FCA Pricing Practices regulatory changes.

These are early days but we have seen positive new business premium inflation across the Home and Motor markets in January and February 2022, with search volumes higher but with switching reduced when compared to the same period in 2021. Our retention levels in Motor and Home have remained strong. These movements are within the range of outcomes we had projected and prepared for.

Our initial focus was on aiming to safely land the changes compliantly, while seeking to understand both market and consumer behaviour in the new environment. Our multi-brand portfolio sets us up well as it enables us to both protect value and be competitive in new business. This will enable us, as we move through the year, to optimise for growth and shareholder value whilst all the time delivering great outcomes for customers.

There are a range of inflationary pressures currently being seen within our market. Our claims expertise, including our repair cost advantage in Motor, puts us in a good position to manage these. Elsewhere, we have delivered absolute reductions in our overall cost base and we plan to reduce costs further during 2022.

Reflecting this, as well as our long-term confidence underpinned by our strategic transformation, we reiterate our combined operating ratio target range of 93% to 95%, normalised for weather, in 2022 and over the medium term. We also reiterate our expense ratio target of 20% for 2023, assuming modest premium growth, and our ongoing target of achieving at least a 15% return on tangible equity each year.

Having completed the main elements of our technology build we have complemented our strengths in strong brands, fantastic customer service and market-leading claims capabilities with a step change in our pricing capability, greater digitalisation and improved efficiency.

Whilst we are already seeing some of the benefits of this new capability coming through, the full benefits are yet to be realised, which leaves us well positioned to build on this strong performance through 2022 and beyond.



Penny James

Chief Executive Officer

Market overview

Consumer trends

In 2021 we witnessed consumer trends further align with our strategy, consistent with our technology transformation:

- More customers taking advantage of our digital capability where we are providing greater flexibility for people to manage their insurance how they want, whether it is amending policy cover or making a claim. It is part of our aim to use the best technology to make every customer interaction effortless, instant and transparent however customers come to us.
- A desire for trusted, famous brands offering distinctive customer offers and insurance propositions. We want to create and tailor solutions and give customers the flexible, modular and on-demand products that give them control. We were delighted to launch our new electric vehicle proposition for our Direct Line brand in 2021.
- Car technology is increasingly sophisticated and as the green transition picks up pace, electric vehicles are becoming more popular in the UK. Owning our garage network gives us beneficial commercial insights on vehicle technology, alongside upskilling our technicians in electric vehicle repair.
- The Covid-19 pandemic has changed consumer travel patterns, as more people work from home meaning fewer people are using cars in peak commuting hours, impacting claims behaviour. Insurers will need to adapt to this new environment and our ability to deploy more sophisticated pricing, as a result of our new motor platform, gives the Group greater competitiveness as the UK emerges from the pandemic.
- Increasingly people are taking advantage of partnerships where they can access insurance products. We are aiming to be the insurance partner of choice because it allows us to reach new sets of customers, which is why we are delighted to be partnering with Motability. Our new Direct Line electric vehicle proposition offers a free bundle of services from our partner, Zoom EV, and our Commercial business is working with Cazoo, providing motor insurance to customers within their monthly car subscription.

Financial Conduct Authority Pricing Practices Review

In May 2021 the FCA published its General Insurance Pricing Practices Final Policy Statement outlining the implementation timetable for the reforms. Following the Final Policy Statement, the Group successfully met the product governance deadline at the end of September 2021, as well as implementing the pricing reforms which came into effect on 1 January 2022.

We have been supportive of the reforms since the FCA announced its intention for firms to equalise customer prices by offering a renewal price no higher than the equivalent new business price through the same sales channel for motor and home policies.

For several years, before the FCA announced its intention to reform the market, we have taken a proactive approach to reduce the pricing differential between new business and renewal customers, including reviewing customers' renewal prices when they reach their five-year anniversary.

As the market rebalances, in line with the FCA's rule changes, we believe customers will continue to look for both value for money and trusted brands, especially those with a reputation for excellent customer service, market-leading customer offers in terms of what people receive with their cover and a strong track record in claims handling, which are where we have fundamental strengths. We remain confident that our core strengths will assist in helping the Group to navigate this new market with the aim of delivering the right outcomes for our customers and shareholders.

“We have been supportive of the reforms since the FCA announced its intention for firms to equalise customer prices by offering a renewal price no higher than the equivalent new business price through the same sales channel for motor and home policies.”

Inflation

The Group is not immune from global inflationary pressures which became more pronounced in the UK during the second half of 2021. Like other insurers, heightened inflation in construction materials such as concrete and lumber has impacted home claims. Meanwhile, motor claims inflation has trended upwards largely due to the limited global supply of new vehicles increasing costs for second-hand vehicles, impacting total loss settlements. In Motor we continued to focus on maintaining the quality of our book and continued to price for claims inflation at a time when we believe market pricing was not reflective of observed claims inflation.

While inflation is expected to persist throughout 2022 we believe the Group has strengths which can help navigate an increasingly inflationary environment. Owning the largest garage network of any insurer allows us to repair vehicles effectively and economically, enabling us to mitigate some inflationary pressures. Whilst we have a large home business, construction materials only make up a small amount of our claims costs, with a greater proportion relating to labour costs and decorating materials meaning we are insulated from certain inflationary pressures partially caused by supply chain disruption. If supply chain delays reverse as a result of a relaxation of Covid-19 restrictions we could see some of these impacts unwind.

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Climate

Climate change affects the Group in several ways and, like other companies, the Group is focusing its efforts on how to manage the transition to a low-carbon future. In October 2021 the Chancellor published the ‘Greening Finance’ roadmap, setting out plans for new Sustainability Disclosure Requirements to create a framework for sustainability disclosures across the economy, building on TCFD to integrate global standards.

The Group has taken a number of steps in recent years to publish its energy usage and emissions transparently. It continues to develop risk-mitigation measures to reduce operational emissions and has enhanced its assessments of climate-related risks to our business.

This year the Group has published its second TCFD-aligned disclosure (see page 76) which sets out our strategic response to climate change. We have also continued to publish our Scope 1 and 2 emissions as well as Scope 3 emissions¹ with greater clarity of the activities under our direct control. We are now also publishing our Scope 3 supply chain emissions as well as, for the first time, our homeworking emissions following the Group's adoption of a mixed (remote and site-based) working model (see page 64).

In 2021 the Group joined the Race to Zero committing to set Science-Based Targets to reduce our emissions based on a 1.5°C pathway. We are in the process of setting Science-Based Targets, which will guide the Group to reduce our emissions as part of the Science Based Target initiative (“**SBTi**”), where we are aiming for a validated set of targets in 2022. This will cover our operational emissions (Scope 1 and 2 emissions), as well as our Scope 3 emissions including our supply chain and investments. In recognition that our carbon reduction strategy will take time we remain a carbon neutral business through offsetting.

“Alongside our climate change scenario analysis we are focused on supporting customers to make sustainable choices.”

Understanding climate-related risks is important because we manage insurance risks presented by weather-related events, such as flooding and storm damage. The Group continues to evaluate the risks presented by climate change and last year we participated in the Bank of England's Climate Biennial Exploratory Scenario (“**CBES**”).

Alongside our climate change scenario analysis we are focused on supporting customers to make sustainable choices. In 2021 we launched our electric vehicle offer for our Direct Line brand and our commercial business partnerships are offering customers the flexibility to try electric vehicles.

UK economy and Brexit

The UK's new international trading relationships may have had an impact on claims inflation and may still do so, although the Covid-19 pandemic continues to mask the effects of these relationships. Certain risks related to Brexit could still occur or be exacerbated and we continue to be alert to possible developments.

1. Excluding investments