Direct Line Insurance Group plc
Preliminary results for the year ended 31 December 2013

26 February 2014

Financial highlights

- Operating profit from ongoing operations[1] of £526.5 million for 2013, up 14.2% (2012: £461.2 million); and total Group profit before tax of £423.9 million (2012: £249.1 million)
- Combined operating ratio[2] for ongoing operations[1] of 96.1% for 2013, an improvement of 3.1 percentage points against 2012 (99.2%), and ahead of the target 98% for 2013
- Combined operating ratio[2] for ongoing operations[1] in 2013 included higher than expected contribution from prior-year reserve releases of 12.4 percentage points (£435.1 million) compared to 8.7 percentage points in 2012 (£322.0 million)
- Return on tangible equity[3] from ongoing operations[1] of 16.0% for 2013 (2012: reported 11.5%; pro forma[4] 2012: 13.4%)
- 5.0% increase in final dividend per share to 8.4 pence per share and second special interim dividend of 4.0 pence per share taking total dividends for 2013 to 20.6 pence per share
- Strong capital position maintained with risk-based capital coverage[5] of 148.7% post final and second special interim dividends, towards the upper end of the target range of 125% to 150%

Strategic and operational highlights

- Investment in improved customer focused capabilities and propositions, launch of two telematics products and start of roll-out of smartphone and tablet optimised websites
- Extended efficiency programme particularly in head office functions and announced additional cost savings, targeting a reduced total cost base[6] of approximately £1,000 million in 2014
- Completed claims transformation for Motor and Home, extended ClaimCenter to Commercial Motor and Italy, and laid the foundations for DLG Legal Services Limited
- Continued to develop Commercial and International, in particular full roll-out of eTrading and strong growth in Germany

Paul Geddes, CEO of Direct Line Group, commented

"We have continued to make good progress on our strategic priorities, helping us to achieve our 2013 financial targets in highly competitive markets. We increased operating profit from ongoing operations by 14.2%, delivered a combined operating ratio of 96.1% and a return on tangible equity of 16.0%.

"In UK Motor, our improved pricing capability and claims management, as well as benefits arising from recent legal reforms, enabled us to reduce average prices for customers by 3% during 2013. In Home, recent UK weather events have emphasised the importance of insurance. I am proud of our people who have been working tirelessly around the clock to assist customers affected by the floods and storms, both on the phones and on the ground.

"Looking forward to 2014, we will continue to pursue our strategic priorities and self-help agenda to enable us to deliver benefits for our customers and shareholders."

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Notes:

1. Ongoing operations include Direct Line Group's (the "**Group**") ongoing segments: Motor, Home, Rescue and other personal lines, Commercial and International. It excludes the Run-off segment and Restructuring and other one-off costs.

2. Combined operating ratio ("**COR**") is the sum of the loss, commission and expense ratios. The ratio is a measure of the amount of claims costs, commission and expenses compared to net earned premium generated.

3. Return on tangible equity ("**RoTE**") is adjusted profit after tax from ongoing operations, divided by the Group's average tangible shareholders' equity. Profit after tax is adjusted to exclude the Run-off segment and Restructuring and other one-off costs and the gain on disposal of subsidiary and is stated after charging tax (using the UK standard tax rate of 23.25%; 2012: 24.5%).

4. Pro forma RoTE is based on the return on tangible equity but assumes that the capital actions taken by the Group prior to the initial public offering ("**IPO**") (£1 billion dividend payment and £500 million long-term subordinated debt issue) occurred on 1 January 2012.

5. A measure to show the level of capital held compared to the level that is required, taking into account the risks faced by the business.

6. Operating expenses and claims handling expenses from ongoing operations, excluding the Run-off segment and Restructuring and other one-off costs.

Forward-looking statements disclaimer

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", "anticipates", "believes", "continue", "could", "estimates", "expects", "guidance", "intends", "may", "outlook", "plans", "predicts", "projects", "seeks", "should", "targets" or "will" 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 a number of 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 and the industry in which the Group operates. Examples of forward-looking statements include financial targets which are contained in this document specifically with respect to RoTE, the Group's COR, the COR for the Group's Commercial division, and cost savings. 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 or are beyond the Group's control. Forward-looking statements are not guarantees of 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, UK domestic and global economic business conditions, market-related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory authorities (including changes related to capital and solvency requirements or the Ogden discount rate), the impact of competition, currency changes, inflation and deflation, the timing impact and other uncertainties of future acquisitions, disposals, joint ventures or combinations within relevant industries, as well as the impact of tax and other legislation and other regulation in the jurisdictions in which the Group and its affiliates operate. In addition, even if the Group's actual results of operations, financial condition and the development of the business sector in which the Group operates are consistent with the forward-looking statements contained in this document, those results or developments may not be indicative of results or developments in subsequent periods.

The forward-looking statements contained in this document reflect knowledge and information available as of the date of preparation of this document. The Group and the Directors expressly disclaim any obligations or undertaking to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, unless required to do so by applicable law or regulation. Nothing in this document should be construed as a profit forecast.

Neither the content of Direct Line Group's website nor the content of any other website accessible from hyperlinks on the Group's website is incorporated into, or forms part of, this document.

Financial summary

	Q4 2013 £m	Q4 2012 £m	FY 2013 £m	FY 2012 £m
Ongoing operations[1]:				
Gross written premium	**873.0**	905.4	**3,826.6**	3,990.6
Net earned premium	**868.0**	918.4	**3,520.6**	3,708.7
Underwriting profit	**15.8**	19.8	**138.2**	28.2
Instalment and other operating income	**42.7**	51.5	**180.2**	198.3
Investment return	**50.2**	42.0	**208.1**	234.7
Operating profit – ongoing operations	**108.7**	113.3	**526.5**	461.2
Run-off segment	**32.8**	7.9	**63.6**	6.1
Restructuring and other one-off costs	**(53.3)**	(52.6)	**(140.5)**	(189.5)
Operating profit	**88.2**	68.6	**449.6**	277.8
Finance costs	**(9.3)**	(8.4)	**(37.7)**	(28.7)
Gain on disposal of subsidiary	**12.0**	-	**12.0**	-
Profit before tax	**90.9**	60.2	**423.9**	249.1
Tax	**(21.2)**	(17.7)	**(111.1)**	(64.8)
Profit after tax	**69.7**	42.5	**312.8**	184.3
Of which ongoing operations[2]	**76.3**	79.2	**375.2**	326.5
Key metrics – ongoing operations[1]				
Loss ratio	**65.8%**	66.9%	**62.6%**	67.1%
Commission ratio	**11.6%**	10.5%	**11.2%**	9.1%
Expense ratio	**20.8%**	20.5%	**22.3%**	23.0%
Combined operating ratio	**98.2%**	97.9%	**96.1%**	99.2%
Earnings per share:				
Adjusted[3] (pence)			**25.0**	21.8
Return on tangible equity[4]			**16.0%**	11.5%
Pro forma return on tangible equity[5]			**n/a**	13.4%
Key metrics – total Group				
Investment income yield			**2.1%**	2.0%
Investment return			**2.5%**	2.8%
Earnings per share:				
Basic (pence)			**20.9**	12.3
Diluted (pence)			**20.8**	12.3
Return on equity			**11.1%**	5.7%
Dividend per share - interim (pence)			**4.2**	n/a
- final (pence)			**8.4**	8.0
- regular (pence)			**12.6**	8.0
- first special interim (pence)			**4.0**	n/a
- second special interim (pence)			**4.0**	n/a
- total (pence)			**20.6**	8.0
- pro forma regular (pence)			**n/a**	12.0
As at 31 December			**2013**	2012
Net asset value per share (pence)			**186.6**	189.1
Tangible net asset value per share (pence)			**153.2**	161.0

Notes:
1. See note 1 on page 2.
2. See note 1 on page 2, adjusted for finance costs, excluding gain on disposal of subsidiary and stated after charging tax (using the standard tax rate of 23.25%; 2012: 24.5%).
3. Adjusted earnings per share (diluted) excludes the Run-off segment and Restructuring and other one-off costs (using UK standard tax rate).
4. See note 3 on page 2.
5. See note 4 on page 2.

Business update

Overview

Direct Line Group (the "**Group**") continued to make good progress in 2013 on its strategic priorities and financial targets, while maintaining its disciplined approach to underwriting in a competitive marketplace.

Ongoing operating profit improved by 14.2 % to £526.5 million (2012: £461.2 million) and COR for ongoing operations by 3.1 percentage points to 96.1% (2012: 99.2%). These were driven by an improved underwriting profit, including higher than expected prior-year reserve releases, and were partially offset by lower investment return and instalment and other income.

Total Group profit before tax was £423.9 million (2012: £249.1 million), an increase of 70.2%. This benefited from an increase in profit from the Run-off segment to £63.6 million (2012: £6.1 million) as a result of higher reserve releases, and lower Restructuring and other one-off costs of £140.5 million (2012: £189.5 million).

The growth in operating profit arose mainly from the Motor division, which benefited from a continued high level of prior-year reserve releases and increased operating profit by 32.8% to £347.7 million, (2012: £261.8 million) and Home which, despite significant claims in the fourth quarter, experienced fewer claims from major weather events for the year as a whole. The Commercial and International divisions both improved profit on an underlying basis, although headline results for International were impacted by hailstorms in Germany. The operating profit for Rescue and other personal lines reduced due to the non-repeat of one-off benefits reported in 2012 mainly from the creditor business.

UK Motor and Home trading

The UK motor and home markets were highly competitive during 2013 with significant premium deflation experienced across the industry. In the Group's Motor business, gross written premium fell by 10.8% (adjusting for the effect of reclassifying van business to Commercial) as the Group balanced underwriting margins and volumes and only reduced prices where claims data was supportive.

Overall the Group reduced motor prices on average by 3% during 2013 as it experienced positive trends in small and large bodily injury claims, in part reflecting its claims transformation programme, but also recognising benefits from recent legal reforms. Overall in-force policies for Motor fell by 5.4% (adjusting for the effect of reclassifying van business to Commercial) while risk mix resulted in a reduction of premium income of 4% due in part to competition in higher premium segments.

Motor – effect on premium income of changes in price and risk mix

Change versus same period in previous year	Q1 2013 £m	Q2 2013 £m	Q3 2013 £m	Q4 2013 £m	FY 2013 £m
Change in price	+1%	-3%	-5%	**-4%**	**-3%**
Change in risk mix	-6%	-4%	-2%	**-3%**	**-4%**

After some signs in the fourth quarter of 2013 of market stabilisation, early 2014 has seen increased competition. A number of market participants have reduced prices, putting additional pressure on new business volumes. The Group has continued its strategy of pricing in line with claims trends and gross written premium for Motor in the first quarter of 2014 is currently expected to be approximately 10% lower than in the same period in 2013. This reflects a combination of lower volumes, prices and risk mix.

In Home, gross written premium reduced by 4.6% in 2013 as the Group reinvested the benefits from its pricing and claims transformation programmes. Underlying in-force policies fell by 2.6%. Claims arising from major weather events in 2013 were £69 million (2012: £105 million) with the vast majority occurring in the fourth quarter.

Business update

During 2013, the Group has continued to make good progress in advancing its key strategic priorities. The key developments were:

Distribution – The Group continued to invest in building improved customer capability and propositions. This included the roll-out of two telematics products across the brands, with one in five new Direct Line motor policies with drivers aged under 25 now including telematics. The Group also created differentiated product offerings, such as Direct Line 'Together' and Green Flag's 'One-hour response', while reducing marketing expenditure by 9.4%. At the same time the Group invested in a new digital content platform and enhanced web tool analytics, and started the roll-out of new smartphone and tablet optimised websites. These are aimed at improving the customer 'quote and buy' journey significantly.

Pricing – Updated technical pricing models were launched in Motor with improved granularity at individual peril level. The use of these rating models helped the Group to optimise its exposure to higher premium segments of the market, an area of the market that has become increasingly competitive. The Group also implemented enhanced renewal management capabilities in Home, which has helped to increase retention by 2.2 percentage points. The Group has over 30 pricing initiatives to be delivered in 2014 with a number of specific initiatives targeting enhanced price comparison website ("**PCW**") capability.

Claims – The claims transformation programme for Motor and Home was completed with the full roll-out of ClaimCenter alongside new operating models. Further initiatives included a new home estimation tool and in Motor included improved customer propositions, for example a car replacement service, which make full use of the claims fulfilment network. The foundations for DLG Legal Services were also laid and this is currently expected to launch in early March 2014.

Costs – The Group continued to implement initiatives in relation to business transformation and cost savings, particularly in the head office functions. These initiatives, designed to improve efficiencies and reduce complexities, enabled the Group to increase its cost saving target during the year. The total cost base for 2013 was 9.2% lower than in 2012 as the benefits from these initiatives began to be recognised. In addition the first stage in the delivery of IT migration from RBS Group infrastructure was reached with the launch of new data centres in conjunction with Capgemini and new voice and desktop tools started to be rolled out. This investment aims to create a low-cost self-service digital infrastructure.

Commercial and International – The Commercial division launched NIG's full-cycle e-trading platform 'The Hub' and continues to roll this out to new products. Where products have been migrated onto this new platform, trading has been encouraging. Furthermore, Commercial has reorganised its operations and separated trading and operational functions, together with a restructure of the regional functions to enhance new business focus and improve efficiency. The International business grew in Germany, where it benefited from positive market conditions. Its efficient platform enabled it to grow its share of year-end business without significant additional cost. In Italy, the business leveraged best practice from the UK and implemented ClaimCenter, which aims to deliver better processes for its customers and efficiencies for the business.

Regulatory update

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

The Group continues to engage proactively in new or emerging regulatory priorities. Good conduct is integral to the success of the Group's business, which is why the decision was taken to switch the sale of the motor legal protection product to opt-in prior to the publication of regulatory guidance, and why the Group has chosen to set up DLG Legal Services as an alternative business structure which should help to shield existing customers from potentially excessive third party solicitor fees.

In December 2013, the CC published the provisional findings of its ongoing investigation into the UK private motor insurance market. The Group continues to work with the CC, and has always said it welcomes the investigation if it results in a level playing field by removing market dysfunction, which should benefit consumers.

Separation from RBS Group

The Group moved a step closer to full divestment following two share placings in 2013 by RBS Group, which have reduced RBS Group's shareholding to 28.5%. With the opening of its own data centres, the Group aims to make substantial progress on IT migration during 2014 and reduce its dependence on RBS Group's IT infrastructure.

On 1 October, Bruce Van Saun stepped down from the Board and Mark Catton was reappointed. RBS Group is entitled, under its Relationship Agreement with Direct Line Group, to nominate one Non-Executive Director to the Board while its shareholding in the Company remains 20% or more.

Sale of Direct Line Life and Tracker
In November 2013, the Group sold Direct Line Life ("**the Life business**") to Chesnara plc with gross proceeds including a pre-sale dividend of £62.3 million. The Life business had been closed to new business since 2011. Additionally in February 2014, the Group sold its stolen vehicle recovery business, Tracker. The proceeds from these transactions have contributed to the two special interim dividends announced for 2013.

Dividends and capital management
The Board is proposing a final dividend of 8.4 pence per share making a total regular dividend for 2013 of 12.6 pence per share. This represents 5.0% growth over the pro forma[1] 2012 regular dividend and is in line with the Group's aim to grow dividends annually in real terms.

In addition, the Board is also declaring a further special interim dividend of 4.0 pence per share, in addition to the 4.0 pence per share paid in December 2013. This second special interim dividend reflects the better than planned performance in the Run-off segment and the proceeds from the recently announced sale of Tracker. Both these items are considered to be one-off in nature and as a result the Board believes it is appropriate in this instance to return this capital to shareholders.

After deduction of the proposed final dividend and second special interim dividend, the estimated risk-based capital coverage ratio at 31 December 2013 was 148.7% (31 December 2012: 145.4%). The Board constantly reviews the level of capital held by the Group and currently believes that it is appropriate to maintain capital at the upper end of its risk-based capital coverage range. This assessment has been made after taking into account a number of factors including: the Prudential Regulation Authority's ("**PRA**") new Individual Capital Adequacy Standards Plus ("**ICAS+**") process used to assess the Group's future individual capital guidance; the route to Solvency II implementation; and the effect of recent and planned changes to the Group's target asset mix. The Board will continue to review this position as clarity improves on the factors mentioned above and the Group makes further progress along its transformation plan.

UK weather update
Adverse weather conditions experienced in the fourth quarter of 2013 have continued in the first quarter of 2014 resulting in further storm damage and severe flooding. While it is too early to assess with accuracy, the Group's preliminary estimate for the cost of Home claims from this event up to 22 February 2014 is in the range of £70 to £90 million. This compares to an expectation in an average year of £80 million of claims from major weather events. More certainty around the actual claims costs will be possible only once flood waters have receded. The Group has also experienced weather-related claims of approximately £20 million in its Commercial division. With elevated ground water levels, the potential for future claims is increased in the event of further storms.

Outlook
The UK motor and home markets remain highly competitive and competition has also intensified in the Italian motor market following a period of falling claims frequency. In this trading environment, the Group will continue to prioritise targeting appropriate margins even if this is at the expense of premium volumes. The Group continues to progress initiatives supporting its strategic objectives of improving its competitive position and performance in the longer term.

For 2014, the Group aims to achieve a combined operating ratio in the range of 95% to 97% for ongoing operations assuming a normal level of claims from major weather events. Assuming underlying claims trends continue, a significant contribution from prior-year reserve releases is currently expected, albeit at a lower level than in 2013. In addition, the Group is aiming to deliver a total cost base of approximately £1,000 million[2] and a combined operating ratio of less than 100% for its Commercial division in 2014, assuming a normal level of claims from weather-related events and large losses.

Notes:
1. Pro forma dividend based on 2012 final dividend of 8.0 pence per share being two-thirds of regular annual dividend.
2. See note 6 on page 2.

Finance review

Against a backdrop of competitive markets, the Group made progress on its financial targets, achieving a COR for ongoing operations of 96.1% and a 16.0% return on tangible equity. The Group maintains a strong capital position, with a conservative approach to reserving and a high-quality investment portfolio.

Operating profit – ongoing operations

	Q4 2013 £m	Q4 2012 £m	**FY 2013 £m**	FY 2012 £m
Underwriting profit	**15.8**	19.8	**138.2**	28.2
Instalment and other operating income	**42.7**	51.5	**180.2**	198.3
Investment return	**50.2**	42.0	**208.1**	234.7
Operating profit	**108.7**	113.3	**526.5**	461.2

Overall operating profit from ongoing operations of £526.5 million represented a 14.2% increase on 2012 (2012: £461.2 million). There was a significant improvement in the underwriting result, driven by higher than expected reserve releases of £435.1 million (2012: £322.0 million) and, despite poor weather in the last quarter, fewer claims from major weather events in Home in 2013. This more than offset a lower investment return, lower instalment and other operating income and higher than normal weather-related claims in Commercial and International.

Operating profit in the fourth quarter of £108.7 million was 4.1% lower than the fourth quarter of 2012 (£113.3 million). The underwriting profit of £15.8 million in the fourth quarter was lower than the previous year as higher weather-related claims were offset by higher reserve releases. Other income was lower reflecting the ban of solicitors' referral fee income and lower volumes, while investment return benefited from changes to the Group's investment asset allocation.

In-force policies – ongoing operations (thousands)

As at 31 December	**2013**	2012
Motor	**3,762**	4,050
Home	**3,719**	4,239
Rescue and other personal lines	**8,801**	9,431
Commercial	**583**	466
International	**1,610**	1,462
Total	**18,475**	19,648

In-force policies for ongoing operations decreased by 6.0% during 2013 to 18.5 million. The fall related primarily to Rescue and other personal lines and Home. The Rescue and other personal lines reduction arose mainly from travel policies from packaged bank accounts. Home in-force policies fell mainly as a result of the removal of Home Response[1] policies (around 420,000) from certain packaged bank accounts no longer sold through partners. Excluding this effect, which had little impact on gross written premium, Home in-force policies decreased by 2.6% during 2013.

The fall in Motor in-force policies of 7.1% reflects the Group's focus on maintaining its underwriting discipline in a competitive marketplace, particularly for new business. The reclassification of van business to Commercial (around 70,000 in-force policies) from 1 January 2013 represented 1.7 percentage points of the reduction.

Commercial continued to grow in-force policies, particularly in Direct Line for Business and also benefited from the reclassification of van business from Motor. International growth arose from Germany where the Group has benefited from improved market conditions.

Note:
1. Insurance policy giving customers access to vetted tradesmen for home emergencies and repairs.

Gross written premium – ongoing operations

	Q4 2013 £m	Q4 2012 £m	FY 2013 £m	FY 2012 £m
Motor	**303.7**	341.8	**1,421.1**	1,623.5
Home	**226.3**	237.6	**943.1**	989.0
Rescue and other personal lines	**88.2**	86.5	**383.4**	389.8
Commercial	**113.0**	102.1	**474.5**	435.6
International	**141.8**	137.4	**604.5**	552.7
Total	**873.0**	905.4	**3,826.6**	3,990.6

Gross written premium of £3,826.6 million fell 4.1% compared with the prior year (2012: £3,990.6 million). This reflects the impact of a competitive market, particularly in UK motor, together with the Group's continued focus on maintaining its underwriting discipline.

Gross written premium for Commercial of £474.5 million increased by 8.9% (2012: £435.6 million) due to the transfer of van business and growth in Direct Line for Business.

International gross written premium of £604.5 million was 9.4% higher than the previous year (2012: £552.7 million) as a result of strong growth in Germany more than offsetting subdued trading in Italy. Gross written premium in local currency terms increased by 4.9%, broadly in line with the growth of in-force policies.

In total, gross written premium for ongoing operations of £873.0 million in the fourth quarter fell by 3.6% compared to 2012 (fourth quarter 2012: £905.4 million).

Underwriting profit – ongoing operations

	FY 2013	FY 2012
Underwriting profit (£ million)	**138.2**	28.2
Loss ratio	**62.6%**	67.1%
Commission ratio	**11.2%**	9.1%
Expense ratio	**22.3%**	23.0%
Combined operating ratio	**96.1%**	99.2%

The Group's COR for ongoing operations improved by 3.1 percentage points to 96.1% (2012: 99.2%), resulting in an increase in underwriting profit for ongoing operations to £138.2 million (2012: £28.2 million).

The improvement was primarily the result of a 4.5 percentage points reduction in the loss ratio, which arose from two main factors: significant reserve releases, in part due to management actions to improve the risk profile of the book and initiatives relating to claims, and despite poor weather in the last quarter, fewer claims from major weather events in Home. In 2013, the Home division incurred approximately £69 million of claims from major weather events (2012: approximately £105 million). This latter benefit was partially offset by higher than normal weather-related claims in International (German hailstorms in June and July 2013) and in Commercial (storms and floods in the fourth quarter of 2013).

Current-year attritional loss ratio – ongoing operations

	FY 2013	FY 2012
Reported loss ratio	**62.6%**	67.1%
Prior year reserve releases	**12.4%**	8.7%
Major weather events – Home[1]	**(2.0%)**	(2.8%)
Current-year attritional loss ratio	**73.0%**	73.0%

Note:
1. Home claims from major weather events, including inland and coastal flooding and storms.

The Group views the trend in the current-year attritional loss ratio as a good indicator of underlying performance as it excludes prior-year reserve movements and claims from major weather events in the Home division.

Overall, the current-year attritional loss ratio remained unchanged at 73.0% in 2013, despite competitive market conditions and higher than expected weather-related claims in International and Commercial.

Prior-year reserve releases – ongoing operations[1]

	FY 2013 £m	FY 2012 £m
Motor	**291.9**	174.3
Home	**43.3**	37.4
Rescue and other personal lines	**9.0**	23.9
Commercial	**51.6**	56.2
International	**39.3**	30.2
Total	**435.1**	322.0

Note:
1. This excludes the Run-off segment reserve releases £52.1 million (2012: £67.5 million).

Overall prior-year reserve releases from ongoing operations increased to £435.1 million (2012: £322.0 million), equivalent to 12.4% of net earned premium (2012: 8.7% of net earned premium). Assuming underlying claims trends continue, a significant contribution from prior-year reserve releases is currently expected in 2014, albeit at a lower level than in 2013.

The commission ratio increased by 2.1 percentage points to 11.2% (2012: 9.1%), partly due to profit-share payments, reflecting the higher profitability of partnership business in the Home division. This is mainly attributable to fewer claims from major weather events.

The expense ratio improved 0.7 percentage points to 22.3% (2012: 23.0%), reflecting the benefits of cost reduction initiatives and reduced parallel running costs, but these benefits were partially offset by the effect of lower net earned premium.

Combined operating ratio by division – ongoing operations

	Reported basis	
	FY 2013	FY 2012
Motor	**93.2%**	101.6%
Home	**93.8%**	96.6%
Rescue and other personal lines	**92.4%**	82.7%
Commercial	**106.8%**	108.2%
International	**103.9%**	103.3%
Total ongoing	**96.1%**	99.2%

On a segmental basis, the COR improved in Motor, Home and Commercial compared with 2012. Rescue and other personal lines COR increased in 2013 as positive one-off benefits in 2012 mainly from the creditor business were not repeated. The International COR remained broadly stable.

Current-year attritional loss ratio by division – ongoing operations

	FY 2013	FY 2012
Motor	**85.3%**	85.4%
Home	**51.1%**	51.3%
Rescue and other personal lines	**62.5%**	57.2%
Commercial	**74.1%**	77.0%
International	**88.0%**	86.9%
Total ongoing	**73.0%**	73.0%

In Motor, the 8.4 percentage points improvement in COR reflects management actions to improve the risk profile of the book as well as higher releases of reserves from prior years. Reserve releases of £291.9 million in 2013 were driven primarily by favourable bodily injury experience for recent accident years, partly attributable to better risk selection and benefits arising from the Group's claims transformation programme. Assuming underlying claims trends continue, a significant contribution from prior-year reserve releases is currently expected in 2014, albeit at a lower level than in 2013. The current-year attritional loss ratio was in line with 2012.

The Home COR improved to 93.8% in 2013 from 96.6% in 2012. The improvement was almost entirely driven by reduction in claims from major weather events. In 2013, claims from major weather events totalled approximately £69 million compared with approximately £105 million in 2012. The current-year attritional loss ratio was in line with the prior period, reflecting stable underwriting margins, albeit in a more competitive operating environment. Reserve releases were broadly in line with 2012.

The COR for Rescue and other personal lines increased to 92.4% (2012: 82.7%). The 2012 result benefited from positive one-offs (relating primarily to the run-off of the legacy creditor business) that were not repeated in 2013. The performance was also affected by higher claims frequency on the travel book and increased Green Flag marketing costs. The Life business, which contributed £6.4 million to operating profit in 2013 (2012: £8.1 million), was sold in November 2013.

The Commercial division improved its COR to 106.8% from 108.2% principally as a result of better underlying underwriting performance and a lower commission and expense ratio. The current-year attritional loss ratio improved despite higher weather-related claims demonstrating the positive effect of recent management actions. The division continues to experience significant reserve releases. Excluding the impact of weather-related claims above normal levels, the COR would have been approximately 104%.

International COR in 2013 increased to 103.9% from 103.3% in 2012. The increase was due to claims relating to hailstorms in Germany in June and July. For 2013 as a whole weather-related net claims were approximately £8 million more than expected. Reserve releases increased to £39.3 million (2012: £30.2 million) although are not expected to remain at these levels.

Operating expenses and total cost base – ongoing operations

	Q4 2013 £m	Q4 2012 £m	**FY 2013 £m**	FY 2012 £m
Staff costs	**79.9**	81.2	**336.7**	312.8
Marketing	**35.8**	30.7	**184.1**	203.1
Management fees	**-**	-	**-**	129.2
Depreciation	**5.0**	4.4	**21.0**	13.1
Amortisation and impairment of other intangible assets	**10.0**	22.5	**37.2**	40.7
Other operating expenses	**49.7**	49.7	**207.4**	155.9
Total operating expenses	**180.4**	188.5	**786.4**	854.8
Claims handling expenses	**67.5**	78.3	**245.5**	282.0
Total cost base	**247.9**	266.8	**1,031.9**	1,136.8
Expense ratio			**22.3%**	23.0%
Claims handling ratio			**7.0%**	7.6%

The expense ratio improved by 0.7 percentage points to 22.3% due to a reduction in operating expenses compared with 2012, partially offset by the impact of lower net earned premium.

Ongoing operating expenses of £786.4 million were reduced by 8.0% from the prior year (2012: £854.8 million). The reduction was principally due to the benefits from the Group's cost savings plan announced in 2012, tight cost control and the non-repeat of certain expenses under the historic RBS Group recharge.

From 1 July 2012, the Group no longer paid a management fee to RBS Group and this was replaced by directly paying third-party suppliers for the majority of services that RBS Group had previously provided. Consequently, expenses previously reported under management fees are now reflected within their relevant line items. The Group continues to pay RBS Group for transitional IT infrastructure, the costs of which are included within other operating expenses.

The Group is targeting a total cost base of approximately £1,000 million in 2014[1] and the total cost base in 2013 of £1,031.9 million showed good progress towards this target.

The total cost base of £247.9 million in the fourth quarter fell by £18.9 million compared to the previous period (fourth quarter 2012: £266.8 million).

Note:
1. See note 6 on page 2.

Instalment and other operating income – ongoing operations

	Q4 2013 £m	Q4 2012 £m	FY 2013 £m	FY 2012 £m
Instalment income	**28.5**	31.7	**117.8**	125.4
Other operating income:				
- Solicitors' referral fee income			**6.9**	21.1
- Vehicle replacement referral income			**15.7**	17.2
- Revenue from vehicle recovery and repair services[1]			**31.8**	25.9
- Fee income from insurance intermediary services			**1.7**	1.9
- Other income			**6.3**	6.8
Total other operating income	**14.2**	19.8	**62.4**	72.9
Total	**42.7**	51.5	**180.2**	198.3

Note:
1. Vehicle recovery includes post-accident and pay on use recovery and vehicle tracking. Repair services constitute the provision of non-insurance related services.

Instalment and other operating income from ongoing operations reduced by 9.1% from 2012. This was primarily as a result of the cessation of solicitors' referral fee income from 1 April 2013 and lower instalment income.

Instalment income, representing interest charged on insurance premiums paid by instalments, of £117.8 million reduced by £7.6 million compared with the prior year (2012: £125.4 million) as a result of lower in-force policies in Motor and Home and changes to business mix.

In February 2014, the Group sold its stolen vehicle recovery business, Tracker. In 2013, Tracker's revenue was £18.4 million (2012: £18.2 million) which was included in the above. Operating losses from the business were £1.4 million (2012: £3.9 million).

Cessation of solicitors' referral fee income and lower in-force policies similarly affect on the fourth quarter, with instalment and other income of £42.7 million, a reduction of £8.8 million compared to the previous period.

Investment return

	Total Group		Ongoing operations	
	FY 2013 £m	FY 2012 £m	**FY 2013 £m**	FY 2012 £m
Investment income	**188.6**	199.3	**175.5**	179.9
Net realised and unrealised gains	**32.5**	82.5	**32.6**	54.8
Total investment return	**221.1**	281.8	**208.1**	234.7

The total investment return reduced to £221.1 million compared with 2012, due to a decrease in realised gains and lower investment income resulting from lower assets under management.

During 2013, the investment asset base decreased by 8.5% to £8.6 billion. Key reasons for the reduction include the repayment of the £258.5 million Tesco loan note and investment outflows resulting from a net reduction in insurance liabilities.

Investment yields – total Group

	FY 2013	FY 2012
Investment income yield[1]	**2.1%**	2.0%
Investment return[2]	**2.5%**	2.8%

Notes:
1. Investment income yield excludes net gains.
2. Investment return includes net gains.

Investment income was £188.6 million, a 5.4% decrease on 2012, as a result of a lower average investment asset base, which was partially offset by an increase in investment income yields.

Net realised and unrealised gains recognised in 2013 were £32.5 million compared with £82.5 million in 2012. Realised gains in 2012 reflected significant portfolio restructuring actions. Total realised gains at 31 December 2013 were £58.8 million net of deferred tax (2012: £158.8 million).

The investment income yield on the total portfolio for 2013 was 2.1%, an improvement on 2012 driven primarily by management actions to increase the credit and property weighting within the target investment mix.

Income on invested assets

	FY 2013		FY 2012	
	Asset allocation	**Income**	Asset allocation	Income
Credit	**63.2%**	**2.6%**	56.4%	2.7%
Securitised credit[1]	**2.7%**	**0.8%**	0.5%	2.1%
Sovereign	**16.4%**	**1.9%**	19.7%	1.6%
Cash and cash equivalents	**15.1%**	**0.4%**	22.0%	0.8%
Investment property	**2.6%**	**6.5%**	1.4%	4.4%
Total	**100.0%**	**2.1%**	100.0%	2.0%

Note:
1. Income of 2.1% in 2012 is as a result of £241 million legacy mortgage-backed securities holdings, which were disposed of at the end of 2012.

Investment portfolio

The Group's investment strategy comprises primarily of investments in sovereign debt securities, investment grade fixed income securities and cash. The strategy ensures adequate liquidity is always available to meet customers' claims, particularly in periods of stress (for example natural disasters). It is also designed to ensure that asset and liability durations match closely where possible; and that risk is diversified and return maximised relative to the Group's risk appetite and capital allocated to investment risk.

During 2013, key achievements included:

- Undertaking a major asset and liability management study on U K Insurance Limited ("**UKI**"), which reconfirmed liquidity requirements and proposed some changes to the current asset mix to deliver a better overall risk adjusted return
- Transferring the management of AAA fixed-income credit in-house to improve the overall cost effectiveness of the operating model
- Increasing the benchmark allocation to investment grade credit and the sub-allocation to BBB rated assets
- Investing into externally managed securitised credit, with the focus on investment into the highest-quality debt tranches and having a well-diversified range of collateral types and pools backing such investments
- The continuing selective purchase of assets for the UK commercial property portfolio. The asset brings portfolio return diversification and long-term returns to support inflation-linked liabilities

In 2014, the Group plans to invest in infrastructure debt as a new asset class to back long-tailed liabilities.

Investment holdings – total Group

As at 31 December	2013 £m	2012 £m
Corporate debt securities[1]	**4,915.8**	4,483.4
Supranational	**365.7**	521.8
Local government	**134.5**	271.1
Credit	**5,416.0**	5,276.3
Securitised credit[1]	**229.8**	45.2
Sovereign	**1,399.5**	1,842.8
Total debt securities	**7,045.3**	7,164.3
Cash and cash equivalents[2]	**1,288.9**	2,062.5
Investment property	**223.4**	128.9
Total	**8,557.6**	9,355.7

Notes:
1. Asset allocation at 31 December 2013 includes investment portfolio derivatives, which have been netted and have a mark-to-market value of £39.8 million, split £37.7 million in corporate debt securities and £2.1 million in securitised credit (31 December 2012: corporate debt securities £7.8 million).
2. Net of bank overdrafts and including term deposits with financial institutions with maturities in excess of three months.

Total debt securities are £7,045.3 million (2012: £7,164.3 million), of which 12.9% are rated as ‘AAA’ and a further 70.5% are rated as ‘AA’ or ‘A’. Corporate, local government and supranational debt securities account for 63.3% of the portfolio.

The total value of the investment portfolio at 31 December 2013 was £8,557.6 million, 8.5% lower than at 31 December 2012. Assets under management provide adequate access to liquidity, with 15.1% of the funds held in cash and cash equivalents at the year end.

The duration as at 31 December 2013 of total investment assets was 2.0 years, with the breakdown being: UK 1.9 years; Italy 3.3 years; and Germany 2.4 years (2012: 1.8 years; UK 1.7 years; Italy 2.8 years; and Germany 2.5 years).

The internally managed gilt and AAA credit portfolios have intentionally been held at a shorter duration than benchmark given the expectation of improvements in the interest rate environment. In addition, to minimise further interest rate risk the Group has increased its investment allocation to floating rate instruments, for example, securitised credit. The US credit portfolios have been swapped to a floating basis since inception in 2012.

Investment property holdings shown as at 31 December 2013 comprised 20 properties. The primary sector exposures are industrial warehouses (26.5%) and supermarkets (19.7%).

Operating profit – ongoing operations

	FY 2013 £m	FY 2012 £m
Motor	**347.7**	261.8
Home	**106.2**	93.3
Rescue and other personal lines	**46.5**	84.4
Commercial	**9.5**	2.2
International	**16.6**	19.5
Total	**526.5**	461.2

In the year ended 31 December 2013, all divisions were profitable. All except Rescue and other personal lines and International improved profit versus 2012.

Reconciliation of operating profit

	Q4 2013 £m	Q4 2012 £m	FY 2013 £m	FY 2012 £m
Ongoing operations	**108.7**	113.3	**526.5**	461.2
Run-off segment	**32.8**	7.9	**63.6**	6.1
Restructuring and other one-off costs	**(53.3)**	(52.6)	**(140.5)**	(189.5)
Total Group	**88.2**	68.6	**449.6**	277.8

Run-off

The Run-off segment made a profit of £63.6 million in 2013 compared with a profit of £6.1 million in 2012 and a profit of £32.8 million in the fourth quarter. Similar to the ongoing operations, the Run-off segment benefited from positive prior-year reserve releases from the recognition of improved claims experience, in particular in relation to large bodily injury claims. Going forward, it is currently expected that the Run-off segment will contribute positively to operating profit, albeit at a lower level than in 2013.

Restructuring and other one-off costs

Restructuring and other one-off costs for 2013 fell to £140.5 million (2012: £189.5 million) as a result of the non-repeat of costs associated with separation and divestment from RBS Group. This includes £60.2 million relating to IT migration and £80.3 million relating to the Group's cost saving initiatives. The Group currently expects that Restructuring and other one-off costs in 2014 will be approximately £80 million.

Finance costs

Finance costs increased to £37.7 million (2012: £28.7 million), primarily reflecting a full year of interest on the £500 million of long-term subordinated debt issued in April 2012.

Gain on disposal of subsidiary

On 8 October 2013, the Group announced an agreement with Chesnara plc for the sale of the Life business. Total sale proceeds of £62.3 million, which include a pre-closing dividend of £23.0 million, represent 85% of the embedded value of the business at 30 June 2013. The sale completed on 28 November 2013 and the profit on disposal was £12.0 million.

Taxation

The effective tax rate for 2013 was 26.2% (2012: 26.0%) compared with the standard UK corporation tax rate of 23.25% (2012: 24.5%). This is driven primarily by earnings from the International operations which are subject to higher corporation tax rates, re-measurement of deferred tax asset, disallowable expenses, non-taxable disposal of a subsidiary, and adjustments to provisions in respect of prior-year tax.

Profit for the year and return on tangible equity

Profit for the year amounted to £312.8 million (2012: £184.3 million), an increase of 69.7% on 2012.

RoTE from ongoing operations increased to 16.0% (2012: 11.5% and pro forma 13.4%) as a result of both the improved operating result and the capital actions taken to improve the efficiency of the Group's capital position.

Earnings per share

Basic earnings per share of 20.9 pence increased 69.9% (2012: 12.3 pence), reflecting the improved operating profit from ongoing operations and the Run-off segment, and a decrease in Restructuring and other one-off costs. Diluted earnings per share were 20.8 pence (2012: 12.3 pence).

Adjusted basic earnings per share, which excludes the Run-off segment and Restructuring and other one-off costs, increased by 15.1% to 25.1 pence (2012: 21.8 pence). Diluted adjusted earnings per share were 25.0 pence (2012: 21.8 pence).

Net asset value

As at 31 December	2013 £m	2012 £m
Net assets	**2,790.0**	2,831.6
Goodwill and other intangible assets	**(500.1)**	(421.5)
Tangible net assets	**2,289.9**	2,410.1
Net asset value per share (pence)	**186.6**	189.1
Tangible net asset value per share (pence)	**153.2**	161.0

The net asset value at 31 December 2013 was £2,790.0 million (31 December 2012: £2,831.6 million) with tangible net asset value of £2,289.9 million (31 December 2012: £2,410.1 million). This equates to 186.6 pence and 153.2 pence per share respectively as at 31 December 2013 (31 December 2012: 189.1 pence and 161.0 pence, respectively).

The reduction in net asset value and tangible net asset value principally reflects the payment of the final 2012, interim and first special interim 2013 dividends, a reduction in the level of unrealised gains in the debt securities portfolio and increased investment in intangible assets, offset by profit for the period.

Capital management

The Group seeks to manage its capital efficiently, maintaining an appropriate level of capitalisation and solvency, while aiming to grow its dividend annually in real terms.

In determining the appropriate level of capitalisation and solvency the Group considers capital on a number of metrics, including risk-based capital, regulatory capital and rating agency capital. The Group targets holding capital in the range of 125% to 150% of risk-based capital and holding capital sufficient to maintain a credit rating in the 'A' range.

Where the Board believes the Group has capital which is surplus to requirements, for example if it had an expectation that the risk-based capital coverage would be significantly above the 125% to 150% target range for a prolonged period, it would expect to look to return capital to shareholders.

Risk-based capital

For its principal UK general insurance underwriter, U K Insurance Limited (“**UKI**”), the Group uses its own risk-based capital model to determine the level of capital required to operate within its risk appetite. The internal model is calibrated to a 99.5% confidence interval and considers both earned business and future business written over a one-year period. Furthermore, the model allows for uncertainty on this business until ultimate settlement. This approach is consistent with the ICA methodology set by the PRA.

For UKI, the major part of its required capital is held against reserve risk (approximately 46%) followed by underwriting risk (approximately 27%) and operational risk (approximately 13%). The high level of reserve risk reflects the size of the claims reserves still held against business written when the Group’s premium base was larger (including the Run-off segment) and the Group’s exposure to periodic payment orders (“**PPOs**”) which carry a high capital requirement.

Capital allocated by risk type - U K Insurance Limited

As at 31 December	2013 £m
Reserving risk	**46.2%**
Underwriting risk	**26.7%**
Operational risk	**12.9%**
Counterparty risk	**8.0%**
Market risk	**6.2%**

The Group's International entities, in Italy and Germany, hold capital is excess of that required by their local regulators.

Current capital position and outlook

The Board considers the Group is currently strongly capitalised with a risk-based capital coverage ratio at the upper end of its risk-based capital coverage target range and an 'A' rating with stable outlook from its credit rating agencies.

In determining this position, the Board has considered a number of factors that may positively and negatively affect the Group's capital position over the next 12 months. In particular, the Group's UK regulated general insurance underwriters are currently going through the new ICAS+ process with the PRA to assess the Group's future individual capital guidance. The ICAS+ process will also enable firms to obtain feedback on their progress towards Solvency II. This process is more involved than in previous years and includes a detailed assessment of the Group's internal risk-based capital model. In addition, the introduction of Solvency II from 2016 and changes to capital requirements and reporting are still being confirmed, especially in the area of long-term guarantees.

During 2013, the Group updated its investment target asset mix and in 2014 is developing further its asset liability management solutions for longer tail insurance liabilities. This includes investing in infrastructure debt. As these changes take affect, it is expected that there will be an increase in the capital allocated to market risk. Furthermore with current bond yields remaining low, the Group expects to continue to see its level of unrealised bond gains reduce as bonds mature and are reinvested.

The Group continues to invest in its operations and is likely to see an increase in intangible assets that may not qualify fully towards the Group's capital base.

Taken together the Board believes that it is appropriate to maintain capital at the upper end of its risk-based capital coverage range. The Board will continue to review this position as clarity improves on the factors mentioned above and the Group makes further progress along its transformation plan.

Dividends

In relation to 2013, the Group has paid, or is recommending, dividends amounting to £308.7 million and 20.6 pence per share. This consists of a regular dividend of 12.6 pence per share, representing 5% growth on the pro forma 2012 full year dividend, and two special interim dividends totalling 8.0 pence per share. The regular dividend is consistent with the Group's policy to aim to raise dividends annually in real terms.

The two special interim dividends relate to specific items that the Board considers to be one-off in nature – the disposal of its closed life business, the proceeds from the recently announced sale of Tracker and the higher than planned profit in the Run-off segment. Total dividends are equivalent to 98.6% of post-tax profit. The regular dividend represents 50.4% of post-tax profit from ongoing operations.

The final dividend, which is subject to shareholder approval at the AGM on 15 May 2014, and the second special interim dividend will be paid on 30 May 2014 to shareholders on the Register of Members at close of business on 14 March 2014. The shares will trade 'ex' both of these dividends from the start of trading on 12 March 2014.

Capital position and leverage

The Group is well capitalised with key capital metrics within the Group's risk appetite and significantly above regulatory minima.

As at 31 December	2013 £m	2012 £m
Consolidated statutory solvency capital		
Shareholders' equity	**2,790.0**	2,831.6
Goodwill and other intangible assets	**(500.1)**	(421.5)
Regulatory adjustments	**6.2**	(73.5)
Total Tier 1 capital	**2,296.1**	2,336.6
Lower Tier 2 capital[1]	**496.9**	495.5
Regulatory adjustments	**(28.9)**	(23.7)
Total regulatory capital	**2,764.1**	2,808.4
Insurance Group Directive		
IGD required capital[2]	**947.9**	1,005.0
IGD excess solvency	**1,816.2**	1,803.4
IGD coverage ratio	**291.6%**	279.4%
Risk-based capital coverage ratio	**158.7%**	151.4%
Risk-based capital coverage ratio (adjusted for final and second special interim dividend)	**148.7%**	145.4%

Notes:
1. Includes that element of the subordinated dated notes applicable for regulatory capital purposes.
2. Based on the IGD for the Group and 2012 adjusted to include the capital requirement for Direct Line Versicherung AG acquired on 2 April 2012.

The above regulatory numbers are estimated, based on preliminary regulatory returns for 31 December 2013.

At 31 December 2013, the Group had an estimated risk-based capital coverage ratio of 158.7% (31 December 2012: 151.4%) which reduces to 148.7% after deducting the recommended final and second special interim dividend (31 December 2012: 145.4%). On an Insurance Group Directive ("**IGD**") basis, the coverage is 291.6% (31 December 2012: 279.4%).

The table below sets out the Group's financial leverage ratio:

As at 31 December	2013 £m	2012 £m
Shareholders' equity	**2,790.0**	2,831.6
Undated subordinated loan[1]	**-**	258.5
Subordinated dated notes	**486.6**	529.0
Total financial debt	**486.6**	787.5
Total capital employed	**3,276.6**	3,619.1
Financial leverage ratio[2]	**14.9%**	21.8%

Notes:
1. Repaid in January 2013. Following the repayment of the undated subordinated loan, the financial leverage ratio on a pro forma basis, excluding the undated subordinated loan, as at 31 December 2012 would have been 15.7%.
2. Total financial debt as a percentage of total capital employed.

The Group's leverage ratio remains conservative with a financial leverage of 14.9% at 31 December 2013 (31 December 2012: 21.8%). The main change during 2013 was the repayment of the Tesco loan note in January. Excluding this the leverage ratio at 31 December 2012 would have been 15.7%.

Credit ratings

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

Risk management

Sections of this document contain forward-looking statements which by their nature are subject to significant risks and uncertainty. Actual results, performance and achievements may be materially different from those expressed in such statements.

Our business operates in a highly regulated and politically sensitive sector. Changes in the external environment arising from changes in legislation, regulation, tax laws or other requirements can have material consequences.

In addition, there are a number factors that may cause actual results, performance or achievements to differ from expectations, including the impact of catastrophic events, unexpected operational losses, loss of talent and key personnel, not meeting cost savings targets, not meeting financial targets for the COR, not meeting investment return targets, an inability to optimise distribution effectiveness or to differentiate our brands, an inability to implement price changes in accordance with strategy or in a timely fashion and the possibility that the benefits of the new claims system delivers less value than anticipated.

Principal risks and uncertainties

Risks are always present in our business. The key role of the Risk function is to ensure that these risks have been identified and measured and are monitored and reported throughout the business on an ongoing basis. The Risk function also monitors changes in these risks over time. We believe that these risks are broadly unchanged over the last 12 months.

Principal risks	Management and mitigation examples
Strategic risk The external environment could put at risk our ability to meet our strategic objectives through the five key strategic priorities of distribution, pricing, claims, costs and Commercial and International.	• We have agreed strategic targets which are monitored and managed • Risk assessment of projects designed to enhance pricing and claims capability • Our multi-channel approach provides diversification, which mitigates this risk • Monitoring of cost savings to ensure they remain on track • The Chief Executive Officer owns and manages this risk
Insurance risk: underwriting and pricing We are subject to the risk that inappropriate business could be written (or not specifically excluded) and inappropriate prices charged. Underwriting risk includes catastrophe risk arising from losses due to unpredictable natural and man-made events affecting multiple covered risks, particularly given the concentration of our Home business in the UK.	• We have set underwriting guidelines for all business transacted, restricting the types and classes of business that may be accepted • Pricing is refined through analysis of comprehensive data • Catastrophe reinsurance is purchased, limiting our exposure to large losses. We also purchase excess of loss cover on our Motor portfolio, as well as other selected reinsurance covers • We invest in enhanced external data to mitigate exposures, for example, flood and individual underwriting risk through Geospatial • The Managing Directors of each division own and manage this risk
Insurance risk: reserving Due to the uncertain nature and timing of the risks to which we are exposed, we cannot precisely determine the amounts that we will ultimately pay to meet the liabilities covered by the insurance policies written. Reserving risk is our biggest risk, generated by our large Motor portfolio. Reserving risk is heightened in the case of PPOs because of their long-term nature. Reserving generates both upside and downside risk, with the potential for outcomes to be in our favour, generating reserve releases.	• We estimate the technical reserves using a range of actuarial and statistical techniques. Projections of ultimate claims cost involve assumptions across a range of variables, including estimates of trends in claims frequency and average claim amounts. These are based on facts and circumstances at a given point in time • We ensure that management's best estimate of reserves is not less than the actuarial best estimate • The Chief Financial Officer owns and manages this risk

Principal risks	Management and mitigation examples
Counterparty risk We partner with many suppliers and the failure of any of these to perform their financial obligations in a timely manner could result in a financial loss. Our principal area of counterparty risk is our use of reinsurance against underwriting risk, sometimes called reinsurance risk or reinsurer default risk.	• We set credit limits for each counterparty • Our reinsurance is purchased only from reinsurers that hold a minimum credit rating of A- at the time cover is purchased • The business actively monitors broker credit exposures • The Chief Financial Officer owns and manages this risk
Market risk We are subject to the risk that, as a result of market movements, we may be exposed to fluctuations in the value of our assets or the income from our assets. For the Group this includes: interest rate risk, spread risk, currency risk and property risk.	• We manage and control our investment portfolio through: – Investment strategy and guidelines proposed to the Board by the Investment Committee and monitored by the Asset and Liability Committee – Diversity in the types of assets held, including by geography, sector and credit rating • We use risk reduction techniques such as hedging foreign currency exposures with forwards and hedging foreign interest rates with swaps • The Chief Financial Officer owns and manages this risk
Operational risk We potentially face the risks of direct or indirect losses resulting from inadequate or failed internal processes or fraudulent claims; from systems and people; or from external events. In particular we have IT systems risk, including that we are highly dependent on the use of RBS Group's information technology, software, data and service providers. Migrating IT systems away from RBS Group introduces different operational risks; there is increased likelihood of system failure at the point that functions are moved onto new infrastructure. Further, if the migration fails to stay on schedule, we will incur charges for remaining on RBS Group IT infrastructure. IT migration also introduces people risk, as management may be distracted away from day-to-day activities. Operational risk includes cyber risk, the risks relating to the use of computers, other IT and the storage of data. Within this category, we also consider the risk of the Group not recruiting and retaining suitable talent. This risk is particularly important during the Group's current period of change.	• We have strong operational processes and systems, including fraudulent claims detection systems. Our risk, business and capital strategies are integrated • We maintain a robust internal control environment • We have developed a bespoke risk capture, management and reporting system (IRISS) • Ongoing migration of IT away from RBS Group on to a new enhanced platform is continually monitored and managed by experienced personnel • We have strong recruitment processes to help our aim of ensuring that the right people are recruited and placed into the right roles • In addition to mandatory training, employees are encouraged to use the large number of training tools available to enhance their abilities • Specific members of the Executive own and manage the different aspects of operational risks

Principal risks	Management and mitigation examples
Regulatory risk Regulatory risk arises if changes in law and regulations are not identified or understood, or are inappropriately and incorrectly interpreted or adopted. In particular, Solvency II regulations are currently being introduced. Solvency II requirements are still uncertain and subject to the outcome of discussion between UK and European regulators. The impact of the ICAS+ processes is also uncertain. These uncertainties increase our level of risk. Regulatory risk also includes the risk that business practices are not efficiently modified following a regulatory change. Further, there is a risk that current legal or regulatory requirements are not complied with.	• We have a constructive and open relationship with our regulators • In addition, we use specific risk management tools and resources, such as our upstream risk team, to help manage our exposure to regulatory risk • We exercise risk-based monitoring to ensure our resources are used to greatest impact • The Chief Risk Officer owns and manages this risk
Conduct risk We are subject to the risk of failing to deliver the appropriate treatment for our customers throughout all stages of the customer journey and the risk that our people fail to behave with integrity. This includes the risk that our organisational culture is not appropriate, with a failure to communicate the correct tone from the top.	• Our organisational culture prioritises a consistent approach towards customers and the interests of customers are at the heart of how we operate • We have developed a robust customer conduct risk management framework, to minimise our exposure to conduct risk • The Chief Executive Officer owns and manages this risk
Brand and reputational risk We are dependent on the strength of our brands, our reputation with customers and distributors in the sale of products and services. We have entered into various strategic partnerships that are important to the marketing, sale and distribution of our products.	• Our brand and reputational risk is regularly reviewed through our governance framework • We undertake substantial marketing activities to protect and build our brands, and regularly measure their effectiveness • Specific members of the Executive own and manage this risk

Evolving risks

Risks can emerge and evolve over time, often as a result of changes in the environment in which we operate. As part of our risk management framework, we aim to identify these risks as they first emerge, working efficiently to mitigate their potential impact on the business. Set out below are examples of current significant evolving risks and the way in which we monitor and mitigate these risks.

	Evolving risk details	Our actions
Insurance risk: claims costs	Bodily injury claims costs are a key source of uncertainty with several regulatory, legal and market pressures facing the Group, including: • Underlying trends in bodily injury claims frequency and average cost per claim inflation • The results of the MoJ consultation into the discount rate used to value certain types of bodily injury claim awards • The propensity for large injury claims to settle as PPOs, and the inflation and longevity assumptions used to value PPOs The impact on claims costs of the MoJ consultation and Transport Committee investigation into whiplash injuries.	• Monitoring claims costs to identify trends in the settlement of bodily injury claims • Investigating proposed changes in regulation and legislation and using risk fora to discuss these changes and develop a business response • Investigating asset-liability matching opportunities that would mitigate this risk
Regulatory risk: regulatory environment	The UK insurance market is subject to several regulatory reviews and potential areas of focus which are sources of uncertainty, including: • The Competition Commission investigation into aspects of the private motor insurance market • The FCA's market study of general insurance add-on products • The FCA's thematic review of complaints and claims handling • The impacts of Flood Re and the proposed levy on home insurance premiums There is also uncertainty around the way in which the FCA may apply the principles underpinning behavioural economics to the insurance industry and the impact that this has on our business. The EU is currently developing new EU Data Protection Regulations which will replace the UK Data Protection Act. This may impact our ability to use and benefit from our stored data. Specifically, restrictions or bans on profiling may impact our sales opportunities. The Italian regulatory landscape is changing which could lead to greater regulatory intervention.	• Investigating proposed changes in regulation and legislation and using risk fora to discuss these changes and develop a business response • Regular contact with the regulator to ensure the business is kept abreast of changes in expectations • Where appropriate, participation in lobbying
Strategic risk: business transformation and project delivery	The Group is carrying out initiatives to improve its operational efficiency as part of the implementation of its business transformation plan. There is a strategic risk of the potential failure to execute the plan, or that the expected benefits of the plan may not be achieved on time or to the extent targeted. There is also a potential for upside risk should initiatives provide benefits that are greater than those planned, or if the expected benefits are felt by the business sooner than planned. Uncertainties include the potential changes in the market around use of PCWs, changes in customer behaviour and the increasing use of telematics.	• Having a detailed transformation plan • Monitoring of the project milestones ensures we remain on track and enables us to make adjustments where appropriate • Ensuring that the projects are managed by the right people with the ideal skills • Using 'Lessons learnt' exercises to ensure later projects are improved by our experiences

Risks can emerge over the very long term as a result of significant changes in the environment including technology, weather patterns and socio-economic behaviours. Examples of these risks would include driverless cars, new types of competitor entering the market and climate change.

A specific example of an emerging risk we have considered during 2013 is the failure of a competitor. A competitor failing may lead to an industry levy which we would be subject to. This risk could also impact our relationships with both investors and regulators, depending on the cause of the competitor's failure. There is also potential upside should the failure of a competitor enable us to increase the number of policies we issue.

Consolidated income statement
For the year ended 31 December 2013

	Notes	2013 £m	2012 £m
Gross earned premium	4	**3,896.3**	4,048.5
Reinsurance premium ceded	4	**(373.0)**	(326.5)
Net earned premium	4	**3,523.3**	3,722.0
Investment return	5	**221.1**	281.8
Instalment income		**117.8**	125.4
Other operating income	6	**62.4**	73.3
Total income		**3,924.6**	4,202.5
Insurance claims	7	**(2,334.8)**	(2,875.3)
Insurance claims recoverable from reinsurers	7	**180.5**	451.0
Net insurance claims	7	**(2,154.3)**	(2,424.3)
Commission expenses	8	**(392.4)**	(452.9)
Operating expenses	9	**(928.3)**	(1,047.5)
Total expenses		**(1,320.7)**	(1,500.4)
Operating profit		**449.6**	277.8
Finance costs	10	**(37.7)**	(28.7)
Gain on disposal of subsidiary		**12.0**	–
Profit before tax		**423.9**	249.1
Tax charge		**(111.1)**	(64.8)
Profit for the year attributable to owners of the Company		**312.8**	184.3

Earnings per share:			
Basic (pence)	11	**20.9**	12.3
Diluted (pence)	11	**20.8**	12.3

Consolidated statement of comprehensive income

For the year ended 31 December 2013

	2013 £m	2012 £m
Profit for the year	**312.8**	184.3
Other comprehensive income		
Items that will not be reclassified subsequently to profit or loss:		
Actuarial loss on defined benefit pension scheme	**(6.9)**	(3.4)
Tax relating to items not reclassified	**1.5**	0.6
	(5.4)	(2.8)
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translation of foreign operations	**(4.9)**	(2.4)
Fair value (loss) / gain on available-for-sale investments	**(108.2)**	109.9
Less: realised net gains on available-for-sale investments included in income statement	**(25.7)**	(89.5)
Tax relating to items that may be reclassified	**33.9**	1.3
	(104.9)	19.3
Other comprehensive (loss) / income for the year net of tax	**(110.3)**	16.5
Total comprehensive income for the year attributable to owners of the Company	**202.5**	200.8

Consolidated balance sheet

As at 31 December 2013

	Notes	2013 £m	2012 £m
Assets			
Goodwill and other intangible assets		**500.1**	421.5
Property, plant and equipment		**102.3**	92.4
Investment property		**223.4**	128.9
Reinsurance assets		**1,011.0**	1,102.0
Deferred tax assets		**19.3**	22.5
Current tax assets		**1.3**	5.5
Deferred acquisition costs		**321.5**	327.6
Insurance and other receivables		**1,122.0**	1,164.0
Prepayments, accrued income and other assets		**95.7**	82.6
Derivative financial instruments		**40.7**	37.5
Retirement benefit asset		**–**	2.5
Financial investments	12	**7,441.2**	7,801.5
Cash and cash equivalents	13	**908.3**	1,508.4
Assets held for sale		**1.0**	1.0
Total assets		**11,787.8**	12,697.9
Equity		**2,790.0**	2,831.6
Liabilities			
Subordinated liabilities		**486.6**	787.5
Insurance liabilities	14	**5,757.4**	6,398.5
Unearned premium reserve		**1,818.7**	1,872.9
Retirement benefit obligation		**2.0**	–
Borrowings		**55.1**	90.9
Derivative financial instruments		**19.3**	6.5
Trade and other payables including insurance payables		**818.3**	654.6
Deferred tax liabilities		**19.3**	20.9
Current tax liabilities		**21.1**	34.5
Total liabilities		**8,997.8**	9,866.3
Total equity and liabilities		**11,787.8**	12,697.9

Consolidated statement of changes in equity

For the year ended 31 December 2013

	Share capital £m	Employee trust shares £m	Capital redemption reserve £m	Revaluation reserve £m	Non-distributable reserve £m	Foreign exchange translation reserve £m	Retained earnings £m	Total shareholders equity £m
Balance at 1 January 2012	1,500.0	–	100.0	137.1	30.3	6.4	1,839.0	3,612.8
Profit for the year	–	–	–	–	–	–	184.3	184.3
Other comprehensive income / (loss)	–	–	–	21.7	–	(2.4)	(2.8)	16.5
Dividends	–	–	–	–	–	–	(1,000.0)	(1,000.0)
Transfer to non-distributable reserve	–	–	–	–	32.9	–	(32.9)	–
Capital contribution	–	–	–	–	–	–	30.9	30.9
Movement in net assets of Direct Line Versicherung AG[1]	–	–	–	–	–	1.0	(9.2)	(8.2)
Shares acquired by employee trusts	–	(5.0)	–	–	–	–	–	(5.0)
Credit to equity for equity-settled share based payments	–	–	–	–	–	–	0.3	0.3
Issue of own shares	150.0	–	–	–	–	–	–	150.0
Own shares redeemed	(1,500.0)	–	1,350.0	–	–	–	–	(150.0)
Balance at 31 December 2012	**150.0**	**(5.0)**	**1,450.0**	**158.8**	**63.2**	**5.0**	**1,009.6**	**2,831.6**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**312.8**	**312.8**
Other comprehensive loss	**–**	**–**	**–**	**(100.0)**	**–**	**(4.9)**	**(5.4)**	**(110.3)**
Dividends	**–**	**–**	**–**	**–**	**–**	**–**	**(242.7)**	**(242.7)**
Transfer to non-distributable reserve	**–**	**–**	**–**	**–**	**29.6**	**–**	**(29.6)**	**–**
Credit to equity for equity-settled share based payments	**–**	**–**	**–**	**–**	**–**	**–**	**4.1**	**4.1**
Shares acquired by employee trusts	**–**	**(5.7)**	**–**	**–**	**–**	**–**	**–**	**(5.7)**
Shares distributed by employee trusts	**–**	**0.5**	**–**	**–**	**–**	**–**	**(0.5)**	**–**
Deferred tax on share based payments	**–**	**–**	**–**	**–**	**–**	**–**	**0.2**	**0.2**
Balance at 31 December 2013	**150.0**	**(10.2)**	**1,450.0**	**58.8**	**92.8**	**0.1**	**1,048.5**	**2,790.0**

Notes:

1. The movements in net assets of Direct Line Versicherung AG ceased on 2 April 2012.

	Non-controlling interest £m
Balance at 1 January 2012	258.5
Transfer to subordinated liabilities	(258.5)
Balance at 31 December 2012 and 31 December 2013	**–**

Consolidated cash flow statement
For the year ended 31 December 2013

	Notes	**2013 £m**	2012 £m
Net cash used by operating activities before investment of insurance assets		**(307.0)**	(966.0)
Cash generated from investment of insurance assets		**433.0**	2,004.8
Net cash generated from operating activities		**126.0**	1,038.8
Cash flows from investing activities			
Purchases of property, plant and equipment		**(39.1)**	(63.7)
Purchases of intangible assets		**(115.5)**	(96.6)
Net cash flows from disposal of subsidiary		**18.8**	–
Cash flows from net investment hedges		**(9.5)**	6.1
Net cash used by investing activities		**(145.3)**	(154.2)
Cash flows from financing activities			
Dividends paid		**(242.7)**	(1,000.0)
Repayment of borrowings and subordinated liabilities		**(258.5)**	(246.4)
Proceeds on issue of subordinated debt		**–**	493.0
Finance costs		**(37.8)**	(16.1)
Purchase of employee trust shares		**(5.7)**	(5.0)
Net cash used by financing activities		**(544.7)**	(774.5)
Net (decrease) / increase in cash and cash equivalents		**(564.0)**	110.1
Cash and cash equivalents at the beginning of the year	13	**1,417.5**	1,309.6
Effect of foreign exchange rate changes		**(0.3)**	(2.2)
Cash and cash equivalents at the end of the year	13	**853.2**	1,417.5

Notes to the consolidated financial statements

For the year ended 31 December 2013

1. Accounting policies

Basis of preparation

The financial information included in this preliminary announcement has been prepared in accordance with the recognition and measurement criteria of International Financial Reporting Standards ("**IFRS**"). However this announcement does not itself contain sufficient information to comply with IFRS.

The financial information set out in this preliminary announcement does not constitute the statutory accounts for the year ended 31 December 2013. The financial information is derived from the statutory accounts, which comply with IFRS, within the Group's annual report. These accounts were signed on 25 February 2014 and are expected to be published in March 2014 and delivered to the Registrar of Companies following the Annual General Meeting to be held on 15 May 2014. The independent auditor's report on the Group accounts for the year ended 31 December 2013 was signed on 25 February 2014, is unqualified, does not draw attention to any matters by way of emphasis and does not include a statement under S498(2) or (3) of the Companies Act 2006.

Going concern

The directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 12 months from the date of this report. Accordingly, they continue to adopt the going concern basis in preparing the condensed consolidated financial statements.

Adoption of new and revised standards

Except as noted below, the same accounting policies and basis of recognition and measurement have been followed in the consolidated financial statements as applied in the Group's previous annual audited financial statements for the year ended 31 December 2012, available on its website.

The following new or revised standards have been adopted in the year and have not had a material impact on the Group's financial statements:

IFRS 10 'Consolidated Financial Statements' replaced SIC 12 'Consolidation – Special Purpose Entities' and the consolidation elements of the existing IAS 27 'Consolidated and Separate Financial Statements'. The new standard adopts a single definition of control: a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity;

IAS 27 'Separate Financial Statements' was amended to delete all other aspects of the previous standard other than those dealing with separate financial statements;

IFRS 12 'Disclosure of Interests in Other Entities' covers disclosures for entities reporting under IFRS 10 and IFRS 11, replacing requirements in IAS 28 and IAS 27. Entities are required to disclose information that helps users of financial statements evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries, in associates and joint arrangements and in unconsolidated structured entities;

IFRS 13 'Fair Value Measurement' which sets out a single IFRS framework for defining and measuring fair value and requiring disclosures about fair value measurements;

IAS 1 'Presentation of Items of Other Comprehensive Income' requires items that will never be recognised in the income statement to be presented in other comprehensive income separately from those that are subject to subsequent reclassification;

IFRS 7 ' Financial Instruments: Disclosure – Offsetting Financial Assets and Financial Liabilities' was amended to allow users to consider the impact of netting arrangements as permitted by IAS 32 (paragraph 42) on the financial statements; and

IAS 19 'Employee Benefits' was revised and requires the immediate recognition of all actuarial gains and losses eliminating the 'corridor approach'; interest costs to be calculated on the net pension liability or asset at the appropriate bond rate; and all past service costs to be recognised immediately when a scheme is curtailed or amended.

Notes to the consolidated financial statements

For the year ended 31 December 2013

2. Critical accounting estimates and judgements

Pages 111 to 113 of the Annual Report & Accounts 2012 provide full details of critical accounting estimates and judgements used in applying the Group's accounting policies. There have been no significant changes to the principles or assumptions of these critical accounting estimates and judgements during the year ended 31 December 2013.

3. Segmental analysis

The table below is an analysis of the Group's revenue and results by reportable segment in 2013:

	Motor £m	Home £m	Rescue and other personal lines [1] £m	Commercial £m	International £m	Total ongoing £m	Run-off [1] £m	Total £m
Gross written premium	1,421.1	943.1	383.4	474.5	604.5	**3,826.6**	7.9	**3,834.5**
Gross earned premium	1,498.4	958.9	383.1	468.7	579.3	**3,888.4**	7.9	**3,896.3**
Reinsurance premium ceded	(53.6)	(50.0)	(17.3)	(34.1)	(212.8)	**(367.8)**	(5.2)	**(373.0)**
Net earned premium	1,444.8	908.9	365.8	434.6	366.5	**3,520.6**	2.7	**3,523.3**
Investment return	122.8	24.1	8.2	29.6	23.4	**208.1**	13.0	**221.1**
Instalment income	78.3	25.2	1.3	6.2	6.8	**117.8**	–	**117.8**
Other operating income	48.5	0.7	9.1	3.3	0.8	**62.4**	–	**62.4**
Total income	1,694.4	958.9	384.4	473.7	397.5	**3,908.9**	15.7	**3,924.6**
Insurance claims	(978.3)	(476.7)	(240.0)	(274.8)	(453.0)	**(2,422.8)**	88.0	**(2,334.8)**
Insurance claims recoverable from reinsurers	38.1	(13.7)	20.2	4.2	169.6	**218.4**	(37.9)	**180.5**
Net insurance claims	(940.2)	(490.4)	(219.8)	(270.6)	(283.4)	**(2,204.4)**	50.1	**(2,154.3)**
Commission expenses	(36.3)	(177.9)	(27.3)	(92.2)	(57.9)	**(391.6)**	(0.8)	**(392.4)**
Operating expenses	(370.2)	(184.4)	(90.8)	(101.4)	(39.6)	**(786.4)**	(1.4)	**(787.8)**
Total expenses	(406.5)	(362.3)	(118.1)	(193.6)	(97.5)	**(1,178.0)**	(2.2)	**(1,180.2)**
Operating profit before restructuring and other one-off costs	**347.7**	**106.2**	**46.5**	**9.5**	**16.6**	**526.5**	**63.6**	**590.1**
Restructuring and other one-off costs[2]								**(140.5)**
Operating profit								**449.6**
Finance costs								**(37.7)**
Gain on disposal of subsidiary								**12.0**
Profit before tax								**423.9**
Underwriting profit / (loss)	**98.1**	**56.2**	**27.9**	**(29.6)**	**(14.4)**	**138.2**		
Loss ratio	65.1%	53.9%	60.1%	62.3%	77.3%	**62.6%**		
Commission ratio	2.5%	19.6%	7.5%	21.2%	15.8%	**11.2%**		
Expense ratio	25.6%	20.3%	24.8%	23.3%	10.8%	**22.3%**		
Combined operating ratio	**93.2%**	**93.8%**	**92.4%**	**106.8%**	**103.9%**	**96.1%**		

Notes:

1. The Group's revenue and results for the year ended 2013 relating to the Life business which was disposed of on 28 November 2013 was recorded in two segments: Rescue and other personal lines (net earned premium: £11.8 million, net insurance claims: £1.8 million and operating profit: £6.4 million) and Run-off (net earned premium: £2.8 million, net insurance claims: £0.7 million and operating profit: £1.2 million).

2. Restructuring costs are costs which have been incurred in respect of business activities which have a material effect on the nature and focus of the Group's operations. One-off costs are costs which are non-recurring in nature.

Notes to the consolidated financial statements
For the year ended 31 December 2013

3. Segmental analysis continued

The table below is an analysis of the Group's revenue and results by reportable segment in 2012:

	Motor £m	Home £m	Rescue and other personal lines [1] £m	Commercial £m	International £m	Total ongoing £m	Run-off [1] £m	Total £m
Gross written premium	1,623.5	989.0	389.8	435.6	552.7	3,990.6	10.8	4,001.4
Gross earned premium	1,677.8	1,005.2	402.5	433.2	510.3	4,029.0	19.5	4,048.5
Reinsurance premium ceded	(48.6)	(54.4)	(19.7)	(30.4)	(167.2)	(320.3)	(6.2)	(326.5)
Net earned premium	1,629.2	950.8	382.8	402.8	343.1	3,708.7	13.3	3,722.0
Investment return	140.0	34.1	7.5	29.4	23.7	234.7	47.1	281.8
Instalment income	88.4	25.9	1.2	3.5	6.4	125.4	–	125.4
Other operating income	59.7	0.6	9.5	2.4	0.7	72.9	0.4	73.3
Total income	1,917.3	1,011.4	401.0	438.1	373.9	4,141.7	60.8	4,202.5
Insurance claims	(1,364.8)	(560.7)	(218.1)	(278.2)	(401.9)	(2,823.7)	(51.6)	(2,875.3)
Insurance claims recoverable from reinsurers	148.3	6.0	23.2	24.1	133.9	335.5	115.5	451.0
Net insurance claims	(1,216.5)	(554.7)	(194.9)	(254.1)	(268.0)	(2,488.2)	63.9	(2,424.3)
Commission expenses	(31.9)	(154.2)	(22.9)	(87.0)	(41.5)	(337.5)	(115.4)	(452.9)
Operating expenses	(407.1)	(209.2)	(98.8)	(94.8)	(44.9)	(854.8)	(3.2)	(858.0)
Total expenses	(439.0)	(363.4)	(121.7)	(181.8)	(86.4)	(1,192.3)	(118.6)	(1,310.9)
Operating profit before restructuring and other one-off costs	261.8	93.3	84.4	2.2	19.5	461.2	6.1	467.3
Restructuring and other one-off costs[2]								(189.5)
Operating profit								277.8
Finance costs								(28.7)
Profit before tax								249.1
Underwriting (loss) / profit	(26.3)	32.7	66.2	(33.1)	(11.3)	28.2		
Loss ratio	74.6%	58.4%	50.9%	63.1%	78.1%	67.1%		
Commission ratio	2.0%	16.2%	6.0%	21.6%	12.1%	9.1%		
Expense ratio	25.0%	22.0%	25.8%	23.5%	13.1%	23.0%		
Combined operating ratio	101.6%	96.6%	82.7%	108.2%	103.3%	99.2%		

Notes:

1. The Group's revenue and results for the year ended 2012 relating to the Life business which was disposed of on 28 November 2013 was recorded in two segments: Rescue and other personal lines (net earned premium: £18.1 million, net insurance claims: £1.6 million and operating profit: £8.1 million) and Run-off (net earned premium: £3.8 million, net insurance claims: £0.5 million and operating profit: £1.3 million).

2. See note 2 on page 30.

Notes to the consolidated financial statements
For the year ended 31 December 2013

4. Net earned premium

	2013 £m	2012 £m
Gross earned premium:		
Gross written premium	**3,834.5**	4,001.4
Movement in unearned premium reserve	**61.8**	47.1
	3,896.3	4,048.5
Reinsurance premium ceded:		
Premium payable	**(368.0)**	(365.4)
Movement in reinsurance unearned premium reserve	**(5.0)**	38.9
	(373.0)	(326.5)
Total	**3,523.3**	3,722.0

5. Investment return

	2013 £m	2012 £m
Investment income:		
Interest income on available-for-sale debt securities	**169.9**	172.5
Other investment funds income	**–**	3.1
Cash and cash equivalent interest income	**7.3**	19.3
Rental income from investment property	**11.4**	4.4
	188.6	199.3
Net realised gains:		
Available-for-sale debt securities	**25.7**	66.3
Other investment funds	**–**	23.2
Derivatives	**21.5**	17.8
	47.2	107.3
Net unrealised (losses) / gains:		
Derivatives	**(22.2)**	(20.0)
Investment property	**7.5**	(4.8)
	(14.7)	(24.8)
Total	**221.1**	281.8

The table below analyses the realised and unrealised derivatives included in investment return:

	2013		2012	
	Realised £m	Unrealised £m	Realised £m	Unrealised £m
Derivative gains / (losses)				
Foreign exchange forward	**21.2**	**12.0**	24.3	11.7
Associated foreign exchange risk	**2.0**	**(33.3)**	(2.9)	(32.6)
Net gains / (losses) on foreign exchange forward contracts	**23.2**	**(21.3)**	21.4	(20.9)
Interest rate derivatives	**(0.8)**	**19.6**	(3.8)	(2.1)
Associated interest rate risk	**(0.9)**	**(20.5)**	0.2	3.0
Net (losses) / gains on interest rate derivatives	**(1.7)**	**(0.9)**	(3.6)	0.9
Total	**21.5**	**(22.2)**	17.8	(20.0)

Notes to the consolidated financial statements
For the year ended 31 December 2013

6. Other operating income

	2013 £m	2012 £m
Solicitors' referral fee income[1]	**6.9**	21.2
Vehicle replacement referral income	**15.7**	17.5
Revenue from vehicle recovery and repair services	**31.8**	25.9
Fee income from insurance intermediary services	**1.7**	1.9
Other income	**6.3**	6.8
Total	**62.4**	73.3

Note:
1. Following changes to LASPO (Legal aid, Sentencing and Punishment of Offenders Act 2012) the payment of referral fees in personal injury cases were prohibited with effect from 1 April 2013.

7. Net insurance claims

	2013		
	Gross £m	**Reinsurance £m**	**Net £m**
Current accident year claims paid	**1,306.2**	**(90.5)**	**1,215.7**
Prior accident years claims paid	**1,566.6**	**(75.8)**	**1,490.8**
Movement in insurance liabilities	**(538.0)**	**(14.2)**	**(552.2)**
Total	**2,334.8**	**(180.5)**	**2,154.3**

	2012		
	Gross £m	Reinsurance £m	Net £m
Current accident year claims paid	1,360.0	(71.3)	1,288.7
Prior accident years claims paid	1,612.1	(55.6)	1,556.5
Movement in insurance liabilities	(96.8)	(324.1)	(420.9)
Total	2,875.3	(451.0)	2,424.3

Claims handling expenses for the year ended 31 December 2013 of £246.8 million (2012: £290.3 million) have been included in the claims figures above.

A decrease in the liability adequacy provision for the year ended 31 December 2013 of £4.3 million (2012: £0.7 million increase) has been included in the movement in claims provision.

8. Commission expenses

	2013 £m	2012 £m
Commission expenses	**333.3**	316.5
Expenses incurred under profit participations	**59.1**	136.4
Total[1]	**392.4**	452.9

Note:
1. Includes commission expenses for the Run-off segment of £0.8 million (2012: £115.4 million).

Notes to the consolidated financial statements
For the year ended 31 December 2013

9. Operating expenses

	2013 £m	2012 £m
Staff costs	**395.3**	416.7
Marketing	**184.2**	203.1
Management fees	**–**	145.5
Depreciation	**21.0**	13.1
Amortisation and impairment of other intangible assets	**37.2**	40.7
Other operating expenses	**290.6**	228.4
Total	**928.3**	1,047.5

Staff costs attributable to claims handling activities are allocated to the cost of insurance claims.

Management fees were in respect of expenses recharged from RBS Group up until 30 June 2012; management fees were charged on an arm's length basis. From 1 July 2012 the equivalent costs have been incurred directly by the Group and included in staff costs and other operating expenses.

The table below analyses restructuring and other one-off costs included in operating expenses.

	2013 £m	2012 £m
Staff costs[1]	**57.9**	103.9
Management fees	**–**	16.3
Other operating expenses	**82.6**	69.3
Total	**140.5**	189.5

Note:
1. Staff costs within restructuring and other one-off costs include redundancy and related expenses amounting to £40.9 million (2012: £34.6 million).

10. Finance costs

	2013 £m	2012 £m
Interest expense on subordinated dated notes[1]	**37.7**	26.7
Other interest expense	**–**	2.0
Total	**37.7**	28.7

Note:
1. On 27 April 2012 the Group issued subordinated dated notes with a nominal value of £500 million at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year hedge to exchange the fixed rate of interest on the subordinated dated notes for a floating rate of three-month LIBOR plus a spread of 706 bps which increased to 707 bps with effect from 29 July 2013.

11. Earnings and net assets per share, return on equity

Earnings per share is calculated by dividing earnings attributable to the owners of the Company by the weighted average of Ordinary Shares in issue during the period.

Basic
Basic earnings per share is calculated by dividing the earnings attributable to the owners of the Company and the weighted average of Ordinary Shares in issue during the period, excluding Ordinary Shares held as employee trust shares.

	2013 £m	2012 £m
Earnings attributable to owners of the Company	**312.8**	184.3
Weighted average number of Ordinary Shares in issue (millions)	**1,495.4**	1,499.4
Basic earnings per share (pence)	**20.9**	12.3

Notes to the consolidated financial statements

For the year ended 31 December 2013

11. Earnings and net assets per share, return on equity continued

Diluted

Diluted earnings per share is calculated by dividing the earnings attributable to the owners of the Company and the weighted average of Ordinary Shares in issue during the period adjusted for the dilutive potential Ordinary Shares. The Company has share options and contingently issuable shares as categories of dilutive potential Ordinary Shares.

	2013 £m	2012 £m
Earnings attributable to owners of the Company	**312.8**	184.3
Weighted average number of Ordinary Shares in issue (millions)	**1,495.4**	1,499.4
Effect of dilutive potential of share options and contingently issuable shares (millions)	**5.8**	0.6
Weighted average number of Ordinary Shares for diluted earnings per share (millions)	**1,501.2**	1,500.0
Diluted earnings per share (pence)	**20.8**	12.3

Net asset value and tangible net asset value per share

Net asset value per share is calculated as total shareholders' equity divided by the number of Ordinary Shares in issue at the end of the period. Ordinary Shares in issue exclude shares held by employee share trusts at 31 December 2013 of 5,204,771 (2012: 2,848,991).

Tangible net asset value per share is calculated as total shareholders' equity less goodwill and other intangible assets divided by the number of Ordinary Shares in issue at the end of the period.

The table below analyses net asset and tangible net asset value per share.

At 31 December	2013 £m	2012 £m
Net assets	**2,790.0**	2,831.6
Goodwill and other intangible assets	**(500.1)**	(421.5)
Tangible net assets	**2,289.9**	2,410.1
Number of Ordinary Shares in issue (millions)	**1,500.0**	1,500.0
Shares held by employee share trusts (millions)	**(5.2)**	(2.8)
Closing number of Ordinary Shares in issue (millions)	**1,494.8**	1,497.2
Net asset value per share (pence)	**186.6**	189.1
Tangible net asset value per share (pence)	**153.2**	161.0

Return on equity

The table below details the calculation of return on equity.

	2013 £m	2012 £m
Profit for the year	**312.8**	184.3
Opening shareholders' equity	**2,831.6**	3,612.8
Closing shareholders' equity	**2,790.0**	2,831.6
Average shareholders' equity	**2,810.8**	3,222.2
Return on equity	**11.1%**	5.7%

12. Financial investments

	2013 £m	2012 £m
Available-for-sale debt securities:		
Corporate	**4,878.1**	4,475.6
Supranational	**365.7**	521.8
Local government	**134.5**	271.1
Sovereign	**1,399.5**	1,842.8
Securitised credit	**227.7**	45.2
Total	**7,005.5**	7,156.5

Available-for-sale debt securities:		
Fixed interest rate	**6,468.4**	6,854.2
Floating interest rate	**537.1**	302.3
Total	**7,005.5**	7,156.5
Loans and receivables:		
Deposits with credit institutions with maturities in excess of three months	**435.7**	645.0
Total	**7,441.2**	7,801.5

The following table analyses financial instruments held at fair value, which equates to their carrying value, by level of the fair value hierarchy.

	2013 £m	2012 £m
Level 1[1]	**1,393.7**	1,839.9
Level 2[2]	**5,611.8**	5,316.6
Total	**7,005.5**	7,156.5

Notes:

1. Level 1 financial assets are measured in whole or in part by reference to published quotes in an active market. In an active market quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

2. Level 2 financial assets are measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. These are assets for which pricing is obtained via pricing services, but where prices have not been determined in an active market, or financial assets with fair values based on broker quotes, investments in private equity funds with fair values obtained via fund managers or assets that are valued using the Group's own models whereby the majority of assumptions are market-observable.

13. Cash and cash equivalents

	2013 £m	2012 £m
Cash at bank and in hand	**307.5**	201.7
Short-term deposits with credit institutions	**600.8**	1,306.7
Total	**908.3**	1,508.4

Note:

1. Short-term deposits include £nil (2012: £492.5 million) held by the Group in Global Treasury Funds PLC (an open ended umbrella investment company with variable capital incorporated with limited liability in Ireland). RBS Asset Management (Dublin) Limited is the appointed manager of the fund.

The effective interest rate on short-term deposits with credit institutions for the year ended 31 December 2013 was 0.41% (2012: 0.35%) and average maturity was 14 days (2012: 11 days).

13. Cash and cash equivalents continued

The following table details cash and bank overdrafts for the purposes of the cash flow statement.

	2013 £m	2012 £m
Cash and cash equivalents	**908.3**	1,508.4
Bank overdrafts	**(55.1)**	(90.9)
Total	**853.2**	1,417.5

14. Insurance liabilities, unearned premium reserve and reinsurance assets

	2013 £m	2012 £m
Insurance liabilities		
Life insurance	**–**	107.2
General insurance	**5,757.4**	6,291.3
Total	**5,757.4**	6,398.5
Gross general insurance (including unearned premium reserve)		
Claims reported	**3,636.4**	3,969.3
Claims incurred but not reported	**1,992.7**	2,153.9
Claims handling provision	**128.3**	163.8
Liability adequacy provision	**–**	4.3
Total	**5,757.4**	6,291.3
Unearned premium reserve	**1,818.7**	1,872.9
Total	**7,576.1**	8,164.2
Reinsurers' share of general insurance (including unearned premium reserve)		
Claims reported	**(467.5)**	(397.8)
Claims incurred but not reported	**(449.8)**	(511.6)
Total	**(917.3)**	(909.4)
Unearned premium reserve	**(93.7)**	(97.9)
Total	**(1,011.0)**	(1,007.3)
Net general insurance (including unearned premium reserve)		
Claims reported	**3,168.9**	3,571.5
Claims incurred but not reported	**1,542.9**	1,642.3
Claims handling provision	**128.3**	163.8
Liability adequacy provision	**–**	4.3
Total	**4,840.1**	5,381.9
Unearned premium reserve	**1,725.0**	1,775.0
Total	**6,565.1**	7,156.9

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14. Insurance liabilities, unearned premium reserve and reinsurance assets continued

Gross general insurance liabilities

Accident year	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	**Total £m**
Estimate of ultimate claims costs:											
At end of accident year	3,679.1	4,007.5	4,091.6	4,390.5	3,878.1	4,148.0	4,261.9	3,080.5	2,797.3	2,652.5	36,987.0
One year later	(187.2)	(175.8)	(266.1)	(62.0)	23.2	120.0	(98.1)	(80.3)	(168.7)	–	(895.0)
Two years later	(89.8)	(141.7)	(42.0)	(1.1)	43.9	(42.5)	(115.3)	(99.5)	–	–	(488.0)
Three years later	(61.3)	(57.9)	(17.6)	49.4	(38.3)	(24.2)	(55.1)	–	–	–	(205.0)
Four years later	(41.9)	(59.5)	10.1	(7.0)	(22.0)	(101.8)	–	–	–	–	(222.1)
Five years later	(15.2)	15.3	(21.6)	(17.8)	(57.9)	–	–	–	–	–	(97.2)
Six years later	70.5	7.8	(9.1)	(26.3)	–	–	–	–	–	–	42.9
Seven years later	12.8	5.4	(13.4)	–	–	–	–	–	–	–	4.8
Eight years later	22.0	(34.4)	–	–	–	–	–	–	–	–	(12.4)
Nine years later	(29.1)	–	–	–	–	–	–	–	–	–	(29.1)
Current estimate of cumulative claims	3,359.9	3,566.7	3,731.9	4,325.7	3,827.0	4,099.5	3,993.4	2,900.7	2,628.6	2,652.5	35,085.9
Cumulative payments to date	(3,186.6)	(3,447.6)	(3,520.0)	(4,022.7)	(3,528.3)	(3,564.7)	(3,326.3)	(2,201.3)	(1,842.7)	(1,119.6)	(29,759.8)
Liability recognised in balance sheet	**173.3**	**119.1**	**211.9**	**303.0**	**298.7**	**534.8**	**667.1**	**699.4**	**785.9**	**1,532.9**	**5,326.1**
2003 and prior											**303.0**
Claims handling provision											**128.3**
Total gross liability											**5,757.4**

14. Insurance liabilities, unearned premium reserve and reinsurance assets continued

Net general insurance liabilities

Accident year	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	**Total £m**
Estimate of ultimate claims costs:											
At end of accident year	3,486.1	3,869.6	4,030.8	4,341.3	3,816.0	4,113.0	4,219.3	2,946.1	2,570.1	2,401.5	35,793.8
One year later	(169.2)	(159.3)	(249.7)	(81.7)	24.1	70.0	(109.7)	(119.3)	(157.8)	–	(952.6)
Two years later	(94.1)	(159.4)	(52.7)	(23.3)	8.2	(23.0)	(136.4)	(88.1)	–	–	(568.8)
Three years later	(68.3)	(62.0)	(28.2)	17.7	(24.5)	(64.2)	(48.5)	–	–	–	(278.0)
Four years later	(53.3)	(61.6)	9.9	(10.4)	(51.2)	(67.5)	–	–	–	–	(234.1)
Five years later	(13.5)	7.2	(43.5)	(22.4)	(51.2)	–	–	–	–	–	(123.4)
Six years later	60.7	(0.4)	(21.0)	(21.2)	–	–	–	–	–	–	18.1
Seven years later	(4.1)	(12.2)	(14.2)	–	–	–	–	–	–	–	(30.5)
Eight years later	(5.4)	(27.1)	–	–	–	–	–	–	–	–	(32.5)
Nine years later	(18.2)	–	–	–	–	–	–	–	–	–	(18.2)
Current estimate of cumulative claims	3,120.7	3,394.8	3,631.4	4,200.0	3,721.4	4,028.3	3,924.7	2,738.7	2,412.3	2,401.5	33,573.8
Cumulative payments to date	(3,029.2)	(3,317.3)	(3,468.0)	(3,957.6)	(3,490.8)	(3,531.0)	(3,310.0)	(2,110.4)	(1,748.1)	(1,046.4)	(29,008.8)
Liability recognised in balance sheet	**91.5**	**77.5**	**163.4**	**242.4**	**230.6**	**497.3**	**614.7**	**628.3**	**664.2**	**1,355.1**	**4,565.0**
2003 and prior											146.8
Claims handling provision											128.3
Total net liability											**4,840.1**

Notes to the consolidated financial statements
For the year ended 31 December 2013

14. Insurance liabilities, unearned premium reserve and reinsurance assets continued

Movements in general insurance liabilities and reinsurance assets

	Gross £m	Reinsurance £m	Net £m
Claims reported	4,036.9	(318.1)	3,718.8
Incurred but not reported	2,217.5	(281.8)	1,935.7
Claims handling provision	153.2	–	153.2
Liability adequacy provision	3.6	–	3.6
At 1 January 2012	6,411.2	(599.9)	5,811.3
Cash paid for claims settled in the year	(2,949.1)	108.6	(2,840.5)
Increase / (decrease) in liabilities:			
Arising from current-year claims	3,038.2	(227.2)	2,811.0
Arising from prior-year claims	(196.5)	(193.0)	(389.5)
Effect of foreign currency exchange adjustment	(13.2)	2.1	(11.1)
Increase in liability adequacy provision	0.7	–	0.7
At 31 December 2012	6,291.3	(909.4)	5,381.9
Claims reported	3,969.3	(397.8)	3,571.5
Incurred but not reported	2,153.9	(511.6)	1,642.3
Claims handling provision	163.8	–	163.8
Liability adequacy provision	4.3	–	4.3
At 31 December 2012	**6,291.3**	**(909.4)**	**5,381.9**
Cash paid for claims settled in the year	**(2,852.1)**	**149.1**	**(2,703.0)**
Increase / (decrease) in liabilities:			
Arising from current-year claims	**2,894.2**	**(250.9)**	**2,643.3**
Arising from prior-year claims	**(583.9)**	**96.7**	**(487.2)**
Effect of foreign currency exchange adjustment	**12.2**	**(2.8)**	**9.4**
Decrease in liability adequacy provision	**(4.3)**	**–**	**(4.3)**
At 31 December 2013	**5,757.4**	**(917.3)**	**4,840.1**
Claims reported	**3,636.4**	**(467.5)**	**3,168.9**
Incurred but not reported	**1,992.7**	**(449.8)**	**1,542.9**
Claims handling provision	**128.3**	**–**	**128.3**
Liability adequacy provision	**–**	**–**	**–**
At 31 December 2013	**5,757.4**	**(917.3)**	**4,840.1**

Movement in prior-year net claims liabilities by operating segment

	2013 £m	2012 £m
Motor	**(291.9)**	(174.3)
Home	**(43.3)**	(37.4)
Rescue and other personal lines	**(9.0)**	(23.9)
Commercial	**(51.6)**	(56.2)
International	**(39.3)**	(30.2)
Total ongoing	**(435.1)**	(322.0)
Run-off	**(52.1)**	(67.5)
Total	**(487.2)**	(389.5)

14. Insurance liabilities, unearned premium reserve and reinsurance assets continued

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2012	1,931.6	(59.0)	1,872.6
Net decrease in the year	(47.1)	(38.9)	(86.0)
Effect of foreign currency exchange adjustment	(11.6)	–	(11.6)
At 31 December 2012	**1,872.9**	**(97.9)**	**1,775.0**
Net (decrease) / increase in the year	**(61.8)**	**5.0**	**(56.8)**
Effect of foreign currency exchange adjustment	**7.6**	**(0.8)**	**6.8**
At 31 December 2013	**1,818.7**	**(93.7)**	**1,725.0**

15. Related party transactions

Related party transactions in the year ended 31 December 2013 were similar in nature to those for the year ended 31 December 2012.

Full details of the Group’s related party transactions for the year ended 31 December 2012 are included on pages 161 to 163 of the Annual Report & Accounts 2012.

16. Post balance sheet events

On 5 February 2014 the Group sold 100% of the share capital of Tracker Network (UK) Limited to Lysanda Ltd.

During the first quarter of 2014 the UK has seen adverse weather conditions resulting in storm damage and severe flooding. The Group's preliminary estimate of the cost of Home claims from this event up to 22 February 2014 is in the range of £70 million to £90 million. The Group has also experienced weather-related claims of approximately £20 million in its Commercial division.

Directors' responsibility statement

We confirm that to the best of our knowledge:

1. The financial statements within the full Annual Report and Accounts, from which the financial information within this preliminary announcement has been extracted, are prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the undertakings included in the consolidation taken as a whole; and

2. the management report within this preliminary announcement includes a fair review of the development and performance of the business and the position of the Group, and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties faced by the Group.

Signed on behalf of the Board

Paul Geddes	John Reizenstein
Chief Executive Officer	Chief Financial Officer
25 February 2014	25 February 2014

Additional information

Corporate information

Direct Line Insurance Group plc is a public limited company registered in England number 02280426. The address of the registered office is Churchill Court, Westmoreland Road, Bromley BR1 1DP, England.

The Company is an associate of The Royal Bank of Scotland Group plc. RBS Group comprises The Royal Bank of Scotland Group plc and its subsidiaries. In 2009, RBS Group committed to the European Commission to sell its insurance business as a condition of its receipt of State Aid. To comply with this requirement, RBS Group must cede control of the Company by the end of 2013 and must divest its entire interest by the end of 2014.

Statutory accounts information

The statutory accounts for 2012 were signed on 27 February 2013 and were delivered to the Registrar of Companies following the Annual General Meeting held on 6 June 2013. A copy of the statutory accounts for the Group for that year is available at the following website: ara2012.directlinegroup.com .