Interim Management Statement for Direct Line Insurance Group plc for the third quarter and the first nine months of 2014

31 October 2014

Direct Line Group's Interim Management Statement relates to the third quarter and the nine months ended 30 September 2014, and contains information to the date of publication.

Highlights

- Gross written premium for ongoing operations[1] 5.0% lower for the first nine months of 2014 compared with the same period of 2013, reflecting lower gross written premium in Motor and Home, partially offset by growth in Commercial
- Motor in-force policies 0.7% lower than the previous quarter with prices stable in the third quarter of 2014
- Improvement in personal lines capability through new websites, delivery of a number of pricing projects and a new advertising campaign and propositions for the Direct Line brand. Launched self-install telematics proposition in Motor
- Total cost base[2] for the nine months ended 30 September 2014 6.0% lower than for the first nine months of 2013. On track to achieve targeted total cost base[2] of approximately £1,000 million in 2014. Investment income yield increased by 20 basis points on the first nine months of 2013 to 2.3%, reflecting actions to diversify the portfolio
- Announced a binding agreement with Mapfre, S.A. for the sale of the Group's International division for cash sale proceeds of €550.0 million (£430.1 million[3]). It is expected that substantially all of the net proceeds will be returned to shareholders
- Group expects the combined operating ratio for ongoing operations[1] to be within the range of 95% to 97% including the benefit of significant reserve releases. Motor current-year loss ratio in the second half of the year is expected to be similar to the first half of 2014

Paul Geddes, CEO of Direct Line Group, commented

"Progress in the third quarter means we remain on track to deliver our 2014 financial targets, despite a backdrop of markets that remain highly competitive.

"We are working hard to enhance our propositions and I am particularly pleased with how we are harnessing technology to improve our product features and make it easier for our customers to interact with us.

"Looking forward, we remain focused on improving our efficiency and the competitiveness of our offering in this ever-changing marketplace."

For further information, please contact:

Neil Manser Director of Corporate Strategy and Investor Relations Tel: +44 (0)1651 832183	Jennifer Thomas Head of Financial Communications Tel: +44 (0)1651 831686

Notes:
1. Ongoing operations include Direct Line Group's ongoing divisions: Motor, Home, Rescue and other personal lines and Commercial. It excludes the International division, Run-off segment and restructuring and other one-off costs. For the purposes of the Group's 2014 targets, International should be added back to ongoing.
2. Operating expenses and claims handling expenses from ongoing operations and the International division. It excludes the Run-off segment and restructuring and other one-off costs.
3. Cash sale proceeds received in Euros have been converted to Pounds Sterling using the rate within the foreign currency hedge contract.

Business update

Direct Line Group (the "**Group**") continued to make progress in the first nine months of 2014 on its strategic priorities and towards its financial targets, while maintaining its disciplined approach to underwriting in a competitive marketplace.

The Group has continued to develop its propositions and functionality for both Motor and Home during the third quarter, building on initiatives delivered in the first six months of 2014. During 2014 to date, the Group has: launched new motor websites, significantly improving the 'quote and buy' journey; provided a new self-install telematics product; developed 30 pricing projects; refreshed and differentiated the Direct Line customer proposition; and rolled out smartphone technology in the claims process. These initiatives have improved the customer offering while building better trading capability.

Insurance market trends in the third quarter were similar to those seen in the second quarter, namely that the motor market experienced a second successive quarter of pricing stability whereas the home market saw further premium deflation.

Motor – effect on premium income of changes in price and risk mix[1]

Change versus same quarter in previous year	**Q3 2014**	Q2 2014	Q1 2014
Change in price	-0.1%	-2.2%	-4.9%
Change in risk mix	-2.5%	-2.3%	-1.2%

For the Group's Motor portfolio, overall prices were flat in the third quarter of 2014 compared with the same period last year while risk mix[1] reduced by 2.5%, a similar fall to the previous quarter. The reduction in gross written premium of 5.4% in Q3 was less than in previous quarters, as the Group's prices were more competitive in a stable market, and the benefits from improvements in pricing and claims capability continued.

The Home division increased its competitiveness in the third quarter following strong underlying claims performance which reflected the benefits from recent pricing and claims initiatives. Home retention continued at good levels.

While the motor and home markets have remained competitive, the Group has grown premium and policy count in Rescue. The Green Flag direct business continued to deliver excellent levels of customer service at a more affordable price point than its peers.

Commercial continued to grow through eTrade and Direct Line for Business. This was offset by the van market, which experienced similar trends to motor. During 2014, the division extended its eTrade product suite and launched Churchill for Business, which is focused on growing distribution through price comparison websites.

On 25 September 2014, the Group announced that it had reached a binding agreement with Mapfre, S.A. for the sale of the Group's International division for total cash sale proceeds of €550.0 million (£430.1 million[2]). The Group is expecting to recognise a pre-tax gain on disposal of approximately £160 million. The transaction is conditional on the approvals of relevant regulatory authorities and is currently expected to close in the first quarter of 2015. The results of this division, including comparatives, are now classified as discontinued operations and, from the date of the agreement, its assets classified as held for sale.

Notes:
1. Risk mix reflects the expected level of claims from the portfolio. It measures the estimated movement based on risk models used in that period and is revised when risk models are updated.
2. See note 3 on page 1

Financial update

In-force policies (thousands)

As at	**30 Sep 2014**	30 Jun 2014 Restated	31 Mar 2014	31 Dec 2013	30 Sep 2013
Motor	**3,667**	3,692	3,717	3,762	3,790
Home	**3,560**	3,593	3,666	3,719	3,753
Rescue and other personal lines	**8,589**	8,624[1]	8,446	8,801	8,917
Commercial	**606**	600	592	583	571
Total ongoing[2]	**16,422**	16,509	16,421	16,865	17,031
International	**1,655**	1,671	1,670	1,610	1,597
Total	**18,077**	18,180[1]	18,091	18,475	18,628
Analysis of Rescue and other personal lines:					
Rescue	**4,062**	4,035	3,911	3,944	3,931
Other personal lines	**4,527**	4,589	4,535	4,857	4,986

In-force policies for ongoing operations[2] decreased by 2.6% across the first nine months of 2014 to 16.4 million (31 December 2013: 16.9 million). This reduction primarily related to other personal lines (within the Rescue and other personal lines division) and Home.

The reduction in Home and Motor in-force policies of 4.3% and 2.5% respectively across the first nine months of 2014 reflected the Group's focus on maintaining its underwriting discipline in a competitive marketplace. During the first nine months of 2014, Home own brand in-force policies reduced by 3.2% compared to the same period in 2013 and were 0.9% lower across the third quarter. This reflected lower new business volumes, partially offset by a high retention rate.

The Rescue and other personal lines decrease of 2.4% during the first nine months of 2014 derived mainly from Travel policies connected to the sale of packaged bank accounts. However, Rescue in-force policies grew by 3.0% across the year to date, driven by Green Flag's new marketing campaign and propositions.

In-force policy growth in Commercial arose mainly from Direct Line for Business with positive effects on Landlord and Tradesman products, partially offset by a reduction in Van.

In-force policies for ongoing operations[2] decreased by 0.5% across the third quarter of 2014 to 16.4 million (30 June 2014: 16.5 million[1]).

Gross written premium

	Q3 2014 £m	Q3 2013 £m	**9 months 2014 £m**	9 months 2013 £m
Motor	**365.2**	386.0	**1,030.6**	1,117.4
Home	**243.7**	256.4	**681.0**	716.8
Rescue and other personal lines[3]	**101.0**	102.0	**282.2**	295.2
Commercial	**109.6**	110.8	**371.7**	361.5
Total ongoing[2]	**819.5**	855.2	**2,365.5**	2,490.9
International	**108.5**	122.5	**437.3**	462.7
Total	**928.0**	977.7	**2,802.8**	2,953.6
Analysis of Rescue and other personal lines:				
Rescue	**45.1**	41.6	**121.8**	115.3
Other personal lines[3]	**55.9**	60.4	**160.4**	179.9

Notes:
1. In-force policies as at 30 June 2014 have been updated to include an additional 470,000 policies previously excluded in relation to certain packaged accounts in the Rescue and other personal lines division.
2. See note 1 on page 1
3. The sale of Direct Line Life Insurance Company Limited (the "Life business") completed on 28 November 2013. The results of the Life business were recorded in two segments: Rescue and other personal lines, and the Run-off segment. Results recorded in Rescue and other personal lines included gross written premium for the third quarter of 2013 and first nine months of 2013 of £7.5 million and £23.0 million respectively.

Gross written premium for ongoing operations[1] of £2,365.5 million decreased by 5.0% compared with the first nine months of last year (first nine months 2013: £2,490.9 million). This reflects the impact of a competitive market, particularly in motor and home, together with the Group's continued focus on maintaining its underwriting discipline, partially offset by growth in Commercial and Rescue.

Motor gross written premium fell by 7.8% in the first nine months of 2014 compared with the first nine months of 2013, reflecting modest price deflation and a lower risk mix together with a reduction of in-force policies. The fall of 5.0% in Home gross written premium over the same period also reflected lower in-force policies as well as price deflation on new business.

Rescue and other personal lines gross written premium decreased by 4.4% compared with the first nine months of 2013. Within this, Rescue gross written premium increased by 5.6% partly due to Green Flag's new marketing campaign and propositions. Adjusting for the Life business, which was sold in November 2013, underlying gross written premium for Other personal lines rose 2.2% in the first nine months of 2014 compared with the first nine months of 2013, primarily relating to pricing initiatives.

Commercial gross written premium grew by 2.8% in the first nine months of 2014 compared with the same period in 2013. The division continued to benefit from previous investments with growth in gross written premium for Direct Line for Business and etrade. The commercial van market, similar to motor, remained highly competitive.

In total, gross written premium for ongoing operations[1] of £819.5 million in the third quarter fell by 4.2% compared to the same period last year (third quarter 2013: £855.2 million).

Underwriting – claims and reserving trends

There were no claims from UK major weather events in the third quarter of 2014. Home and Commercial claims from major weather events for the first nine months of 2014 remain as previously announced at approximately £64 million and £16 million respectively (first nine months 2013: approximately £5 million in the Home division).

Current-year Motor claims trends have been mixed in 2014 and the Group will continue to take a prudent view of these when assessing current-year loss ratios. During the first nine months of 2014, the Group has experienced higher than expected large bodily injury claims, partially offset by continued positive experience on small bodily injury claims. Taken together it is expected that the Motor current-year loss ratio in the second half of the year will be similar to the first half.

The reserve review in the third quarter resulted in additional releases from prior-year reserves, in particular relating to large bodily injury claims. Prior-year reserve releases in 2014 are at an elevated level, both in the ongoing business and the Run-off segment. Based on the latest data, prior-year reserve releases are expected to be lower in future years, albeit still significant.

Total cost base[2]

	Q3 2014 £m	Q3 2013 £m	**9 months 2014 £m**	9 months 2013 £m
Operating expenses	**184.7**	197.5	**561.1**	606.0
Claims handling expenses	**56.2**	62.4	**175.8**	178.0
Total cost base	**240.9**	259.9	**736.9**	784.0
Of which: International	**12.7**	7.8	**34.5**	28.6

The total cost base[2] for the first nine months of 2014 was £736.9 million, 6.0% lower than the first nine months of 2013 (£784.0 million). The Group is on track to achieve its targeted total cost base of approximately £1,000 million in 2014.

Notes:
1. See note 1 on page 1
2. See note 2 on page 1

Investment return[1]

	Q3 2014 £m	Q3 2013 £m	9 months 2014 £m	9 months 2013 £m
Investment income	**47.9**	45.8	**141.1**	129.2
Net investment gains	**11.3**	14.6	**34.6**	28.7
Total investment return	**59.2**	60.4	**175.7**	157.9
Of which: International	**5.2**	8.0	**17.6**	18.1

The total investment return[1] of £175.7 million for the first nine months of 2014 compared favourably with the first nine months of 2013, due to an increase in both investment income and net realised and unrealised gains. Investment income[1] was £141.1 million, a 9.2% increase on the first nine months of 2013, as a result of changes in asset mix, which were partially offset by lower assets under management.

The annualised investment income yield for the Group for the first nine months of 2014 was 2.3%, compared to 2.1% for the first nine months of 2013. This reflects portfolio actions which increased investments in UK commercial property, securitised credit, and securities within the corporate debt portfolio rated at the 'BBB' level, as the Group moved towards its target allocation.

Total investment return[1] in the third quarter of 2014 of £59.2 million was 2.0% lower than the same quarter in 2013. Net investment gains in the period were lower; however this was partially offset by an increase in investment income.

Investment holdings – total Group

As at	**30 Sep 2014 £m**	30 Jun 2014 £m	31 Dec 2013 £m	30 Sep 2013 £m
Corporate debt securities	**4,205.1**	4,920.0	4,915.8	4,940.7
Supranational	**266.6**	339.4	365.7	449.3
Local government	**183.8**	175.3	134.5	227.1
Credit	**4,655.5**	5,434.7	5,416.0	5,617.1
Securitised credit	**425.1**	468.5	229.8	45.8
Sovereign	**956.4**	1,139.0	1,399.5	1,448.0
Total debt securities	**6,037.0**	7,042.2	7,045.3	7,110.9
Cash and cash equivalents	**784.5**	925.0	1,288.9	1,420.4
Investment property	**296.7**	259.7	223.4	206.2
Sub-total	**7,118.2**	8,226.9	8,557.6	8,737.5
International[2]	**827.6**	-	-	-
Total	**7,945.8**	8,226.9	8,557.6	8,737.5

Total investment holdings reduced by 3.4% in the third quarter and by 7.1% year to date, reflecting similar trends experienced in gross written premium and payment of the £150.0 million special dividend on 12 September 2014. Total unrealised gains, net of tax, on available-for-sale investments were £86.0 million as at 30 September 2014 (31 December 2013: £58.8 million), of which £21.9 million (31 December 2013: £8.5 million) related to International.

During the first nine months of 2014, the UK business has invested a further £233.7 million in securitised credit, £56.5 million in investment property and made an allocation of £286.2 million to short duration high yield investments. The securitised credit and high yield allocations were brought up to target levels and it is expected that investment property will reach target levels during 2015.

The Group has previously approved an allocation of 6% of the UK portfolio to UK infrastructure debt and recently a 4% allocation to private placements of investment grade debt. These investments are expected to commence in the fourth quarter of 2014 and first quarter of 2015 respectively.

Notes:
1. Investment return and income from ongoing operations and the International division. It excludes the Run-off segment.
2. From 25 September 2014, the date of the announcement of the binding sale agreement for the International division, its investment holdings are classified as held for sale.

Following these changes, the target and actual allocations as at 30 September 2014 for the UK portfolio are:

Target allocation for UK investment portfolio

	As at 30 Sep 2014	
	UK target allocation	**Actual allocation**
Investment grade credit	55.0%	**61.4%**
High yield	4.0%	**4.0%**
Investment grade private placements	4.0%	**-**
Total credit	63.0%	**65.4%**
Securitised credit	6.0%	**6.0%**
Sovereign	13.0%	**13.4%**
Total debt securities	82.0%	**84.8%**
Infrastructure debt	6.0%	**-**
Investment property	5.0%	**4.2%**
Cash and cash equivalents	7.0%	**11.0%**
Total	100.0%	**100.0%**

Regulatory update
The Competition and Markets Authority ("**CMA**") released its final report on its investigation into the private motor insurance market on 24 September 2014. The CMA will publish a remedies order which will apply to the motor insurance industry, and it is expected to be published by March 2015. The outcome of this is not expected to have a significant impact on the Group's business.

Separately, in July 2014, the Financial Conduct Authority published its review of add-on products. The Group continues to support proportionate reforms which deliver better outcomes for consumers and a level playing field across the industry.

Outlook
For 2014, the Group reiterates its previously announced aim to achieve a combined operating ratio in the range of 95% to 97% for ongoing operations[1], assuming a normal level of claims from weather events, and a combined operating ratio of less than 100% for its Commercial division, assuming a normal level of claims from weather-related events and large losses.

The Group continues to target a total cost base[2] of approximately £1,000 million in 2014.

Notes:
1. See note 1 on page 1
2. See note 2 on page 1

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.

Statutory information
The Annual Report & Accounts for 2013 were signed on 25 February 2014 and were delivered to the Registrar of Companies following the Annual General Meeting held on 15 May 2014. The Annual Report & Accounts 2013 is available at: ara2013.directlinegroup.com .

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: return on tangible equity, the Group's combined operating ratio, the combined operating ratio 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.