Direct Line Insurance Group plc
Interim Management Statement for the first quarter of 2015

6 May 2015

Direct Line Group's Interim Management Statement relates to the first quarter ended 31 March 2015, and contains information to the date of publication.

Highlights

- Gross written premium for ongoing operations[1] 0.9% lower with stable gross written premium in Motor
- Motor and Home in-force policies stable for a second successive quarter. Growth in Green Flag direct and Commercial eTrade and direct
- Continued investment in initiatives to improve customer experience and propositions including roll out of new quote and buy digital journey for Home products and removal of amendment fees for the Direct Line brand
- Total costs reduced by 10.1% to £220.7 million and on track to reduce costs in absolute terms in 2015
- Reiterate expectation to achieve a combined operating ratio[2] in the range of 94% to 96% for ongoing operations after normalising for claims from major weather events

Paul Geddes, CEO of Direct Line Group, commented

"We have made a good start to 2015 with a stable trading performance in competitive markets and good momentum on the delivery of our strategic priorities. We continued to invest in technical and digital capabilities to improve our customer propositions and satisfaction, whilst maintaining our focus on efficiency. This progress in the first quarter gives us confidence that we are well positioned to meet our 2015 financial objectives."

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.
2. Combined operating ratio 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.

Business update

During the first quarter of 2015, the Group continued to make progress delivering its 2015 strategic objectives and building capability for the future.

The launch of new customer experience programmes has increased net promoter score while reducing complaints, and has contributed to a further improvement in customer retention in Motor and Home own brands.

To build on Direct Line's improved claims propositions, which include a seven day car repair service and an eight hour turnaround to post certain lost or damaged household goods, amendment fees have now been removed from all Direct Line branded products, including Direct Line for Business. These improvements aim to help position Direct Line as the UK's high performance general insurance brand.

The Group's investment in digital continued with the roll out of a new quote and buy journey for its home insurance products. Work associated with the implementation of the next generation of customer systems continued in the period and the initial phase of deployment is expected in the first half of 2016.

As previously announced, the sale of the International division is expected to complete in the second quarter. On completion of the sale, the Group expects to announce a special dividend reflecting substantially all of the net proceeds of the sale, conditional on shareholder approval of a share consolidation.

Financial update

In-force policies – ongoing operations (thousands)

As at	**31 Mar 2015**	31 Dec 2014	30 Sep 2014	30 Jun 2014 Revised[1]	31 Mar 2014 Revised[1]
Own brands	**3,417**	3,415	3,405	3,417	3,434
Partnerships	**251**	257	262	275	283
Motor total	**3,668**	3,672	3,667	3,692	3,717
Own brands	**1,696**	1,693	1,692	1,707	1,732
Partnerships	**1,782**	1,833	1,868	1,886	1,934
Home total	**3,478**	3,526	3,560	3,593	3,666
Rescue	**4,121**	4,075	4,062	4,035	3,911
Other personal lines	**4,385**	4,517	4,527	4,589	4,628
Rescue and other personal lines	**8,506**	8,592	8,589	8,624	8,539
Commercial	**617**	611	606	600	592
Total	**16,269**	16,401	16,422	16,509	16,514

Note:

1. In-force policies at 30 June 2014 and 31 March 2014 have been revised to include an additional 470,000 and 93,000 policies, respectively, previously excluded in relation to certain packaged accounts in the Rescue and other personal lines division.

Gross written premium – ongoing operations

	Q1 2015 £m	Q1 2014 £m	FY 2014 £m
Own brands	**302.7**	300.9	1,248.4
Partnerships	**23.7**	26.0	93.6
Motor total	**326.4**	326.9	1,342.0
Own brands	**96.9**	99.7	416.2
Partnerships	**113.1**	120.8	482.4
Home total	**210.0**	220.5	898.6
Rescue	**37.9**	35.9	156.9
Other personal lines	**57.1**	52.0	214.9
Rescue and other personal lines	**95.0**	87.9	371.8
Commercial	**115.1**	118.0	487.0
Total	**746.5**	753.3	3,099.4

Gross written premium and in-force policies for the Motor division were stable for the first quarter of 2015. In-force polices were flat in the quarter overall with a better performance in own brands versus partnerships. Compared with the first quarter of 2014, in-force policies have reduced by 1.3% with the majority of the reduction relating to partnerships. Motor gross written premium was stable compared with the first quarter of 2014 with modest growth in own brands being offset by a reduction in partnerships.

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

Change versus same quarter in previous year	Q1 2015	Q4 2014	Q3 2014
Change in price	**3.6%**	1.9%	0.1%
Change in risk mix	**(2.0%)**	(1.3%)	(2.7%)

For the Group's Motor portfolio, overall risk-adjusted prices increased by 3.6% in the first quarter of 2015 compared with the same period last year, while risk mix reduced by 2.0%. The trading environment improved modestly in the latter part of the quarter after experiencing seasonally competitive pressures earlier in the period. The Group's stable performance over the quarter reflects these market trends together with technical and market pricing enhancements improving the Group's competitiveness. At a market level, there has been no significant evidence of sustained premium rate increases matching long-term claims inflation.

Overall the Home division experienced modest reductions in in-force policies and gross written premium across the first quarter of 2015. Home in-force policies reduced by 1.4% in the quarter with all of the reduction from partnerships. Own brands in-force policies were stable for a second successive quarter, but remain 2.1% below a year ago. Gross written premium was 4.8% lower than the first quarter of 2014 with own brands 2.8% lower and partnerships 6.4% lower. Retention for own brands again improved in the quarter. The market remained competitive, albeit rate reductions for new business slowed compared with 2014.

Rescue and other personal lines experienced strong gross written premium growth of 8.1% compared with the first quarter of 2014 despite a headline reduction in in-force policies since 31 March 2014. Rescue gross written premium grew 5.6% compared with the first quarter of 2014 driven primarily by growth in Green Flag direct which was supported by sales of increased levels of cover and competitive propositions. In-force policies grew 1.1% in the quarter and at 31 March 2015 were 5.4% higher than a year ago. Other personal lines saw growth of 9.8% in gross written premium in the first quarter of 2015 compared with the same period last year mainly due to repricing within the travel book. Overall in-force policies fell 2.9% since the end of 2014 primarily reflecting volumes of policies linked to packaged bank accounts.

Commercial in-force policies grew by 1.0% with continued growth in Direct Line for Business as well as eTrade products. Gross written premium fell by 2.5% compared with the first quarter of 2014 due to competitive pressure, including the non-renewal of two larger customers, in the regional business. Gross written premium for eTrade and Direct Line for Business grew despite the competitive van market.

Note:
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.

Overall for ongoing operations, gross written premium fell by 0.9% to £746.5 million in comparison to the same period last year (first quarter 2014: £753.3 million) with total in-force policies of 16.3 million, 0.8% lower than at the end of 2014 (31 December 2014: 16.4 million).

Underwriting – claims and reserving trends

The weather in the first quarter of 2015 was relatively benign compared with the long-term average, with only one notable period of bad weather during January. In the Home division, this is estimated to have cost approximately £5 million (first quarter 2014: approximately £60 million).

As noted in the Annual Report & Accounts 2014, the motor market has been returning to a more normal level of claims inflation following the deflationary impact of the Legal Aid, Sentencing and Punishment of Offenders Act reforms. To date, the level of new large bodily injury claims expected to cost in excess of £1 million is tracking lower than in 2014, but it remains early in the year to assess trends. Large bodily injury claims below £1 million remain at an elevated level.

The Group continues to expect, assuming current claims trends continue, to see a significant contribution to operating profit from prior-year reserve releases.

Total cost base[1]

	Q1 2015 £m	Q1 2014 £m	FY 2014 £m
Operating expenses	169.9	189.3	705.4
Claims handling expenses	50.8	56.1	222.3
Total cost base	**220.7**	245.4	927.7

The total cost base for the first quarter of 2015 was £220.7 million, 10.1% lower than the first quarter of 2014. The Group continues to focus on cost control and operating efficiency through its cost-saving initiatives, and aims to reduce costs in absolute terms in 2015 compared with 2014.

Restructuring and other one-off costs were £31.9 million in the first quarter of 2015 primarily reflecting the costs associated with the exit of one location announced earlier in the year. The Group currently expects to incur total restructuring costs and other one-off costs of approximately £50 million in 2015.

Investment return – ongoing operations

	Q1 2015 £m	Q1 2014 £m	FY 2014 £m
Investment income	41.3	42.4	171.7
Net realised and unrealised gains	10.5	13.3	38.9
Total investment return	**51.8**	55.7	210.6

The total investment return for ongoing operations decreased in the first quarter of 2015 to £51.8 million from £55.7 million in the first quarter of 2014. Investment income was £41.3 million, a 2.6% decrease from the first quarter of 2014. An increase in annualised investment income yield for continuing operations[2] to 2.4% (first quarter 2014: 2.3%) was offset by lower assets under management. Net realised and unrealised gains from ongoing operations were £10.5 million (first quarter 2014: £13.3 million gain).

Notes:
1. Operating expenses and claims handling expenses from ongoing operations. It excludes the International division, Run-off segment and restructuring and other one-off costs.
2. Continuing operations include ongoing operations and the Run-off segment.

Investment holdings – total Group

As at	31 Mar 2015 £m	31 Dec 2014 £m
Corporate debt securities	4,364.4	4,092.7
Supranational	153.2	176.2
Local government	115.2	120.3
Credit	**4,632.8**	**4,389.2**
Securitised credit	410.0	419.6
Sovereign	580.8	993.7
Total debt securities	**5,623.6**	**5,802.5**
Infrastructure	75.0	76.2
Cash and cash equivalents	1,062.3	865.4
Investment property	312.9	307.2
Total Group	**7,073.8**	**7,051.3**

Total debt securities, excluding the International division's investment portfolio, are £5,623.6 million (31 December 2014: £5,802.5 million), of which 13.1% are rated as 'AAA', 23.0% as 'AA', 40.0% as 'A' and 18.6% as 'BBB'. As at 31 March 2015, total unrealised gains, excluding the International division and net of tax, on available-for-sale investments were £107.4 million (31 December 2014: £94.4 million).

During the first quarter of 2015, the Group reduced its allocation in sovereign debt securities and allocated funds to investment grade corporate debt securities. Further investments in infrastructure debt, investment property and private placements of investment grade debt are planned during the remainder of the year.

Outlook

For 2015, the Group reiterates its expectation to achieve a combined operating ratio in the range of 94% to 96% for ongoing operations after normalising for claims from major weather events.

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 2014 were signed on 2 March 2015 and will be delivered to the Registrar of Companies following the Annual General Meeting to be held on 13 May 2015. The Annual Report & Accounts 2014 is available at: ara2014.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", "aspire", "believes", "continue", "could", "estimates", "expects", "guidance", "intends", "may", "outlook", "plans", "predicts", "projects", "seeks", "should", "strategy", "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, and cost reduction. 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.

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