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

3 November 2015

Direct Line Group's Interim Management Statement relates to the nine months ended 30 September 2015 and contains information to the date of publication.

Highlights

- Gross written premium for ongoing operations[1] up 1.3% for the first nine months with 4.1% growth in Motor partially offset by Home, and for the third quarter up 3.1% with 6.8% growth in Motor
- Motor own brands in-force policies increased by 0.8% in the first nine months of 2015, while Home own brands in-force policies were stable
- Continued investment in customer propositions, with the inclusion of guaranteed hire car in all Direct Line comprehensive motor policies. This builds on the seven day car repair service and the removal of amendment fees for all Direct Line branded products
- Total costs[2] for ongoing operations reduced by 7.0%, while investment income yield increased to 2.4%, in comparison to the first nine months of 2014
- Reiterate expectation to achieve a 2015 combined operating ratio[3] in the range of 92% to 94% for ongoing operations after normalising for claims from major weather events. Underlying trends remain broadly in line with prior expectations of a combined operating ratio in the range of 94% to 96%

Paul Geddes, CEO of Direct Line Group, commented

"Our strategy is progressing well and we continue to see the benefits of our programmes to improve customer experience and differentiate our brands, with a strong performance in Motor helping us deliver overall growth in our gross written premium. At the same time, we have also realised further efficiencies throughout the business, with costs reducing 7.0% compared to the first nine months of last year.

"We will continue to build on these developments through investment in the future capability and technology of our business, with the aim of making insurance much easier and better value for our customers."

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Notes:
1. Ongoing operations comprise Direct Line Group's ongoing divisions: Motor, Home, Rescue and other personal lines and Commercial. It excludes discontinued operations, the Run-off segment and restructuring and other one-off costs.
2. Total costs include operating expenses and claims handling expenses.
3. 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 nine months of 2015, the Group continued to make progress delivering its 2015 strategic objectives and building capability for the future.

Work on differentiating the Group's brands has continued with, in particular, enhancements for the Direct Line brand's customers. During the third quarter of 2015, guaranteed hire car was included as standard in Direct Line comprehensive motor policies. The enhancement builds on a seven day car repair service and the removal of amendment fees from all Direct Line branded products. These improved propositions, as well as Churchill's refreshed branding, have contributed to an increase in the Group's overall brand Net Promoter Score, along with an increase in Motor and a stabilisation of Home own brands in-force policies.

The Group's investment in digital capability continued with the roll out of smartphone and tablet optimised websites, including new quote and buy journeys, for its Home and Green Flag insurance products. These have built on last year's successful implementation of a new quote and buy journey for Motor.

The Group continued to improve its efficiency with a reduction in total costs of 7.0% compared to the first nine months of 2014. This has been achieved while continuing to invest in future capability. Work associated with the implementation of the next generation of customer systems continued and the initial phase for deployment to Motor products is expected in 2016.

The Group continues to build on its current strong market positions by identifying and investing in market developments that it believes can contribute to future growth. In particular, Motor has continued to grow its telematics-based insurance, with a 76% increase during 2015 to 67,000 in-force policies.

Commercial has further enhanced its product coverage with the launch of Professional Indemnity cover for Direct Line for Business's customers, and Cyber cover for NIG's customers distributed through the broker channel. These products are fully reinsured.

Financial update

In-force policies – ongoing operations (thousands)

	30 Sep 2015	30 Jun 2015	31 Mar 2015 Revised[1]	31 Dec 2014 Revised[1]	30 Sep 2014 Revised[1]
Own brands	**3,441**	3,435	3,417	3,415	3,405
Partnerships	**252**	251	251	257	262
Motor total	**3,693**	3,686	3,668	3,672	3,667
Own brands	**1,696**	1,696	1,696	1,693	1,692
Partnerships	**1,725**	1,755	1,782	1,833	1,868
Home total	**3,421**	3,451	3,478	3,526	3,560
Rescue	**3,997**	4,034	4,008	3,976	3,975
Other personal lines	**4,361**	4,374	4,385	4,517	4,527
Rescue and other personal lines	**8,358**	8,408	8,393	8,493	8,502
Commercial	**648**	629	617	611	606
Total	**16,120**	16,174	16,156	16,302	16,335

Note:
1. Rescue in-force policies have been revised to exclude partner post-accident vehicle recoveries.

Gross written premium – ongoing operations

	Q3 2015 £m	Q3 2014 £m	9 months 2015 £m	9 months 2014 £m
Own brands	363.4	340.7	998.6	957.9
Partnerships	26.5	24.5	74.6	72.7
Motor total	389.9	365.2	1,073.2	1,030.6
Own brands	114.6	116.9	308.5	316.9
Partnerships	121.2	126.8	345.1	364.1
Home total	235.8	243.7	653.6	681.0
Rescue	46.5	45.1	127.1	121.8
Other personal lines	59.4	55.9	173.6	160.4
Rescue and other personal lines	105.9	101.0	300.7	282.2
Commercial	112.9	109.6	369.0	371.7
Total	844.5	819.5	2,396.5	2,365.5

Total in-force policies for ongoing operations during the first nine months of 2015 reduced by 1.1% to 16.1 million (31 December 2014: 16.3 million). The fall primarily related to other personal lines, within the Rescue and other personal lines division, and Home partnerships. Commercial grew in-force policies by 6.1% across the period, while Motor and Rescue increased marginally. Gross written premium of £2,396.5 million increased by 1.3% compared with the first nine months of 2014 (£2,365.5 million) and by 3.1% on the third quarter of 2014 as growth in Motor, Commercial and Rescue and other personal lines was partially offset by Home.

Motor

Effect on premium income of changes in price and risk mix[1] – total

Change versus same quarter in previous year	Q3 2015	Q2 2015	Q1 2015
Change in price	8.4%	5.9%	4.2%
Change in risk mix	(1.0%)	(0.8%)	(2.7%)

Motor gross written premium increased by 4.1% in comparison to the first nine months of 2014. Own brands performed well with strong retention overall and increased sales, particularly on price comparison websites from the Churchill brand.

In the third quarter of 2015, gross written premium increased by 6.8% and risk-adjusted Motor prices increased by 8.4% compared with the same period last year, while risk mix was broadly stable. At a market level, prices have increased in each of the last two quarters, albeit the Group believes this is indicative of market claims inflation.

Home

Effect on premium income of changes in price and risk mix – own brands

Change versus same quarter in previous year	Q3 2015	Q2 2015
Change in price	(0.9%)	(1.9%)
Change in risk mix	(1.2%)	(1.3%)

In-force policies for Home own brands remained stable at 1.7 million over the first nine months of 2015, while partner in-force policies reduced by 5.9%. Gross written premium was 4.0% lower than for the first nine months of 2014 primarily due to partnerships which were 5.2% lower, while own brands experienced a smaller reduction of 2.7%.

Home's strong brands maintained their competitiveness in a deflationary market supported by previous investments in pricing and claims management initiatives. Total Home gross written premium reduced by 3.2% on the third quarter of 2014, while own brands reduced by 2.0%. Risk-adjusted Home own brands prices decreased by 0.9% in the third quarter of 2015 compared with the same quarter last year, while risk mix decreased by 1.2%. Own brands retention continued to be strong, supported by previous investments in propositions. As previously disclosed, Nationwide, one of the Group's partners, is currently reviewing its Home insurance provider.

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.

Rescue and other personal lines

Gross written premium for Rescue and other personal lines experienced growth of 6.6% compared with the first nine months of 2014, while gross written premium was up 4.9% on the third quarter of 2014. Rescue gross written premium increased by 4.4% compared with the first nine months of 2014, mainly due to Green Flag direct sales. The take up of higher levels of cover and competitive propositions supported this. Gross written premium for other personal lines rose 8.2% compared to the first nine months of 2014, driven primarily by pricing on travel partnerships. The reduction in in-force policies for other personal lines of 3.5% since the start of the year primarily reflected lower packaged bank account volumes.

Commercial

Commercial in-force policy growth across the first nine months of 2015 was achieved by increased sales through the Direct Line for Business and eTrade channels. Gross written premium was broadly stable at £369.0 million in comparison to the first nine months of 2014. In the first half of the year, gross written premium decreased following competitive pressures in the regional market, while growth of 3.0% was achieved in the third quarter primarily through the eTrade and direct channels.

Underwriting – claims and reserving trends

When compared with the long-term average, the weather in the first nine months of 2015 continued to be benign with no claims from major weather events (first nine months 2014: approximately £64 million). The Group normally expects in the region of £80 million of claims from major weather events annually.

Motor and Home underlying claims trends have been similar overall to those in the first half of the year. Within these trends, the development of motor large bodily injury claims costs for the 2014 accident year has stabilised; while for the less mature 2015 accident year, development has continued to be volatile.

Releases from prior-year reserves continued to be significant, having been higher than expected in the first half of the year. However, the overall level for 2015 is expected to be lower than in 2014.

Total cost base

	Q3 2015 £m	Q3 2014 £m	9 months 2015 £m	9 months 2014 £m
Operating expenses	165.4	176.9	505.1	538.5
Claims handling expenses	49.7	51.3	148.3	163.9
Total cost base	215.1	228.2	653.4	702.4

The total cost base for ongoing operations of £653.4 million was 7.0% lower than for the first nine months of 2014 (£702.4 million). A continued focus on operating efficiency and cost-savings initiatives supported the reduction.

In the first nine months of 2015, restructuring and other one-off costs were £41.1 million, principally reflecting the costs associated with the exit of a location announced at the beginning of the year and IT migration. Total restructuring and other one-off costs for 2015 are currently expected to be in the region of £50 million.

Investment return – ongoing operations

	Q3 2015 £m	Q3 2014 £m	9 months 2015 £m	9 months 2014 £m
Investment income	41.5	44.1	124.6	129.1
Net realised and unrealised gains	1.1	9.9	27.8	29.0
Total investment return	42.6	54.0	152.4	158.1

The total investment return for ongoing operations of £152.4 million decreased by 3.6% compared to the first nine months of 2014. This was driven mainly by a reduction in investment income. Investment income of £124.6 million decreased by 3.5% on the first nine months of 2014 and was as a result of lower average assets under management. In the first nine months of 2015, the annualised investment income yield for continuing operations[1] increased to 2.4% (first nine months 2014: 2.3%).

Net realised and unrealised gains for ongoing operations of £27.8 million were lower than for the comparative period (first nine months 2014: £29.0 million gain) due primarily to lower realised gains on disposals of fixed income debt securities.

Note:

1. Continuing operations include ongoing operations and the Run-off segment.

Investment holdings – total Group

At	30 Sep 2015 £m	30 Jun 2015 Adjusted[1] £m	31 Dec 2014 £m
Corporate[2]	**4,048.6**	4,070.0	4,092.7
Supranational[2]	**143.1**	136.9	176.2
Local government[2]	**103.8**	124.6	120.3
Credit	**4,295.5**	4,331.5	4,389.2
Securitised credit[2]	**314.5**	398.6	419.6
Sovereign[2]	**503.8**	672.4	993.7
Total debt securities	**5,113.8**	5,402.5	5,802.5
Infrastructure	**301.0**	221.4	76.2
Cash and cash equivalents	**1,105.2**	916.4	865.4
Investment property	**340.1**	322.0	307.2
Total Group	**6,860.1**	6,862.3	7,051.3

At 30 September 2015, total debt securities were £5,113.8 million (31 December 2014: £5,802.5 million), of which 12.9% were rated as 'AAA' and a further 62.6% were rated as 'AA' or 'A'. Corporate, supranational and local government debt securities account for 62.6% of the portfolio. Total unrealised gains, net of tax, on available-for-sale investments at 30 September 2015 were £13.0 million (31 December 2014 excluding the International division: £94.4 million).

The Group continued to diversify its investment portfolio during the first nine months of 2015. Good progress has been made on acquiring infrastructure debt, whereas further investment in private placements within credit has been slower than expected. Reflecting market conditions, including further delays in market expectations for a base rate rise, there is some downward pressure on the Group's expected 2.6% interest income yield for 2016.

Solvency II

The Group continues to make good progress transitioning to the Solvency II regulatory regime. In the third quarter, the Prudential Regulation Authority has confirmed that it would accept a formal internal model application from the Group. The Group expects to submit its application in December 2015 and, subject to Prudential Regulation Authority approval, operate using its internal model from mid-2016. From 1 January 2016, pending approval of the internal model, the Prudential Regulation Authority has confirmed that the Group will operate under the standard formula.

Under the current capital regime, the Group's risk appetite is to hold capital between 125% and 150% of risk-based capital ("RBC"). Although the standard formula and RBC calculations are not directly comparable, the Group currently expects coverage of the Solvency II standard formula capital requirement to be broadly similar to its RBC capital coverage.

In line with previous statements, the Board will first consider any return of capital alongside the 2015 results. At that point, the consideration will take into account the Group's Solvency II standard formula capital requirement as well as progress with the internal model approval process. In line with its existing policy, the Board will consider current and forecast business developments and capital requirements over a prolonged period. Furthermore, the Group is currently recalibrating its risk appetite range in relation to the Solvency II internal model and expects to disclose the output of this later in 2016.

Outlook

The Group's markets remained highly competitive in the first nine months of 2015. The motor market overall has seen price rises, but this should be viewed in the context of rising claims costs. Deflation in the home market has continued, while competition was stronger in the rescue market in the third quarter.

Against this backdrop, the Group continues to adopt a disciplined approach to managing the trade-off between margin and volumes. Meanwhile, the Group is investing in building future capability and continues to identify opportunities to improve efficiency.

The Group reiterates its expectation to achieve a combined operating ratio for 2015 in the range of 92% to 94% for ongoing operations. This assumes a normal annual level of Home claims from major weather events of approximately £80 million. This revised range is supported by higher than expected prior-year reserve releases in the first half of 2015. Underlying trends remain broadly in line with prior expectations of a combined operating ratio in the range of 94% to 96%.

Notes:
1. Adjusts for the payment of the special interim dividend on 24 July 2015, in relation to the sale of the Group's International division
2. Investment holdings include investment portfolio derivatives which have been netted within debt securities. This excludes non-investment derivatives used to hedge subordinated debt and operational cash flows.

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 were delivered to the Registrar of Companies following the Annual General Meeting held on 13 May 2015. The Annual Report & Accounts 2014 is available at: ara2014.directlinegroup.com

Forward-looking statements disclaimer

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