Direct Line Insurance Group plc
Trading Update for the first quarter of 2016

4 May 2016

Direct Line Group's Trading Update relates to the first quarter ended 31 March 2016, and contains information to the date of publication.

Highlights

- Gross written premium for ongoing operations[1] 4.2% higher than the first quarter of 2015, with continued growth in Motor
- Motor and Home own brands in-force policies grew for a second successive quarter. Continued growth in Green Flag direct and Commercial direct
- Trading benefited from investment in Direct Line brand differentiation and proposition initiatives. Continued strong customer retention rates in Motor and Home
- Investment income yield maintained, with a significant improvement in the available-for-sale reserve. Net investment losses of £7.7 million mainly reflect decisions to sell certain assets in the high-yield portfolio
- Continued expectation to achieve a 2016 combined operating ratio[2] in the range of 93% to 95% for ongoing operations, assuming a normal annual level of claims from major weather events

Paul Geddes, CEO of Direct Line Group, commented:

"This was another quarter of top line growth for Direct Line Group, as customers responded favourably to the many improvements we have made to the business over the last few years. For the rest of 2016, we will aim to build on these foundations, while keeping a firm control of our costs, and we reiterate our combined operating ratio target of 93% to 95% for ongoing operations."

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Notes:
1. Ongoing operations include 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. Combined operating ratio is the sum of the loss, commission and expense ratios. The ratio measures the amount of claims costs, commission and expenses compared to net earned premium generated.

Business update

During the first quarter of 2016, Direct Line Group (the "**Group**") delivered further policy growth in its Motor and Home own brands and made good progress towards its strategic objectives, including continued investment to build future capability.

The Group has continued investment in brand differentiation through a succession of Direct Line proposition initiatives. Direct Line Home recently launched a new proposition to provide customers with an emergency plumber within three hours[1]. With customers shopping more following insurance premium tax rises, the Group's improved capability, together with better price competitiveness, has attracted customers and driven the growth in own brands in-force policies.

Partnerships remain strategically important and the Group will look to build on its improving manufacturing capability in order to develop propositions for current partners. Recently, the Group has worked successfully with Peugeot and Citroën on a new car proposition for young drivers incorporating telematics technology. This proposition has now been extended across a greater number of car models within their ranges.

With its focus on providing insurance to small and medium-sized enterprises, Commercial has continued to enhance its offering with the launch of a further full-cycle product for NIG's customers distributed through the eTrade broker channel.

The Group also continued to focus on new car technology, centred on improving safety, and is now offering discounts for customers with vehicles that have autonomous emergency braking.

Financial update

In-force policies – ongoing operations (thousands)

As at	31 Mar 2016 ('000)	31 Dec 2015 ('000)	30 Sep 2015 ('000)	30 Jun 2015 ('000)	31 Mar 2015 ('000) Revised[2]
Own brands	3,487	3,459	3,441	3,435	3,417
Partnerships	244	248	252	251	251
Motor total	3,731	3,707	3,693	3,686	3,668
Own brands	1,729	1,719	1,696	1,696	1,696
Partnerships	1,677	1,699	1,725	1,755	1,782
Home total	3,406	3,418	3,421	3,451	3,478
Rescue	3,805	3,932	3,997	4,034	4,008
Other personal lines	4,275	4,356	4,361	4,374	4,385
Rescue and other personal lines	8,080	8,288	8,358	8,408	8,393
Commercial	653	655	648	629	617
Total	15,870	16,068	16,120	16,174	16,156

Gross written premium – ongoing operations

	Q1 2016 £m	Q1 2015 £m	FY 2015 £m
Own brands	331.4	302.7	1,307.5
Partnerships	29.3	23.7	99.2
Motor total	360.7	326.4	1,406.7
Own brands	95.3	96.9	408.4
Partnerships	107.5	113.1	457.9
Home total	202.8	210.0	866.3
Rescue	39.4	37.9	163.3
Other personal lines	57.4	57.1	230.8
Rescue and other personal lines	96.8	95.0	394.1
Commercial	117.5	115.1	485.3
Total	777.8	746.5	3,152.4

Notes:
1. Home Plus product for uncontrollable water leaks
2. Rescue in-force policies have been revised to exclude partner post-accident vehicle recoveries.

Total in-force policies for ongoing operations reduced by 1.8% compared with the end of the first quarter of 2015. The fall primarily related to Rescue and Travel, within the Rescue and other personal lines division, and was mainly due to a decline in partner volumes. Growth in in-force policies continued to be experienced in Motor, Home's own brands, Green Flag direct and Commercial direct. Gross written premium of £777.8 million increased by 4.2% compared with the first quarter of 2015 (£746.5 million) primarily due to continued growth in Motor, which was partially offset by a reduction in Home partnerships.

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

Change versus same quarter in previous year	Q1 2016	Q4 2015	Q3 2015
Change in price	9.4%	7.7%	7.0%
Change in risk mix	(1.5%)	(1.0%)	0.1%

Total Motor in-force policies increased by 1.7% compared with the end of the first quarter of 2015. The market continued to experience high levels of shopping around. Motor's own brands grew by 2.0% over the same period with customer retention remaining strong. Investment in brand differentiation through a succession of Direct Line proposition initiatives and competitive pricing contributed to the improved performance. Motor gross written premium increased by 10.5% in comparison to the first quarter of 2015 as premium inflation returned to the market, which in part reflects ongoing claims inflation. Motor's risk-adjusted prices increased by 9.4% compared with the first quarter of 2015.

The Group continued to experience positive development in large bodily injury claims from the 2014 and 2015 accident years, both of which the Group believes are prudently reserved. In damage and small bodily injury claims, the current-year trends are similar to those previously reported and overall claims inflation remained around the top end of the long-term range of 3% to 5%.

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

Change versus same quarter in previous year	Q1 2016	Q4 2015	Q3 2015
Change in price	(2.3%)	(3.0%)	(1.6%)
Change in risk mix	(2.2%)	(2.6%)	(0.5%)

In-force policies for Home's own brands increased by 1.9% compared with the end of the first quarter of 2015, while partnership volumes reduced by 5.9%. Gross written premium was 3.4% lower than for the first quarter of 2015 primarily due to partners which were 5.0% lower, while own brands experienced a smaller reduction of 1.7%. Home's own brands risk-adjusted prices decreased by 2.3% compared with the first quarter of 2015, in part supported by improved claims trends. Home's own brands maintained their competitiveness in a deflationary market supported by the investments which the Group has made; this also helped continued strong retention.

When compared with the long-term average, the weather in the first quarter was benign with approximately £5 million of claims from major weather events (first quarter 2015: £nil). Flood Re launched successfully on 1 April 2016; the Group has supported its formation and ceded chosen risks to Flood Re from its inception.

Rescue and other personal lines experienced a reduction in in-force policies of 3.7% compared with the first quarter of 2015 mainly related to partner volumes in Rescue. Gross written premium for Rescue and other personal lines experienced growth of 1.9% compared with the first quarter of 2015. Rescue gross written premium increased by 4.0% compared with the first quarter of 2015, mainly due to Green Flag direct sales.

Commercial in-force policies were 5.8% higher than the first quarter of 2015 reflecting increased sales through Direct Line for Business, while volumes sold through broker channels were stable. The increase in gross written premium of 2.1% in comparison to the first quarter of 2015 reflected growth in Commercial direct. In particular, the Group's Landlord product benefited from an increase in buy-to-let properties ahead of changes in stamp duty.

Total costs[2]

	Q1 2016 £m	Q1 2015 £m	FY 2015 £m
Operating expenses	174.3	169.9	689.1
Claims handling expenses	45.1	50.8	195.6
Total costs	219.4	220.7	884.7

Notes:

1. Risk mix reflects the expected level of claims from the portfolio. It measures the estimated movement, excluding insurance premium tax, based on risk models used in that period and is revised when risk models are updated.
2. Operating expenses and claims handling expenses from ongoing operations. It excludes discontinued operations, the Run-off segment and restructuring and other one-off costs.

The total costs for ongoing operations of £219.4 million were slightly lower than for the first quarter of 2015 (£220.7 million). A reduction in claims handling expenses was partly offset by an increase in operating expenses, including IT costs.

The Group aims to reduce total costs in absolute terms in 2016 compared to 2015 although the rate of reduction is expected to be lower in 2016 than in 2015, due in part to the cost of Flood Re. The Group's contribution to the annual levy, based on its market share, is expected to be in the region of £25 million and will be charged to operating expenses in the second quarter of 2016. Total costs therefore in the first half of 2016 will be higher than in the same period last year.

Investment return – ongoing operations

	Q1 2016 £m	Q1 2015 £m	FY 2015 £m
Investment income	41.1	41.3	165.6
Net realised and unrealised (losses) / gains	(7.7)	10.5	29.1
Total investment return	33.4	51.8	194.7

Against a background of volatile debt markets in the first quarter of 2016, the Group generated investment income of £41.1 million and achieved an annualised income yield for continuing operations[1] of 2.4% (first quarter 2015: 2.4%) in line with the Group's expectations of 2.5% for 2016.

During the first quarter of 2016, the Group recognised net realised and unrealised losses of £7.7 million (first quarter 2015: gains £10.5 million). These losses primarily reflected the Group's decision to sell certain high-yield securities, where credit quality was of concern, which resulted in realised losses of £4.6 million. At the year end, the available-for-sale reserve was £5.4 million and this reserve has increased to £40.8 million at 31 March 2016.

Investment holdings – total Group

As at	31 Mar 2016 £m	31 Dec 2015 £m
Corporate[2]	3,871.6	3,815.0
Supranational	113.4	140.1
Local government[2]	28.7	104.9
Investment-grade credit	4,013.7	4,060.0
Investment-grade private placements	38.7	13.5
High yield[2]	387.2	327.4
Credit	4,439.6	4,400.9
Securitised credit[2]	318.6	350.8
Sovereign	413.8	442.7
Total debt securities	5,172.0	5,194.4
Infrastructure debt	341.8	329.6
Cash and cash equivalents	1,072.9	947.3
Investment property	347.4	347.4
Total Group	6,934.1	6,818.7

At 31 March 2016, total investment holdings of £6,934.1 million were 1.7% higher than at the beginning of the year. Total debt securities were £5,172.0 million (31 December 2015: £5,194.4 million), of which 12.1% were rated as 'AAA' and a further 59.1% were rated as 'AA' or 'A'.

Outlook

For 2016, the Group reiterates its expectation to achieve a combined operating ratio in the range of 93% to 95% for ongoing operations, assuming a normal annual level of claims from major weather events.

Notes:
1. Continuing operations include ongoing operations and the Run-off segment.
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 & Wales, number 02280426. The address of the registered office is Churchill Court, Westmoreland Road, Bromley BR1 1DP.

The Annual Report & Accounts 2015 is available at: www.directlinegroup.com

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