Direct Line Insurance Group plc
Preliminary results for the year ended 31 December 2017

27 February 2018

Strong financial performance, final dividend up 40.2% to 13.6p and special dividend of 15.0p

Paul Geddes, CEO of Direct Line Group, commented

"2017 is the fifth successive year in which we have delivered a strong financial performance. We have seen significant growth in our direct own brand policies as more customers respond positively to the many improvements we have made to the business. This success has resulted in our proposing an increase in the final dividend by 40.2% to 13.6 pence, bringing the total ordinary dividends to 20.4 pence, and declaring a special dividend of 15.0 pence. This amounts to a cash return of £486 million to shareholders for 2017.

"At half year we refreshed our medium term targets and today's results show we've been delivering on our management priorities to maintain revenue growth, reduce expense and commission ratios and deliver underwriting and pricing excellence.

"Looking to the future, this success enables us to continue investing in our technology and customer experience, supporting our plans to grow the business whilst improving efficiency. Together with our track record of delivery, these give us the confidence to continue to target a combined operating ratio of 93% to 95% over the medium term."

Results summary

	FY 2017 £m	FY 2016 £m	Change
Gross written premium	3,392.1	3,274.1	3.6%
Operating profit – Ongoing operations[1]	610.9	403.5	51.4%
Combined operating ratio[2]	91.8%	97.7%	(5.9pts)
Profit before tax	539.0	353.0	52.7%
Return on tangible equity[1]	21.7%	14.2%	7.5pts
Dividend per share – interim (pence)	6.8	4.9	38.8%
Dividend per share – final (pence)	13.6	9.7	40.2%
Dividend per share – special (pence)	15.0	10.0	50.0%
Solvency capital ratio post-dividend – estimated[3]	162%	165%	(3.0pts)

Financial highlights

- Strong growth in direct own brands[1] premiums and in-force policies up 9.3% and 5.3% respectively, driven again by continued Direct Line momentum in Motor.
- Operating profit from Ongoing operations of £610.9 million (2016: £403.5 million), primarily due to the non-repeat of the Ogden discount rate change which was reflected in 2016's results. Profit before tax of £539.0 million (2016: £353.0 million).
- Reported expense ratio in line with 2016. Excluding non-cash intangible assets impairments of £56.9 million (2016: £39.3 million), underlying expense ratio improved 0.5 percentage points to 23.5%.
- Combined operating ratio from Ongoing operations of 91.8% (2016: 97.7%) reflecting strong Motor and Commercial performance, including from prior-year reserve releases. Adjusted for normal weather, combined operating ratio towards the lower end of the target range of 93% to 95%.
- Final dividend up by 40.2% to 13.6 pence bringing the total ordinary dividends to 20.4 pence (2016: 14.6 pence) and a special dividend of 15.0 pence (2016: 10.0 pence). Total dividends for 2017 of 35.4 pence per share (2016: 24.6 pence).

Notes:

1. See glossary on pages 39 and 40 for definitions and appendix A – Alternative performance measures on page 42 for reconciliation to financial statement line items.
2. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration. See glossary on page 39 for definitions.
3. Estimates based on the Group's solvency II partial internal model.

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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, the outcome of the negotiations relating to the UK's withdrawal from the European Union, 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

	FY 2017 £m	FY 2016 £m	Change
Ongoing operations:			
In-force policies (thousands)	**15,714**	15,806	(0.6%)
In-force policies – direct own brands[1] (thousands)	**6,909**	6,563	5.3%
Gross written premium	**3,392.1**	3,274.1	3.6%
Net earned premium	**3,135.0**	3,000.6	4.5%
Underwriting profit	**256.9**	70.1	266.5%
Instalment and other operating income	**179.3**	165.3	8.5%
Investment return	**174.7**	168.1	3.9%
Operating profit – Ongoing operations	**610.9**	403.5	51.4%
Run-off	**43.8**	26.6	64.7%
Restructuring costs	**(11.9)**	(39.9)	70.2%
Operating profit	**642.8**	390.2	64.7%
Finance costs	**(103.8)**	(37.2)	(179.0%)
Profit before tax	**539.0**	353.0	52.7%
Tax	**(105.0)**	(74.2)	(41.5%)
Profit after tax	**434.0**	278.8	55.7%
Of which Ongoing operations[2]	**462.9**	293.0	58.0%
Key metrics – Ongoing operations			
Loss ratio[3]	**57.4%**	60.9%	(3.5pts)
Commission ratio[3]	**9.1%**	11.5%	(2.4pts)
Expense ratio[3]	**25.3%**	25.3%	–
Combined operating ratio[3]	**91.8%**	97.7%	(5.9pts)
Adjusted diluted earnings per share [1] (pence)	**33.6**	21.2	58.5%
Return on tangible equity[1]	**21.7%**	14.2%	7.5pts
Key metrics			
Investment income yield[1]	**2.5%**	2.5%	–
Net investment income yield[1]	**2.1%**	2.2%	(0.1pts)
Investment return yield[1]	**2.6%**	2.6%	–
Basic earnings per share [1] (pence)	**31.8**	20.4	55.9%
Return on equity	**16.6%**	10.8%	5.8pts
Dividend per share – interim (pence)	**6.8**	4.9	38.8%
– final pence)	**13.6**	9.7	40.2%
– total ordinary (pence)	**20.4**	14.6	39.7%
– special (pence)	**15.0**	10.0	50.0%
– total (pence)	**35.4**	24.6	43.9%
Net asset value per share (pence)	**198.9**	184.7	7.7%
Tangible net asset value per share (pence)	**164.4**	147.4	11.5%
Solvency capital ratio[4] – estimated	**162%**	165%	(3.0pts)

Notes:

1. See glossary on pages 39 and 40 for definitions and appendix A – Alternative performance measures on pages 41 to 43 for reconciliation to financial statement line items.
2. Profit after tax for Ongoing operations has been adjusted to exclude the one-off subordinated debt buy back charge of £53.4 million net of tax.
3. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration.
4. See note 3 on page 1, reported after proposed dividends.

Business update

Overview

Direct Line Group (the "**Group**") had a successful 2017, delivering a strong result and achieving its key priorities. The Group grew direct own brands, with in-force policies up 5.3% to 6.9 million (2016: 6.6 million) and gross written premiums up 9.3% to £2,184.1 million (2016: £1,997.6 million); delivered a combined operating ratio ("**COR**") of 91.8%, which when normalised for major weather events was towards the lower end of its target range of 93% to 95%; and reduced commission and underlying expense ratios (down 2.4 percentage points and 0.5 percentage points respectively). These improvements delivered a return on tangible equity ("**RoTE**") of 21.7%. The solvency capital ratio was 190% before dividends, demonstrating the strong capital generation of the business and the cumulative benefits of the Group's long-term risk management approach.

In line with the Group's trading update of 9 February 2018, operating profit from Ongoing operations increased to £610.9 million (2016: £403.5 million). The underwriting result (for both current and prior-year), instalment and other operating income and investment income were all higher than in 2016, which was impacted by the change to the Ogden discount rate announced in February 2017. Operating profit from Ongoing operations in 2017 included strong growth at improved margins in the Motor business and strong Commercial results, offset by Home, where 2016 benefitted from significant one-off reserve releases.

Total Group profit before tax was £539.0 million (2016: £353.0 million), reflecting a strong run-off result and a one-off charge related to the refinancing of debt in November 2017.

The Group remained focussed on developing its future capabilities, with investments in digital offerings, customer experience and operational efficiency. This helped support growth across its direct brands, including in the small and micro business market, and further developed its partnership capabilities. The Group continued to invest in its IT systems and capability. During the year, the Group reviewed its progress, and as part of its updated plan identified elements to rework, resulting in an intangible assets impairment charge of £56.9 million. The Group's total expense ratio was stable year on year, despite the higher intangible assets impairments and increased industry levies.

Motor

The Motor division grew in-force polices 3.8% in the year to 4.0 million and premiums grew 8.5% to £1,670.4 million. This growth was driven by the Direct Line brand, once again demonstrating the success of the Group's strategic focus on being a great retailer and the power of the direct model in a highly competitive switching market.

Motor current-year loss ratio improved to 79.7% (2016: 84.1%) as the Group priced to reflect the higher costs of the lower Ogden discount rate and benefitted from having renewed its reinsurance arrangements at the beginning of the year, before the Ogden discount rate change. Motor also benefitted from a £49 million reserve release after a detailed review in H1 of the Group's Ogden provision within case reserves. Other prior-year releases were lower year on year, albeit large bodily injury claims developed favourably. In addition, in 2017 the Group's claims experience was better than expected.

The Motor excess of loss reinsurance programme renewed on 1 January 2018 at a somewhat increased cost reflecting the reduction in the Ogden discount rate and at a level within the Group's plans and risk appetite. The Group renewed all layers, but retained 10% of the first risk layer (£2 million excess £1 million). This was a successful renewal in an uncertain climate reflecting the Group's historically strong performance and financial position.

The Group's ambition is to be the partner of choice for motor manufacturers. The Group's focus on being a smart and efficient manufacturer and its determination to embrace new technology has led to improved digital capabilities to enhance the customer journey and new propositions to meet customer needs which support this ambition. The Group already has a partnership with PSA Finance UK (part of Groupe PSA, owners of the Peugeot and Citroën brands) and an introducer relationship with Tesla, and the Group has recently signed a letter of intent for a partnership arrangement intended to be for five or more years with Volkswagen Insurance Service (Great Britain) Limited covering five well-known brands – Volkswagen, Audi, Seat, Skoda and Volkswagen Commercial Vehicles.

Home

In Home, the Group grew direct own brand in-force policies by 2.0% to 1.8 million and premiums by 1.2% to £409.7 million, although this was more than offset by the continuing fall in the partnership channel where in-force policies declined by 10.2% and premiums declined by 9.4%.

Underwriting performance was supported by lower weather losses of £13 million (2016: £18 million), but was offset by lower prior-year reserve releases of £23.7 million (2016: £75.9 million), as 2016 benefitted from significant releases from the reserves established following the storms of late 2015. Home's underwriting performance was also impacted by an increase in escape of water ("**EoW**") claims costs which affected current-year performance. Management took actions throughout the year on pricing, claims and underwriting which helped return EoW inflation to more normal levels.

The change in distribution of Home's insurance business from partners to price comparison websites ("**PCWs**") continued in 2017, increasing market price competitiveness and commoditisation. The Group remained competitive across all channels and successfully grew its PCW policies in 2017 at attractive margins, helping to support the strong profitability of the category.

The Group's focus on capital and risk management led to a successful renewal of its catastrophe reinsurance programme in July 2017, for the first time with a fixed rate three year arrangement for approximately 60% of its programme, providing more certainty over the costs it will incur on the majority of its programme until 2020.

The Group's focus on being a great retailer was demonstrated again with the launch of another Direct Line Home proposition in 2017, with 'Emergency Hotel sorted within one hour'; in the event of a major home fire, the Group provides rapid support to its customers at the point of need. Propositions such as this continue to differentiate Direct Line from its peers. The Group's investment in its digital capabilities has strengthened its partnership capabilities as demonstrated by a faster quote and buy journey that its partners RBS and NatWest can now provide to their customers, increasing new business sales by 50% in 2017.

Commercial

The Commercial business grew in-force policies 4.9% to 708k with Direct Line for Business ("**DL4B**") up 8.1% to 468k and the broker business, NIG, down 0.8% to 240k. Commercial premiums were up 0.3% to £501.5 million, with 11.9% growth in DL4B partially offset by a 2.9% reduction in NIG.

The Commercial business continued its improvement in profitability, increasing operating profit to £74.0 million (2016: £41.8 million) primarily due to the non-repeat of the Ogden discount rate change and higher prior-year reserve releases due to favourable development on liability classes. Weather was benign in 2017 and 2016.

In line with the Group's strategic pillar to 'lead and disrupt', DL4B made significant strides in its strategy to disrupt the small and micro commercial insurance industry, launching its new direct insurance platform for UK businesses in April 2017. Hair and Beauty was the first product launched and in December this was followed up by DL4B's Bed & Breakfast proposition. Management aims to have 75% of its targeted trades launched by the end of 2018.

In addition to the direct channel, NIG continued to support commercial insurance brokers by focusing on enabling easier trading. This included using technology to improve trading efficiency through more on-line products, moving to a paperless offering and investing in new systems for more complex business.

Rescue and other personal lines

Overall Rescue and other personal lines in-force policies fell by 1.8% to 7.7 million, but the product mix continued to improve. The Rescue business is made up of three distribution channels: the Group's direct brand (Green Flag), sales from the Group's insurance brands (linked) and partnerships. Green Flag, the most profitable channel, grew in-force policies by 10.0% to 802k and reached the highest number of policies since the Group's initial public offering in 2012, increasing sales of its higher premium products, resulting in 11.5% premium growth. Rescue partnership premiums decreased by 19.5% as the sale of packaged products continued to decline and the Group lost a partner. Nonetheless, the partnership business continued to provide benefit in terms of scale and distribution.

During Q4 2017 the Group agreed to renew its rescue services partnership with RBS/NatWest for a further 5 years. The Group is currently in discussion with RBS/NatWest regarding its travel partnership, which is subject to a tender.

The Rescue category has positioned itself as the market disruptor and is seeking to challenge the rescue market. Green Flag launched a new advertising campaign in the second half of 2017, highlighting the value of Green Flag policies compared to its main competitors.

Investments

The Group's investment strategy is intended to protect capital and match its UK liabilities with a diverse, high quality, and liquid asset portfolio. As part of this strategy the Group uses hedging to protect itself from movements in the US dollar/sterling exchange rate and in US dollar interest rates.

Assets under management increased £128.3 million in the year reflecting lower capital distributions in 2017, strong investment performance and business growth offset by continued reduction in the Group's net liabilities.

Total investment return was £175.4 million (2016: £171.5 million), giving a total yield of 2.6% (2016: 2.6%). Whilst investment income has benefitted from an increase in US interest rates, this has been offset by an increase in the cost of hedging to a sterling floating rate, resulting in a hedging cost of £27.0 million. This was more than offset by other realised and unrealised gains, including on the property portfolio.

Investment income remained broadly stable at £167.1 million (2016: £167.9 million) and the investment income yield was in line with management guidance at 2.5% (2016: 2.5%). Investment income net of hedging costs was £140.1 million (2016: £150.8 million) and the investment income yield net of the hedging result was 2.1% (2016: 2.2%).

Data and technology

Data and technology as a key enabler remained an ongoing area of focus. This includes developing future capability and managing the risks associated with IT systems' stability and cyber security. Technology remains at the heart of the Group's operations and the focus is on upgrading the Group's IT systems and capabilities, aimed at improving the digital offering, customer experience and operational efficiency. Whilst progress has been made in each of the three areas, implementation and integration of a range of new IT systems is inherently complex and challenging, and the Group is working with an experienced systems integrator. The Group remains focused on building the right capabilities and will take the time necessary to do so and has a phased programme of build, testing and roll out activities planned in 2018/2019 and beyond in Personal Lines and Commercial. The Group expects to incur capital expenditure of an average of around £80 million to £100 million per annum over the period 2017 to 2019.

Management have invested significantly in the IT and data knowledge and capability of the Group. The Group has brought in new talent over the past two years across IT, IT security, digital, and data to help achieve this. During the year, the Group updated its plans and decided that some of the investment undertaken as part of the improvement in IT capability would not deliver the targeted performance levels to meet its customers' expectations. Therefore, as part of its new plans, the Group decided to rework some elements of data storage and data flows. As a result the Group incurred an intangible assets impairment charge of £56.9 million in the year, reflecting capitalised costs of intangible assets that will no longer be utilised.

Dividends and capital management

During 2017 the Group increased its capital flexibility by issuing restricted Tier 1 notes and buying back half of its existing Tier 2 debt. Overall the Group achieved the primary objectives of the transaction, which were to spread the maturity of the Group's debt call dates and to increase headroom for Tier 2 debt issuance, should this be needed in the future. The transaction was successfully completed in December 2017. £250 million nominal value of Tier 2 debt with a coupon of 9.25% was repurchased and £350 million of Tier 1 notes were issued with a coupon of 4.75%. These transactions have increased the solvency capital ratio by approximately 2 percentage points and reduced future finance costs.

As announced in the Group's 2017 half year results, the Board has rebased the ordinary dividend upwards, increasing the proposed final dividend by 3.9 pence to 13.6 pence per share (2016: 9.7 pence). This reflects the Group's confidence in its earnings and the progress the business has made since the Group's initial public offering in 2012.

In normal circumstances, the Group expects to operate around the middle of its solvency capital ratio risk appetite range of 140% to 180%. As a result of the Group's lower capital requirements in 2017 and the strong financial performance in the year, the Group has announced a special dividend of 15.0 pence per share, taking the estimated Group solvency capital ratio post-dividends to 162% as at 31 December 2017.

Outlook

For 2018 and over the medium term, the Group targets achieving a 93% to 95% COR assuming a normal annual level of claims from major weather events and no further change to the Ogden discount rate, supported by reductions in its expense and commission ratios; and reiterates its ongoing target of achieving at least a 15% return on tangible equity.

For 2018, the Group targets net investment income yield to be around 2.1% with overall investment return in the region of £150 million.

Finance review

Performance

Operating profit – Ongoing operations

	FY 2017 £m	FY 2016 £m
Underwriting profit	256.9	70.1
Instalment and other operating income	179.3	165.3
Investment return	174.7	168.1
Total operating profit	610.9	403.5

Operating profit from Ongoing operations increased to £610.9 million (2016: £403.5 million). The underwriting result (for both current and prior-year), instalment and other operating income and investment income were all higher than 2016, which was impacted by the change to the Ogden discount rate announced in February 2017. Operating profit from Ongoing operations in 2017 included strong growth at improved margins in the Motor business and strong Commercial results, offset by Home, where 2016 benefitted from significant releases from reserves established following the storms of late 2015. Investment return was higher, with investment income stable while strong realised and unrealised gains more than offset the increased cost of hedging.

In-force policies and gross written premium

In-force policies – Ongoing operations (thousands)

At	31 Dec 2017	30 Sep 2017	30 Jun 2017	31 Mar 2017	31 Dec 2016
Own brands	3,845	3,805	3,761	3,691	3,642
Partnerships	174	188	205	220	231
Motor total	4,019	3,993	3,966	3,911	3,873
Own brands	1,794	1,783	1,770	1,764	1,759
Partnerships	1,454	1,499	1,534	1,593	1,619
Home total	3,248	3,282	3,304	3,357	3,378
Of which Nationwide and Sainsbury's	631	665	688	706	719
Rescue	3,591	3,635	3,663	3,676	3,646
Other personal lines	4,148	4,159	4,178	4,188	4,234
Rescue and other personal lines	7,739	7,794	7,841	7,864	7,880
Of which Green Flag direct	802	788	759	739	729
Direct Line for Business	468	462	452	441	433
NIG	240	244	248	245	242
Commercial	708	706	700	686	675
Total in-force policies	15,714	15,775	15,811	15,818	15,806

Total in-force policies for Ongoing operations during 2017 reduced by 0.6% to 15.7 million (31 December 2016: 15.8 million). The fall primarily related to lower partner volumes in Home and Rescue and other personal lines partially offset by increases in more profitable Motor and Home direct own brands business. Motor in-force policies grew by 3.8% and Commercial by 4.9% across the period. Own brands direct in-force policies in 2017 grew by 5.3% including a 5.6% increase in Motor, 2.0% increase in Home, 10.0% increase in Green Flag direct and a 8.1% increase in DL4B.

Gross written premium – Ongoing operations

	Q4 2017 £m	Q4 2016 £m	H2 2017 £m	H2 2016 £m	FY 2017 £m	FY 2016 £m
Own brands	368.5	333.3	809.7	734.4	1,590.9	1,428.7
Partnerships	15.5	24.0	36.3	54.4	79.5	110.4
Motor total	384.0	357.3	846.0	788.8	1,670.4	1,539.1
Own brands	102.2	100.1	216.5	213.1	409.7	404.7
Partnerships	91.8	105.2	194.5	218.1	389.4	429.7
Home total	194.0	205.3	411.0	431.2	799.1	834.4
Of which Nationwide and Sainsbury's	45.1	54.1	96.2	110.5	193.8	215.5
Rescue	34.2	34.9	77.7	81.2	161.3	163.1
Other personal lines	63.6	60.2	130.1	121.9	259.8	237.7
Rescue and other personal lines	97.8	95.1	207.8	203.1	421.1	400.8
Of which Green Flag direct	13.2	11.6	31.5	28.0	60.9	54.6
Direct Line for Business	29.7	27.1	62.5	56.6	122.6	109.6
NIG	85.2	93.3	170.6	181.3	378.9	390.2
Commercial	114.9	120.4	233.1	237.9	501.5	499.8
Total gross written premium	790.7	778.1	1,697.9	1,661.0	3,392.1	3,274.1

Gross written premium increased by 3.6% to £3,392.1 million (2016: £3,274.1 million) primarily relating to an increase in Motor and Home own brands and other personal lines partially offset by a reduction in Motor and Home partnerships.

Motor

Motor in-force policies increased by 3.8% to 4.0 million during 2017, primarily due to growth in own brands. This was supported by higher levels of new business and higher levels of customer retention. Investment in brand differentiation continued in 2017, and helped drive the strong performance in Direct Line. Motor gross written premium increased by 8.5% to £1,670.4 million as a result of higher volumes and higher average premiums.

Motor risk-adjusted prices increased by 9.5% in 2017 while risk mix reduced by 3.2% reflecting the way the Group deployed Ogden pricing changes which were in line with claims experience. As a result, Motor average premium[1] grew by 5.9% in 2017. The Group traded well throughout 2017 and benefitted from its reinsurance programme which was fixed prior to the Ogden discount rate change. Motor also benefitted from better claims experience in 2017 compared with the Group's long-term view of claims inflation. These two factors enabled the Group to grow policy count and premiums at attractive margins.

The market continued to experience a high level of shopping behaviour following the change to the Ogden discount rate, insurance premium tax increases and the introduction of last year's premium disclosures. Market premiums increased during 2017, albeit slowing in the second half, due to better claims experience.

Home

In-force policies for Home own brands increased by 2.0% to 1.8 million over 2017 and gross written premium grew by 1.2%. Partnership in-force policies and premiums continued to fall in line with previous years.

Home own brands maintained competitiveness in 2017. The Group was quick to adjust new business prices to reflect claims inflation and due to its strong propositions and improved competitiveness, wrote higher new business volumes. Total own brands risk adjusted prices were 2.6% ahead of prior-year. Higher new business growth, particularly through PCWs led to a reduction of 1.3% in Home own brands average premium[2]. As expected, renewal premiums continue to experience some reduction year on year due to channel mix moving towards lower premium PCW and web channels, whilst strong retention enabled policy renewals to grow year on year.

The market continued to experience a high level of shopping behaviour following insurance premium tax increases and the introduction of last year's premium disclosures. Market new business premiums began to increase in 2017 albeit not reflective of claims inflation.

The Group's Home partnership with Nationwide ended in December 2017 when new business ceased to be written. Existing in-force policies will run off during 2018.

Notes:

1. Average incepted written premium excluding IPT for total Motor for year ended 31 December 2017.
2. Average incepted written premium excluding IPT for Home own brands for year ended 31 December 2017.

Rescue and other personal lines

Rescue and other personal lines in-force policies reduced 1.8% to 7.7 million compared with 2016, primarily due to lower partner volumes. Green Flag direct in-force polices increased by 10.0% in the year from 729k to 802k. Gross written premium increased 5.1% compared with 2016, primarily due to price increases in Travel and strong growth in Green Flag direct, which increased 11.5% compared with 2016.

Commercial

Commercial in-force policies increased 4.9% to 708k compared with 2016 with a particularly strong performance in DL4B which increased 8.1%. Commercial gross written premium increased by 0.3% to £501.5 million compared to 2016, reflecting strong growth in DL4B, up 11.9%, particularly in landlord and van products. Gross written premium for NIG decreased by 2.9% compared to 2016, as the Group continued to price for risk and improved profitability.

Underwriting profit and combined operating ratio – Ongoing operations

	FY 2017	FY 2016
Underwriting profit (£ million)	**256.9**	70.1
Loss ratio	**57.4%**	60.9%
Commission ratio	**9.1%**	11.5%
Expense ratio	**25.3%**	25.3%
COR	**91.8%**	97.7%

The COR for Ongoing operations of 91.8% (2016: 97.7%) improved 5.9 percentage points, primarily as a result of the improvement in the loss and commission ratios. At the start of the year, the Group set its 2017 COR target for Ongoing operations in the range of 93% to 95%. This assumed a normal level of claims from major weather events. On this basis, the Group achieved a normalised COR towards the lower end of the Group's target range. This also includes an intangible asset impairment charge of £56.9 million (2016: £39.3 million).

The loss ratio was 3.5 percentage points lower at 57.4% (2016: 60.9%) and reflects a broadly flat current-year loss ratio and higher prior-year reserve releases. The current year loss ratio was broadly stable, as improvements in Motor were offset by EoW claims in Home. Prior-year reserves releases included a charge in 2016 of £175.1 million due to the impact of the change to the Ogden discount rate announced in February 2017, while 2017 includes a reserve release of £49 million, arising after a detailed case review of the Group's 2016 Ogden provision. Other prior-year releases were lower year on year, albeit large bodily injury claims developed favourably. Home was impacted by higher EoW claims in 2017, whilst 2016 included favourable development from the storms of late 2015.

The decrease in the commission ratio by 2.4 percentage points to 9.1% primarily reflected lower profit share payments to Home partners, as a result of lower prior-year reserve releases, a higher current-year attritional loss ratio and changes to the business mix and partnership arrangements.

The Group's expense ratio remained stable at 25.3%, as efficiency improvements in the cost base offset higher intangible asset impairments and industry levies. Excluding the impairment charge of £56.9 million (2016: £39.3 million), the underlying expense ratio improved by 0.5 percentage points to 23.5% (2016: 24.0%).

Loss ratio analysis by division – Ongoing operations

	Notes	Motor £m	Home £m	Rescue and other personal lines £m	Commercial[1] £m	Total Ongoing £m
For the year ended 31 December 2017						
Net earned premium	3	1,470.6	790.5	417.6	456.3	3,135.0
Net insurance claims	3	896.0	400.5	273.3	227.5	1,797.3
Prior-year reserve releases	19	275.5	23.7	6.8	86.3	392.3
Major weather events		n/a	(13.0)	n/a	n/a	(13.0)
Attritional net insurance claims		1,171.5	411.2	280.1	313.8	2,176.6
Loss ratio – current-year attritional		79.7%	52.0%	67.1%	68.8%	69.4%
Loss ratio – prior-year reserve releases		(18.8%)	(3.0%)	(1.7%)	(18.9%)	(12.4%)
Loss ratio – major weather events – Home[2]		n/a	1.6%	n/a	n/a	0.4%
Loss ratio - reported	3	60.9%	50.6%	65.4%	49.9%	57.4%
Commission ratio	3	2.5%	17.7%	5.5%	19.1%	9.1%
Expense ratio	3	28.5%	21.1%	23.4%	24.4%	25.3%
COR	3	91.9%	89.4%	94.3%	93.4%	91.8%
For the year ended 31 December 2016						
Net earned premium	3	1,337.1	816.3	394.4	452.8	3,000.6
Net insurance claims	3	1,001.7	332.0	243.0	250.5	1,827.2
Prior-year reserve releases	19	123.5	75.9	17.5	49.8	266.7
Major weather events		n/a	(18.0)	n/a	n/a	(18.0)
Attritional net insurance claims		1,125.2	389.9	260.5	300.3	2,075.9
Loss ratio – current-year attritional		84.1%	47.8%	66.0%	66.3%	69.2%
Loss ratio – prior-year reserve releases		(9.2%)	(9.3%)	(4.4%)	(11.0%)	(8.9%)
Loss ratio – major weather events – Home[2]		n/a	2.2%	n/a	n/a	0.6%
Loss ratio – reported	3	74.9%	40.7%	61.6%	55.3%	60.9%
Commission ratio	3	3.2%	22.6%	7.2%	19.5%	11.5%
Expense ratio	3	28.2%	21.7%	24.5%	23.9%	25.3%
COR	3	106.3%	85.0%	93.3%	98.7%	97.7%

Notes:

1. Commercial attritional loss ratio includes weather claims costs.
2. Home claims for major weather events, including inland and coastal flooding and storms.

The movement in the current-year attritional loss ratio is a key indicator of underlying accident year performance as it excludes prior-year reserve movements and claims from major weather events. The Group's current-year attritional loss ratio is broadly flat at 69.4% in 2017 (2016: 69.2%) with a significant improvement in Motor partially offset by deterioration in other segments.

By division, the COR improved in 2017 in Motor and Commercial, mainly due to higher prior-year reserve releases, as 2016 included a £175.1 million charge for the Ogden discount rate change while 2017 included a £49 million reserve release. The COR deteriorated in Home, primarily due to lower prior-year reserve releases, as 2016 included releases from the 2015 storms; and the impact of higher EoW claims inflation.

Motor

The COR for the Motor division was 91.9% (2016: 106.3%), a significant improvement due to the non-repeat of £150.3 million of the Ogden charge incurred in 2016. Excluding the impact of Ogden in 2016, the COR improved due to strong growth at improved margins. Motor also benefitted from a £49 million reserve release after a detailed review in H1 of the Group's Ogden provision within case reserves. Other prior-year releases were lower year on year, albeit large bodily injury claims developed favourably. The expense ratio increased slightly due to a higher intangible asset impairment of £56.9 million (2016: £39.3 million). The commission ratio improved 0.7 percentage points compared with 2016.

The current-year attritional loss ratio improved by 4.4 percentage points to 79.7% (2016: 84.1%). This reflects strong trading in 2017, the benefit of the Group's reinsurance arrangements renewed prior to the Ogden discount rate change announcement in February 2017 and better than expected claims experience.

While bodily injury claims frequency was better than expected in 2017, claims severity inflation, particularly in relation to damage perils, remained a headwind. Overall, claims inflation in 2017, excluding Ogden, was below the Group's expected long-term average of 3% to 5% per annum.

Home

In Home, the COR increased by 4.4 percentage points primarily as a result of a higher loss ratio, partially offset by a reduced commission ratio. The loss ratio increased 9.9 percentage points compared with 2016, mainly as prior-year reserve releases were lower than for 2016 at £23.7 million (2016: £75.9 million), as 2016 benefitted from significant releases from the reserves established following the storms of late 2015. The impact of major weather events in 2017 was slightly lower at approximately £13 million (2016: £18 million), lower than the normal annual level of claims costs expected from major weather events of approximately £65 million. Based on planned volumes for 2018, the Group's current assumption of a normal annual level of claims costs from major weather events is approximately £55 million.

The current-year attritional loss ratio, excluding claims costs from major weather events, was 4.2 percentage points higher than in 2016. This was predominately driven by elevated EoW claims inflation costs and a change in channel mix. Claims, pricing and underwriting actions taken since Q1 2017 have been on track to reduce claims inflation to a more normal level.

Rescue and other personal lines

The COR for Rescue and other personal lines was 1.0 percentage point higher at 94.3% (2016: 93.3%) primarily due to an increase in the loss ratio as a result of lower prior-year reserve releases in Travel. The commission ratio improved 1.7 percentage points due to lower payments to partners while the expense ratio improved 1.1 percentage points primarily due to improved marketing efficiency for Rescue. The COR for Rescue was 82.8% (2016: 83.4%).

Commercial

The Commercial COR of 93.4% benefitted from low weather-related claims costs. This COR was 5.3 percentage points lower than 2016, primarily due to higher prior-year reserve releases following favourable development on liability classes and the non-repeat of the Ogden charge of £24.8 million incurred in 2016. The current-year attritional loss ratio was 2.5 percentage points higher in 2017 as the Group continued to set current accident year reserves conservatively. Based on planned volumes for 2018, the Group's current assumption of a normal annual level of claims costs from major weather events is approximately £20 million.

Total costs – Ongoing operations

	Notes	FY 2017 £m	FY 2016 £m
Staff costs		409.6	406.5
Other operating expenses		307.2	277.8
Marketing	9	113.7	112.6
Amortisation and impairment of other intangible assets	9	111.0	96.7
Depreciation	9	27.9	30.1
Total costs		969.4	923.7
Operating expenses	9	794.4	759.3
Claims handling expenses	7	175.0	164.4
Total costs		969.4	923.7

Total costs for Ongoing operations increased to £969.4 million (2016: £923.7 million) reflecting additional costs in line with business growth, along with increases in levies of £13 million during the year and higher intangible asset impairments of £56.9 million (2016: £39.3 million). The impairments are in respect of intangible assets capitalised on the balance sheet and primarily relate to IT projects which aim to improve customer experience, support growth and increase the efficiency of the business. Staff and marketing costs remain broadly flat while absorbing business growth. The increase in claims handling expenses is primarily due to a claims handling provision release of £14 million in 2016. Operating expenses includes £12.5 million (2016: £14.2 million) of investment expenses.

The Group's expense ratio remained stable at 25.3% (2016: 25.3%). Excluding the impairment charge the underlying expense ratio improved 0.5 percentage points to 23.5% (2016: 24.0%).

Instalment and other operating income – Ongoing operations

	Note	FY 2017 £m	FY 2016 £m
Instalment income		116.4	107.1
Other operating income:			
Vehicle replacement referral income	6	16.9	14.1
Revenue from vehicle recovery and repair services	6	11.3	19.3
Legal services income	6	11.0	11.2
Other income	6	23.7	13.6
Other operating income	6	62.9	58.2
Total instalment and other operating income		179.3	165.3

Instalment and other operating income from Ongoing operations of £179.3 million increased 8.5% (2016: £165.3 million). Instalment income increased by £9.3 million compared to 2016, primarily as a result of higher Motor volumes. Other operating income increased £4.7 million to £62.9 million (2016: £58.2 million). Vehicle recovery and repair services include post-accident and pay-on-use-recovery and repairs performed on behalf of third party customers. This income decreased due to a change in the basis of allocation. Other income, which includes salvage income and fee income, increased by £10.1 million in the year to £23.7 million (2016: £13.6 million), primarily due to a change in contractual terms for salvage income.

Investment return

	Note	FY 2017 £m	FY 2016 £m
Investment income		167.1	167.9
Hedging to a sterling floating rate basis		(27.0)	(17.1)
Net investment income		140.1	150.8
Net realised and unrealised gains excluding hedging		35.3	20.7
Total group investment return	3	175.4	171.5

Investment yields – total Group

	FY 2017	FY 2016
Investment income yield[1]	2.5%	2.5%
Net investment income yield[1]	2.1%	2.2%
Investment return yield[1]	2.6%	2.6%

Note:

1. See glossary on pages 39 and 40 for definition.

The Group's investment strategy is to seek to match the duration of its UK liabilities and protect the Group's capital. To avoid over-concentration in the limited credit market the Group invests in US and some global investment-grade credit. The Group uses derivatives to hedge the currency and interest rate risk back to a sterling floating rate basis, and as a result benefits from credit diversification while hedging to a UK interest rate exposure.

Assets under management increased by £128.3 million reflecting lower capital distributions in 2017 as a result of the Ogden discount rate change, strong investment performance and business growth offset by continued reduction in the Group's net liabilities.

The total investment return increased to £175.4 million (2016: £171.5 million) to give a total yield of 2.6% (2016: 2.6%). Whilst investment income has benefitted from an increase in US interest rates, this has been offset by an increase in the cost of hedging to a sterling floating rate, resulting in a hedging cost of £27.0 million. This was more than offset by other realised and unrealised gains, including on the property portfolio.

Investment income remained broadly stable at £167.1 million (2016: £167.9 million) and the investment income yield was in line with management guidance at 2.5% (2016: 2.5%). Investment income net of hedging costs was £140.1 million (2016: £150.8 million) and the investment income yield net of the hedging result was 2.1% (2016: 2.2%).

For 2018 the Group expects the net investment yield, after cost of hedging, to be around 2.1%, reflecting the UK's current low interest rate environment. The performance of the Group's property portfolio has been very strong since its commencement in 2012. However, given the current levels of the UK property market, the Group does not expect significant gains on property in 2018. Overall, the Group currently anticipates a total investment return in the region of £150 million in 2018.

Investment holdings – total Group

At 31 December	2017 £m	2016 £m
Investment-grade credit[1]	3,893.1	3,888.3
High yield	388.6	409.9
Investment-grade private placements	103.6	85.1
Credit	4,385.3	4,383.3
Sovereign	224.8	341.2
Total debt securities	4,610.1	4,724.5
Infrastructure debt	316.4	337.0
Commercial real estate loans	169.0	79.7
Cash and cash equivalents[2]	1,304.5	1,110.8
Investment property	309.3	329.0
Total Group	6,709.3	6,581.0

Notes:

1. Asset allocation at 31 December 2017 includes investment portfolio derivatives, which have been included and have a mark-to-market asset value of £55.1 million included in investment grade credit (31 December 2016 mark-to-market value of £5.8 million liability). This excludes non-investment derivatives that have been used to hedge interest on subordinated debt and operational cash flows.
2. Net of bank overdrafts: includes cash at bank and in hand and money market funds with no notice period for withdrawal.

At 31 December 2017, total investment holdings of £6,709.3 million were 1.9% higher than at 31 December 2016, reflecting operating cash inflows offset by dividends paid. Total debt securities were £4,610.1 million (31 December 2016: £4,724.5 million), of which 4.8% were rated as 'AAA' and a further 61.9% were rated as 'AA' or 'A'. The average duration at 31 December 2017 of total debt securities was 2.3 years (31 December 2016: 2.3 years).

At 31 December 2017, total net unrealised gains, net of tax, on available-for-sale ("**AFS**") investments were £80.2 million (2016: £92.1 million).

Reconciliation of operating profit

	FY 2017 £m	FY 2016 £m
Motor	364.5	149.1
Home	128.8	166.7
Rescue and other personal lines	43.6	45.9
Commercial	74.0	41.8
Operating profit – Ongoing operations	610.9	403.5
Run-off	43.8	26.6
Restructuring costs	(11.9)	(39.9)
Operating profit	642.8	390.2
Finance costs	(103.8)	(37.2)
Profit before tax	539.0	353.0
Tax	(105.0)	(74.2)
Profit after tax	434.0	278.8

Ongoing operations

All divisions were profitable in 2017, with Motor and Commercial reporting significant improvements in operating profit compared to 2016 due mainly to the non-repeat of the Ogden discount rate change. This was partially offset by a decrease in Home, primarily due to lower prior-year reserve releases and the impact of higher EoW claims. Rescue operating profit of £43.5 million (2016: £42.8 million) is included in the Rescue and other personal lines result.

Run-off costs

The Run-off segment generated a profit of £43.8 million in 2017 (2016: £26.6 million). This increase over 2016 was largely due to the non-repeat of the Ogden charge in 2016.

Restructuring costs

Restructuring costs were significantly lower at £11.9 million (2016: £39.9 million), following the exit of a major site in 2016.

Previously the Group has reported that Run-off profits and restructuring costs which are not reported in Ongoing operations will broadly offset each other between 2015 and 2018 inclusively. Up to the end of 2017, the accumulated net result from Run-off and restructuring was a profit of £43 million.

For simplicity of reporting going forward, the Group's reporting will focus on operating profit rather than operating profit from Ongoing operations. Material restructuring activities or other one-off items will be disclosed if they occur.

Finance costs

Finance costs increased significantly to £103.8 million (2016: £37.2 million) due to the one-off cost associated with the repurchase of £250 million nominal value of the Group's subordinated guaranteed dated notes. The price paid included a premium to nominal value of £76.8 million, reflecting the market price of the notes. Taking into account associated costs and the interest rate swaps, the net impact of this repurchase was £66.1 million.

Going forward, the coupon payment for the recently issued Tier 1 notes will be accounted for directly through equity. As a result of the repurchase, reported finance costs are expected to reduce by approximately half.

Taxation

The effective tax rate was 19.5% (2016: 21.0%), which was broadly in line with the standard UK corporation tax rate of 19.25% (2016: 20.0%).

Profit for the year and return on tangible equity

Profit after tax for the year was £434.0 million (2016: £278.8 million) primarily resulting from higher underwriting profit following the change to the Ogden discount rate in 2016 and reduced restructuring costs partially offset by higher finance charges which include a one-off charge of £66.1 million.

RoTE increased to 21.7% predominantly due to an improvement in profit after tax (2016: 14.2%). The profit after tax in 2017 included in the RoTE calculation includes an adjustment to remove the one-off costs in relation to the buy-back of the £250 million subordinated guaranteed dated notes (£66.1 million before tax). See appendix A – Alternative performance measures on page 42.

Following a review of the approach to the Group's Executive Remuneration policy, the Remuneration Committee is proposing that the level of RoTE required for the March 2018 long-term incentive plan awards to vest be increased from the current range of 15.0% to 18.0% to a range of 17.5% to 20.5%, partly reflecting the issue of the Tier 1 notes.

Earnings per share

Basic earnings per share were 31.8 pence (2016: 20.4 pence) reflecting the increase in profit after tax.

Adjusted diluted earnings per share from Ongoing operations were 33.6 pence (2016: 21.2 pence) reflecting the increase in operating profit.

Dividends

The Board is proposing a final dividend of 13.6 pence per share making a total ordinary dividend of 20.4 pence per share (2016: 14.6 pence). This represents 39.7% growth over the 2016 ordinary dividend in line with the increase in the interim dividend announced with the H1 results.

In normal circumstances, the Group expects to operate around the middle of its solvency capital ratio risk appetite range of 140% to 180%. As a result of the Group's lower capital requirements in 2017 and the strong financial performance in the year, the Group has declared a special dividend of 15.0 pence per share as an interim dividend, taking the estimated Group solvency capital ratio post-dividends to 162%. The final dividend will be put to shareholders for approval at the AGM on 10 May, and the final dividend and the special dividend are to be paid on 17 May 2018 to shareholders on the register on 6 April 2018. The ex-dividend date will be 5 April 2018.

Net asset value

At 31 December	Note	2017 £m	2016 £m
Net assets	12	2,715.1	2,521.5
Goodwill and other intangible assets	12	(471.1)	(508.9)
Tangible net assets	12	2,244.0	2,012.6
Closing number of Ordinary Shares	12	1,365.1	1,365.1
Net asset value per share (pence)	12	198.9	184.7
Tangible net asset value per share (pence)	12	164.4	147.4

The net asset value at 31 December 2017 was £2,715.1 million (31 December 2016: £2,521.5 million) with a tangible net asset value of £2,244.0 million (31 December 2016: £2,012.6 million). The increase since the beginning of the year reflected the 2017 profit offset by dividends paid and a decrease in AFS investments reserve from £92.1 million at 31 December 2016 to £80.2 million at 31 December 2017.

Reserving

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling provision.

The Group considers the class of business, the length of time to notify a claim, the validity of the claim against a policy, and the claim value. Claims reserves could settle across a range of outcomes, and settlement certainty increases over time. However, for bodily injury claims the uncertainty is greater due to the length of time taken to settle these claims. Annuity payments for injured parties also increase this uncertainty.

The Group seeks to adopt a conservative approach to assessing liabilities, as evidenced by the favourable development of historical claims reserves. Reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal actuarial best estimate. This margin is made in reference to various actuarial scenario assessments and reserve distribution percentiles. It also considers other short and long-term risks not reflected in the actuarial inputs, as well as management's view on the uncertainties in relation to the actuarial best estimate.

The most common method of settling bodily injury claims is by a lump sum paid to the claimant and, in the cases where this includes an element of indemnity for recurring costs such as loss of earnings or ongoing medical care, settlement calculations have reference to a standardised Ogden annuity factor at a discount rate of minus 0.75% in 2017 (2016: minus 0.75%). This is normally referred to as the Ogden discount rate. Other estimates are also required for case management expenses, loss of pension, court protection fees, alterations to accommodation and transportation fees.

The Lord Chancellor changed the Ogden discount rate from 2.5% to minus 0.75% with effect from 20 March 2017 based on a 3-year average of yields on index-linked government securities and the rate may be sensitive to future movements in these instruments. The Government is currently planning to review the Ogden discount rate again based on 'low risk' investments rather than 'very low risk' investments, however, there is considerable uncertainty if, when and how a change might be made.

The Group will continue to exercise judgement around the Ogden discount rate used in its reserves allowing for the possibility for it to change in the future. It considers the uncertainties around the legal framework and its implementation risks to the future rate as being significant but broadly balanced and therefore provisions at the current proposed rate of minus 0.75%. An allowance for further movements in the Ogden discount rate is made within the Group's solvency II balance sheet and capital requirement. Details of the IFRS sensitivity analysis to the assumed Ogden discount rate are shown overleaf. However, it should be noted that the Government is considering not only the appropriate level for the rate but also the methodology of how it is applied, so any sensitivity has considerable limitations and uncertainty.

The Group's prior-year reserve releases were £435.4 million (2016: £290.1 million) with good experience in large bodily injury claims being a key contributor. The releases in 2017 include a £49 million Ogden specific release where the claims file review performed in H1 following the Ogden discount rate change indicated a lower ultimate cost at the new rate than was assumed at the year-end 2016. In addition, large bodily injury claims developed favourably. Home prior-year reserve releases of £23.7 million (2016: £75.9 million) were affected by EoW experience, whilst in 2016 Home benefitted from favourable development on the December 2015 weather events.

Looking forward, the Group expects to set its initial management best estimate for future accident years conservatively. Over time, the proportion of the Group's underwriting profit attributable to the current-year is expected to increase, including due to targeted improvements in the expense and commission ratios. Assuming current claims trends continue, the contribution from prior-year reserve releases is expected to remain significant, albeit it is expected to reduce over time.

Claims reserves net of reinsurance

At 31 December	2017 £m	2016 £m
Motor	1,919.7	2,084.2
Home	293.3	298.1
Rescue and other personal lines	85.6	72.8
Commercial	578.3	607.0
Total Ongoing	2,876.9	3,062.1
Run-off	267.6	326.2
Total Group	3,144.5	3,388.3

Sensitivity analysis – the discount rate used in relation to PPOs and changes in assumed Ogden discount rate

The table below provides a sensitivity analysis of the potential impact of a change in a single factor with all other assumptions left unchanged. Other potential risks beyond the ones described could have an additional financial impact on the Group.

	Increase / (decrease) in profit before tax and equity[3,4] at 31 December	
	2017 £m	2016 £m
PPOs[1]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	54.6	68.2
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(75.1)	(97.9)
Ogden discount rate[2]		
Impact of the Group reserving at a discount rate of 0% compared to minus 0.75%	68.4	102.1
Impact of the Group reserving at a discount rate of minus 1.5% compared to minus 0.75%	(102.9)	(156.4)

Notes:

1. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0.0%. The PPO sensitivity has been calculated on the direct impact on the change in the real discount rate with all factors remaining unchanged.
2. Ogden discount rate sensitivity has been calculated on the direct impact of a permanent change in the discount rate with all other factors remaining unchanged. The Group will consider the statutory discount rate when setting its reserves but not necessarily provide on this basis. This is to ensure that reserves are appropriate for current and potential future developments.
3. These sensitivities exclude the impact of taxation.
4. These sensitivities reflect one-off impacts at 31 December and should not be interpreted as predictions.

The sensitivity above is calculated on the basis of a permanent change in the rate on the actuarial best estimate reserves as at 31 December 2017. It does not take into account a change in the Ogden discount rate setting regime, nor any second order impacts such as those on the Group's PPO assumptions or reinsurance bad debt assumptions. The year on year reduction in sensitivity to a change in the Ogden discount rate reflects a £49 million reserve release arising after a detailed case review of the Group's 2016 Ogden provision as well as the overall reduction in bodily injury exposures. This is due to continued positive prior-year development of claims reserves for large bodily injury claims, particularly for accident years where the reinsurance retention level was higher than the current level of £1 million.

Capital management

Capital management policy

The Group aims to manage its capital efficiently and generate long-term sustainable value for shareholders, while balancing operational, regulatory, rating agency and policyholder requirements.

The Group aims to grow its regular dividend in line with business growth.

Where the Board believes that the Group has capital which is expected to be surplus to the Group's requirements for a prolonged period, it would intend to return any surplus to shareholders. In normal circumstances, the Board expects that a solvency capital ratio around the middle of its risk appetite range of 140% to 180% of the Group's solvency capital requirements ("**SCR**") would be appropriate and it will therefore take this into account when considering the potential for special distributions.

In the normal course of events the Board will consider whether or not it is appropriate to distribute any surplus capital to shareholders once a year, alongside the full year results.

The Group expects that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend, and two-thirds will be paid as a final dividend in the second quarter of the following year. The Board may revise the dividend policy from time to time. The Company may consider a special dividend and/or a repurchase of its own shares to distribute surplus capital to shareholders.

Solvency II

In its results, the Group has estimated its solvency II own funds, SCR and solvency capital ratio as at 31 December 2017. The Group will formally submit its final Solvency Financial Condition Report in May 2018 to the Prudential Regulation Authority ("**PRA**"), and expects to continue to update the assumptions and implement minor model changes until then. Therefore, the final solvency position may differ from those included in the preliminary results.

Sensitivity analysis

The following table shows the Group's estimated solvency capital ratio sensitivities based on the assessed impact of scenarios as at 31 December 2017.

	Impact on solvency capital ratio	
Scenario	31 Dec 2017	31 Dec 2016
Motor bodily injury deterioration equivalent to accident years 2008 and 2009	**(7pts)**	(8pts)
One-off catastrophe loss equivalent to the1990 storm	**(9pts)**	(9pts)
One-off catastrophe loss based on extensive flooding of the River Thames	**(9pts)**	(9pts)
Change in reserving basis for PPOs to use a real discount rate of minus 1%[1]	**(13pts)**	(13pts)
100bps increase in credit spreads[1,2]	**(11pts)**	(10pts)
100bps decrease in interest rates[2]	**(9pts)**	(7pts)

Notes:

1. The methodology for calculating the impact on the ratio of an increase in credit spreads and a change in the reserving basis for PPOs to use a real discount rate of minus 1% have been updated in 2017 and for the comparative period.
2. The sensitivities only include the assessed impact of the above scenarios in relation to AFS investments.

Capital surplus

The Group's SCR and solvency capital ratio are as follows:

At 31 December	2017	2016
Solvency capital requirement (£ billion)	1.39	1.40
Capital surplus above solvency capital requirement (£ billion)	0.86	0.91
Solvency capital ratio post-dividend	162%	165%

The following table splits the Group's own funds by tier on a solvency II basis.

At 31 December	2017 £bn	2016 £bn
Tier 1 capital before foreseeable dividends	1.98	1.87
Foreseeable dividends	(0.39)	(0.13)
Tier 1 capital – unrestricted	1.59	1.74
Tier 1 capital – restricted	0.35	–
Tier 1 capital	1.94	1.74
Tier 2 capital: subordinated debt	0.26	0.54
Tier 3 capital: deferred tax	0.05	0.03
Total own funds	2.25	2.31

At 31 December 2017, the Group held a solvency II capital surplus of approximately £0.86 billion above its regulatory capital requirements and was equivalent to an estimated solvency capital ratio of 162%, post-dividend.

Tier 1 capital after foreseeable dividends represents 86% of own funds and 139% of the estimated SCR. Tier 2 capital relates solely to the Group's £0.26 billion subordinated debt. The amount of Tier 2 and Tier 3 capital permitted under the solvency II regulations is 50% of the Group's SCR and of Tier 3 it is less than 15%. Therefore, the Group has no ineligible capital.

On 7 December 2017, the Group issued £0.35 billion of Tier 1 notes with a coupon of 4.75%. The notes have an optional redemption date of 7 December 2027 and if the notes are not repaid on that date, the rate of interest will be reset. Proceeds of the issuance were primarily used to fund the repurchase of half of the Group's £0.50 billion 9.25% Tier 2 capital. This repurchase of Tier 2 capital was achieved at a value of approximately £0.33 billion including accrued interest. The remaining Tier 2 capital of £0.25 billion nominal value has a redemption date of 27 April 2022.

The Group has issued Tier 1 notes to mitigate the risk of a single refinancing date. In addition, under solvency II eligibility restrictions the Group previously had limited options to raise additional subordinated debt (Tier 2) capital to recover solvency. As a result of raising the Tier 1 notes and repaying half of the Tier 2 capital the Group has the ability to raise further Tier 2 capital should this be required.

The special dividend will be payable from surplus capital generated from continuing operations of the Group.

Reconciliation of IFRS shareholders' equity to solvency II own funds

At 31 December	2017 £bn	2016 £bn
Total shareholders' equity	2.72	2.52
Goodwill and intangible assets	(0.47)	(0.51)
Change in valuation of technical provisions	(0.19)	(0.05)
Other asset and liability adjustments	(0.08)	(0.09)
Foreseeable dividends	(0.39)	(0.13)
Tier 1 capital – unrestricted	1.59	1.74
Tier 1 capital – restricted	0.35	–
Tier 1 capital	1.94	1.74
Tier 2 capital: subordinated debt	0.26	0.54
Tier 3 capital: deferred tax	0.05	0.03
Total own funds	2.25	2.31

Movement in capital surplus

	2017 £bn	2016 £bn
Capital surplus at 1 January	0.91	0.78
Underlying movement in capital generation	0.49	0.19
Market movements	–	0.12
Capital generation	0.49	0.31
Change in solvency capital requirement	0.01	0.27
Surplus generation	0.50	0.58
Capital expenditure	(0.10)	(0.11)
Management capital action	0.03	-
Capital distribution – ordinary dividends[1]	(0.28)	(0.20)
Capital distribution – special dividends[1]	(0.20)	(0.14)
Net surplus movement	(0.05)	0.13
Capital surplus at 31 December	0.86	0.91

Note:

1. Foreseeable dividends included above are adjusted to exclude the expected dividend waivers in relation to shares held by the employee share trusts, which are held to meet obligations arising on the various share option awards.

During 2017, the Group's own funds reduced from £2.31billion to £2.25 billion. The Group generated £0.49 billion of solvency II capital offset by £0.10 billion of capital expenditure and capital distribution of £0.48 billion, including the 2017 interim and final ordinary dividends and special interim dividends. The capital management action refers to the debt refinancing activity mentioned above.

Leverage

The Group's financial leverage continued to be conservative at 18.4% (2016: 17.6%). While the Tier 1 notes issued during 2017 are presented as equity in the balance sheet, the Group considers this to be part of its total leverage and the £346.5 million (net of arrangement costs) is included in the ratio.

At 31 December	2017 £m	2016 £m
Shareholders' equity	2,715.1	2,521.5
Tier 1 notes	346.5	–
Financial debt – subordinated debt	264.7	539.6
Total capital employed	3,326.3	3,061.1
Financial-leverage ratio[1]	18.4%	17.6%

Note:

1. Total IFRS financial debt as a percentage of total IFRS capital employed.

Credit ratings

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

Regulatory update

The Group has continued to operate within a highly dynamic and evolving regulatory landscape, particularly in the UK motor insurance market where there are a number of reviews and initiatives, including those that have been announced by the UK Government, the Ministry of Justice, the Financial Conduct Authority and the PRA. On 23 February 2017, the Government announced measures to reduce the volume and cost of soft tissue damage 'whiplash' claims and stated its expectation that this will see a reduction in motor insurance premiums of £40 on average. On 27 February 2017 the Lord Chancellor announced a reduction in the Ogden discount rate to minus 0.75% with effect from 20 March 2017. The Group has also been engaged in the consultation to consider options for reform concerning the discount rate.

Throughout 2017, the Financial Conduct Authority's focus has been on value measures and pricing practices as well as the publication of its business plan. The PRA focus has been on the pillars of its financial risk framework, namely reserving, pricing, reinsurance and investments. The Group is exposed to the risk of changes to regulatory rules, policy or interpretation, and to supervisory expectations or approach, by regulators or other bodies or authorities; and of changes to law, tax, monetary or fiscal policies or their interpretation by government or government authorities, any of which may have adverse operational and financial impact.

The Group will continue to support proportionate reforms which result in a level playing field across the industry.

Principal risks and uncertainties

The Group carries out a robust assessment of the principal risks facing it. Principal risks are defined as having a residual risk impact of £40 million or more on a one-in-200 years basis, taking into account customer, financial and reputational impacts. The Group's risk profile has changed during 2017 primarily driven by the Ogden discount rate change and enhanced technology controls. There have been no material breaches of the risk appetite.

Principal risks	Owner	Management and mitigation examples
Insurance risk The risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting. Insurance risk includes reserve, underwriting, distribution, pricing and reinsurance risks.	Chief Financial Officer, Managing Directors of Personal Lines and Commercial	• The Group estimates the technical reserves using various actuarial and statistical techniques. Management's best estimate of total reserves is set at not less than the actuarial best estimate • Third parties review the Group's reserves • Underwriting guidelines are set for all transacted business and pricing refined by analysing comprehensive data • Catastrophe and motor excess of loss reinsurance limits the Group's exposure to events and large losses • The Group invests in enhanced external data to analyse and mitigate exposures • The Group has set reserves using the latest data and trends. In particular, the decision to reduce the Ogden discount rate has been reflected in the estimate of reserves
Market risk The risk of loss resulting from fluctuations in the level and volatility of market prices of assets, liabilities and financial instruments. Market risk includes spread, interest rate and property risks.	Chief Financial Officer	• The Group manages and controls the risks in its investment portfolio through: – ensuring compliance with an investment strategy approved by the Board; – careful diversification of asset classes – limits on exposure to individual asset classes; limits on the amount of illiquid investments; tightly controlling individual credit exposures; and risk-reduction techniques, such as hedging foreign currency exposures with forward contracts and hedging exposure to US interest rates with swap contracts
Credit risk The risk of loss resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which the Group is exposed. Credit risk includes counterparty default and concentration risks.	Chief Financial Officer	• Credit limits are set for each counterparty and the Group actively monitors credit exposures • The Group only purchases reinsurance from reinsurers with at least an 'A-' rating. For liabilities with a relatively long period of time to settlement, this rating will be at least 'A+' • The Group has well defined criteria to determine which customers are offered and granted credit
Operational risk The risk of loss due to inadequate or failed internal processes, people, systems or from external events. Operational risk includes information security, IT and business continuity, partnership contractual obligations, change, financial reporting, model and technology and infrastructure risks.	Specific members of the Executive	• Monitoring operational risk actively in line with a Board approved operational risk appetite • The Group has appropriate operational processes and systems, including detection systems for fraudulent claims • The Group is working to improve the performance of its IT systems, while focusing on developing future systems capability. With significant change underway, the Group is continuing to monitor risks associated with IT systems' stability, cyber security and the internal control environment • The Group's risk management system is designed to enable the capture of risk information in a robust and consistent way • The Group monitors the performance of outsourced and offshored activities
Regulatory and conduct risk The risks arising out of changes to laws, regulatory rules, policy or interpretation, or to supervisory expectations or approach, that have an adverse operational and financial impact as a result of reputational damage, regulatory or legal censure, fines or prosecutions, and any other type of non-budgeted operational risk losses, associated with the Group's conduct and activities. Regulatory and conduct risk includes compliance risk.	Chief Risk Officer and Managing Director, Personal Lines	• The Group maintains a constructive and open relationship with regulators • Specific risk management tools and resources are used to help manage exposure to regulatory risk • The Group has a strong culture of delivering on its commitments to customers • Robust customer conduct risk management is intended to minimise the Group's risk exposure • The Group carries out planned risk based monitoring of customer processes as well as more targeted thematic reviews which consider strategic or regulatory projects
Strategic risk The risk of direct or indirect adverse impact on the earnings, capital, or value of the business resulting from the strategies not being optimally chosen, implemented or adapted to changing conditions. Strategic risk includes strategy formulation and implementation risks.	Chief Executive Officer	• The Group has a plan and targets, against which performance is agreed, monitored and managed • An annual strategy and five-year planning process is run which considers Group performance, competitor positioning and strategic opportunities • Emerging risks are identified and managed using an established governance process and forums

Emerging risks

The Group's definition of emerging risks are newly developing risks which are often difficult to quantify; they are also highly uncertain and are external to the Group. The Group records emerging risks within an Emerging Risk Register. Emerging risks are reported to the Risk Management Committee and Board Risk Committee for review and challenge. The Group's emerging risks processes aim to:

- identify emerging risks on a timely basis;
- manage emerging risks proactively;
- mitigate the impact of emerging risks which could impact the delivery of the strategic plan; and
- reduce the uncertainty and volatility to the Group's results

The Group considers its main emerging risks to be:

Technological changes in driving habits reduce consumer need for motor insurance
New car technologies, such as crash-prevention technologies and driverless cars, could significantly affect the size and nature of the insurance market and the role of insurers. In addition to the Group's partnership with the Government on automated driving systems (MOVE_UK), the Group continues to build strong collaborative relationships including with key manufacturers of driverless cars.

Changes to traditional insurance business models
New market entrants and changes in consumer expectations could result in significant changes to the structure of the general insurance market and require the Group to update its business model. The Group's strategy, aligned to its mission to make insurance much easier and better value for its customers, is positioned to take advantage of changes in technology and customer behaviours, and to build our partnership capabilities.

UK economy
The UK could enter a prolonged period of reduced growth due to the exit from the EU, potentially reducing insurance sales and the value of the Group's investment portfolio. Whilst the Group's operations are based mainly in the UK, the Group continues to monitor implications surrounding Brexit negotiations, including: changes to the value of Sterling which impact claims and non-claims supplier costs; inflation; recruitment and retention of people; potential changes to direct and indirect tax; and the regulatory impact on the Group's capital position.

Climate change
Climate change could increase the frequency of severe weather events in the UK and, in particular, flooding claims costs. The Group continues to monitor changes in claims experience and considers weather trends as part of its pricing and underwriting approach.

Consolidated income statement

For the year ended 31 December 2017

	Notes	2017 £m	2016 £m
Gross earned premium	4	3,339.7	3,202.8
Reinsurance premium	4	(204.7)	(202.2)
Net earned premium	4	3,135.0	3,000.6
Investment return	5	175.4	171.5
Instalment income		116.4	107.1
Other operating income	6	62.9	58.2
Total income		3,489.7	3,337.4
Insurance claims	7	(1,571.1)	(2,179.0)
Insurance claims (payable to) / recoverable from reinsurers	7	(183.1)	375.2
Net insurance claims	7	(1,754.2)	(1,803.8)
Commission expenses	8	(286.4)	(344.0)
Operating expenses	9	(806.3)	(799.4)
Total expenses		(1,092.7)	(1,143.4)
Operating profit		642.8	390.2
Finance costs	10	(103.8)	(37.2)
Profit before tax		539.0	353.0
Tax charge		(105.0)	(74.2)
Profit for the year attributable to owners of the Company		434.0	278.8
Earnings per share:			
Basic (pence)	11	31.8	20.4
Diluted (pence)	11	31.5	20.2

Consolidated statement of comprehensive income

For the year ended 31 December 2017

	2017 £m	2016 £m
Profit for the year	434.0	278.8
Other comprehensive (loss) / income		
Items that will not be reclassified subsequently to the income statement:		
Actuarial gain / (loss) on defined benefit pension scheme	2.1	(4.4)
Tax relating to item that will not be reclassified	(0.4)	0.7
	1.7	(3.7)
Items that may be reclassified subsequently to the income statement:		
Exchange differences on translation of foreign operations	–	0.1
Cash flow hedges	(1.1)	1.4
Fair value gain on AFS investments	8.8	119.6
Less: realised net gains on AFS investments included in income statement	(23.2)	(15.3)
Tax relating to items that may be reclassified	2.5	(17.6)
	(13.0)	88.2
Other comprehensive (loss) / income for the year net of tax	(11.3)	84.5
Total comprehensive income for the year attributable to owners of the Company	422.7	363.3

Consolidated balance sheet

As at 31 December 2017

	Notes	2017 £m	2016 £m
Assets			
Goodwill and other intangible assets		471.1	508.9
Property, plant and equipment		174.4	180.9
Investment property		309.3	329.0
Reinsurance assets	13	1,178.5	1,371.8
Current tax assets		0.1	0.1
Deferred acquisition costs		185.4	203.1
Insurance and other receivables		981.2	988.3
Prepayments, accrued income and other assets		146.2	131.0
Derivative financial instruments		84.4	79.7
Retirement benefit asset		14.4	12.0
Financial investments	14	5,040.4	5,147.0
Cash and cash equivalents	15	1,358.6	1,166.1
Assets held for sale		4.2	3.8
Total assets		9,948.2	10,121.7
Equity			
Shareholders' equity		2,715.1	2,521.5
Tier 1 notes	17	346.5	–
Total equity		3,061.6	2,521.5
Liabilities			
Subordinated liabilities	18	264.7	539.6
Insurance liabilities	19	4,225.7	4,666.6
Unearned premium reserve	20	1,600.3	1,547.9
Borrowings	15	54.1	55.3
Derivative financial instruments		12.0	45.1
Trade and other payables, including insurance payables		658.0	699.2
Deferred tax liabilities		31.1	46.0
Current tax liabilities		40.7	0.5
Total liabilities		6,886.6	7,600.2
Total equity and liabilities		9,948.2	10,121.7

Consolidated statement of changes in equity

For the year ended 31 December 2017

	Share capital £m	Employee trust shares £m	Capital reserves £m	AFS revaluation reserve £m	Non-distributable reserve £m	Foreign exchange translation reserve £m	Retained earnings £m	Shareholders' equity £m	Tier1 notes £m	Total equity £m
Balance at 1 January 2016	150.0	(20.4)	1,450.0	5.4	152.9	(0.1)	892.2	2,630.0	–	2,630.0
Profit for the year	–	–	–	–	–	–	278.8	278.8	–	278.8
Other comprehensive income	–	–	–	86.7	–	1.5	(3.7)	84.5	–	84.5
Dividends paid	–	–	–	–	–	–	(450.6)	(450.6)	–	(450.6)
Transfer from non-distributable reserve	–	–	–	–	(152.9)	–	152.9	–	–	–
Shares acquired by employee trusts	–	(39.5)	–	–	–	–	–	(39.5)	–	(39.5)
Credit to equity for equity-settled share-based payments	–	–	–	–	–	–	16.8	16.8	–	16.8
Shares distributed by employee trusts	–	25.6	–	–	–	–	(25.6)	–	–	–
Tax on share-based payments	–	–	–	–	–	–	1.5	1.5	–	1.5
Balance at 31 December 2016	150.0	(34.3)	1,450.0	92.1	–	1.4	862.3	2,521.5	–	2,521.5
Profit for the year	–	–	–	–	–	–	434.0	434.0	–	434.0
Other comprehensive loss	–	–	–	(11.9)	–	(1.1)	1.7	(11.3)	–	(11.3)
Dividends paid	–	–	–	–	–	–	(225.3)	(225.3)	–	(225.3)
Shares acquired by employee trusts	–	(19.6)	–	–	–	–	–	(19.6)	–	(19.6)
Credit to equity for equity-settled share-based payments	–	–	–	–	–	–	14.8	14.8	–	14.8
Shares distributed by employee trusts	–	19.8	–	–	–	–	(19.8)	–	–	–
Tax on share-based payments	–	–	–	–	–	–	1.0	1.0	–	1.0
Issue of Tier 1 notes (note 17)	–	–	–	–	–	–	–	–	346.5	346.5
Balance at 31 December 2017	150.0	(34.1)	1,450.0	80.2	–	0.3	1,068.7	2,715.1	346.5	3,061.6

Consolidated cash flow statement

For the year ended 31 December 2017

	Notes	2017 £m	2016 £m
Net cash generated from operating activities before investment of insurance assets		204.0	35.0
Cash generated from investment of insurance assets		341.9	827.4
Net cash generated from operating activities		545.9	862.4
Cash flows from investing activities			
Purchases of property, plant and equipment		(22.4)	(49.9)
Purchases of intangible assets		(73.2)	(80.8)
Proceeds on disposals of assets held for sale		–	5.1
Proceeds on disposals of property, plant and equipment		0.3	–
Net cash used in investing activities		(95.3)	(125.6)
Cash flows from financing activities			
Net proceeds from issue of Tier 1 notes		346.5	–
Repayment of subordinated liabilities		(326.8)	–
Dividends paid		(225.3)	(450.6)
Finance costs		(31.7)	(38.3)
Purchase of employee trust shares		(19.6)	(39.5)
Net cash used in financing activities		(256.9)	(528.4)
Net increase in cash and cash equivalents		193.7	208.4
Cash and cash equivalents at the beginning of the year	15	1,110.8	902.4
Cash and cash equivalents at the end of the year	15	1,304.5	1,110.8

Notes to the consolidated financial statements

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 results announcement does not constitute the statutory accounts for the year ended 31 December 2017. The financial information is derived from the statutory accounts, which comply with IFRS, within the Group's Annual Report & Accounts 2017. These accounts were signed on 26 February 2018 and are expected to be published in March 2018 and delivered to the Registrar of Companies following the Annual General Meeting to be held on 10 May 2018. The independent Auditor's report on the Group accounts for the year ended 31 December 2017 was signed on 26 February 2018, 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 consolidated financial statements.

Adoption of new and revised standards

The Group has adopted a small number of new amendments to standards that became effective for the Group for the first time during 2017, none of which have had a significant impact on the consolidated financial statements.

2. Critical accounting estimates and judgements

Full details of critical accounting estimates and judgements used in applying the Group's accounting policies are outlined on pages 134 to 136 of the Annual Reports & Accounts 2016. There have been no significant changes to the principles or assumptions of these critical accounting estimates and judgements during the year ended 31 December 2017.

3. Segmental analysis

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2017.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Ongoing £m	Run-off £m	Total £m
Gross written premium	1,670.4	799.1	421.1	501.5	3,392.1	–	3,392.1
Gross earned premium	1,603.0	819.4	419.2	498.1	3,339.7	–	3,339.7
Reinsurance premium	(132.4)	(28.9)	(1.6)	(41.8)	(204.7)	–	(204.7)
Net earned premium	1,470.6	790.5	417.6	456.3	3,135.0	–	3,135.0
Investment return	117.2	21.1	4.6	31.8	174.7	0.7	175.4
Instalment income	85.3	23.1	2.1	5.9	116.4	–	116.4
Other operating income	43.0	0.9	12.9	6.1	62.9	–	62.9
Total income	1,716.1	835.6	437.2	500.1	3,489.0	0.7	3,489.7
Insurance claims	(799.2)	(403.3)	(273.8)	(176.9)	(1,653.2)	82.1	(1,571.1)
Insurance claims (payable to) / recoverable from reinsurers	(96.8)	2.8	0.5	(50.6)	(144.1)	(39.0)	(183.1)
Net insurance claims	(896.0)	(400.5)	(273.3)	(227.5)	(1,797.3)	43.1	(1,754.2)
Commission expenses	(36.7)	(139.7)	(22.9)	(87.1)	(286.4)	–	(286.4)
Operating expenses	(418.9)	(166.6)	(97.4)	(111.5)	(794.4)	–	(794.4)
Total expenses	(455.6)	(306.3)	(120.3)	(198.6)	(1,080.8)	–	(1,080.8)
Operating profit before restructuring	364.5	128.8	43.6	74.0	610.9	43.8	654.7
Restructuring costs[1]							(11.9)
Operating profit							642.8
Finance costs							(103.8)
Profit before tax							539.0
Underwriting profit	119.0	83.7	24.0	30.2	256.9		
Loss ratio	60.9%	50.6%	65.4%	49.9%	57.4%		
Commission ratio	2.5%	17.7%	5.5%	19.1%	9.1%		
Expense ratio	28.5%	21.1%	23.4%	24.4%	25.3%		
COR	91.9%	89.4%	94.3%	93.4%	91.8%		

Note:

1. Restructuring costs are costs incurred in respect of the business activities where the Group has a constructive obligation to restructure its activities.

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2016.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Ongoing £m	Run-off £m	Total £m
Gross written premium	1,539.1	834.4	400.8	499.8	3,274.1	–	3,274.1
Gross earned premium	1,461.3	851.0	396.1	494.4	3,202.8	–	3,202.8
Reinsurance premium	(124.2)	(34.7)	(1.7)	(41.6)	(202.2)	–	(202.2)
Net earned premium	1,337.1	816.3	394.4	452.8	3,000.6	–	3,000.6
Investment return	116.9	19.9	3.9	27.4	168.1	3.4	171.5
Instalment income	76.1	23.5	1.9	5.6	107.1	–	107.1
Other operating income	40.9	0.8	13.5	3.0	58.2	–	58.2
Total income	1,571.0	860.5	413.7	488.8	3,334.0	3.4	3,337.4
Insurance claims	(1,297.3)	(332.1)	(243.0)	(297.7)	(2,170.1)	(8.9)	(2,179.0)
Insurance claims recoverable from reinsurers	295.6	0.1	–	47.2	342.9	32.3	375.2
Net insurance claims	(1,001.7)	(332.0)	(243.0)	(250.5)	(1,827.2)	23.4	(1,803.8)
Commission expenses	(42.9)	(184.4)	(28.4)	(88.3)	(344.0)	–	(344.0)
Operating expenses	(377.3)	(177.4)	(96.4)	(108.2)	(759.3)	(0.2)	(759.5)
Total expenses	(420.2)	(361.8)	(124.8)	(196.5)	(1,103.3)	(0.2)	(1,103.5)
Operating profit before restructuring	149.1	166.7	45.9	41.8	403.5	26.6	430.1
Restructuring costs[1]							(39.9)
Operating profit							390.2
Finance costs							(37.2)
Profit before tax							353.0
Underwriting (loss) / profit	(84.8)	122.5	26.6	5.8	70.1		
Loss ratio	74.9%	40.7%	61.6%	55.3%	60.9%		
Commission ratio	3.2%	22.6%	7.2%	19.5%	11.5%		
Expense ratio	28.2%	21.7%	24.5%	23.9%	25.3%		
COR	106.3%	85.0%	93.3%	98.7%	97.7%		

Note:

1. Restructuring costs are costs incurred in respect of the business activities where the Group has a constructive obligation to restructure its activities.

4. Net earned premium

	2017 £m	2016 £m
Gross earned premium:		
Gross written premium	3,392.1	3,274.1
Movement in unearned premium reserve	(52.4)	(71.3)
	3,339.7	3,202.8
Reinsurance premium:		
Premium payable	(208.4)	(206.2)
Movement in reinsurance unearned premium reserve	3.7	4.0
	(204.7)	(202.2)
Total	3,135.0	3,000.6

5. Investment return

	2017 £m	2016 £m
Investment income:		
Interest income from debt securities	137.5	136.5
Cash and cash equivalent interest income	3.0	4.2
Interest income from infrastructure debt	6.8	7.8
Interest income from commercial real estate loans	3.6	1.0
Interest income	150.9	149.5
Rental income from investment property	16.2	18.4
	167.1	167.9
Net realised gains / (losses):		
AFS debt securities	23.2	15.3
Derivatives	175.0	(282.3)
Investment property	1.6	1.3
	199.8	(265.7)
Net unrealised (losses) / gains:		
Impairment of loans and receivables	(9.5)	–
Derivatives	(202.0)	265.2
Investment property	20.0	4.1
	(191.5)	269.3
Total	175.4	171.5

The table below analyses the realised and unrealised gains and losses on derivative instruments included in investment return.

	Realised 2017 £m	Unrealised 2017 £m	Realised 2016 £m	Unrealised 2016 £m
Derivative gains / (losses):				
Foreign exchange forward contracts[1]	107.8	62.5	(425.7)	19.1
Associated foreign exchange risk	68.4	(259.1)	151.0	253.0
Net gains / (losses) on foreign exchange forward contracts	176.2	(196.6)	(274.7)	272.1
Interest rate swaps[1]	1.8	(1.7)	(16.9)	20.7
Associated interest rate risk on hedged items	(3.0)	(3.7)	9.3	(27.6)
Net losses on interest rate derivatives	(1.2)	(5.4)	(7.6)	(6.9)
Total	175.0	(202.0)	(282.3)	265.2

Note:

1. Foreign exchange forward contracts are at fair value through the income statement and interest rate swaps are designated as hedging instruments.

6. Other operating income

	2017 £m	2016 £m
Vehicle replacement referral income	16.9	14.1
Revenue from vehicle recovery and repair services	11.3	19.3
Legal services income	11.0	11.2
Other income[1]	23.7	13.6
Total	62.9	58.2

Note:

1. Other income includes salvage income and fee income from insurance intermediary services.

7. Net insurance claims

	Gross 2017 £m	Reinsurance 2017 £m	Net 2017 £m	Gross 2016 £m	Reinsurance 2016 £m	Net 2016 £m
Current accident year claims paid	1,165.0	(0.2)	1,164.8	1,131.7	–	1,131.7
Prior accident year claims paid	847.0	(13.8)	833.2	905.2	(18.8)	886.4
(Decrease) / increase in insurance liabilities	(440.9)	197.1	(243.8)	142.1	(356.4)	(214.3)
Total	1,571.1	183.1	1,754.2	2,179.0	(375.2)	1,803.8

The table below analyses the claims handling expenses included in net insurance claims.

	2017 £m	2016 £m
Ongoing operations	175.0	164.4
Run-off	(0.2)	1.2
Total	174.8	165.6

8. Commission expenses

	2017 £m	2016 £m
Commission expenses	225.4	246.8
Expenses incurred under profit participations	61.0	97.2
Total	286.4	344.0

9. Operating expenses

	Total Ongoing 2017 £m	Restructuring costs 2017 £m	Run-off 2017 £m	Total Group 2017 £m
Staff costs[1]	268.6	11.5	–	280.1
Other operating expenses[1,2]	273.2	0.4	–	273.6
Marketing	113.7	–	–	113.7
Amortisation and impairment of other intangible assets	111.0	–	–	111.0
Depreciation	27.9	–	–	27.9
Total	794.4	11.9	–	806.3

	Total Ongoing 2016 £m	Restructuring costs 2016 £m	Run-off 2016 £m	Total Group 2016 £m
Staff costs[1]	269.0	16.0	–	285.0
Other operating expenses[1,2,3]	250.9	23.9	0.2	275.0
Marketing	112.6	–	–	112.6
Amortisation and impairment of other intangible assets	96.7	–	–	96.7
Depreciation	30.1	–	–	30.1
Total	759.3	39.9	0.2	799.4

Notes:

1. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
2. Other operating expenses include IT costs, insurance levies, professional fees and property costs.
3. A property site in Bristol comprising of freehold property and fixtures and fittings was transferred from freehold property to assets held for sale in 2016. The property with carrying value of £23.5 million was remeasured on transfer to its fair value of £3.8 million resulting in a charge to other operating expenses in restructuring of £19.7 million.

The table below analyses the number of people employed by the Group's operations.

	At 31 December 2017	At 31 December 2016	Average for the year 2017	Average for the year 2016
Operations	9,539	9,692	9,669	9,546
Support	1,269	1,285	1,280	1,353
Total	10,808	10,977	10,949	10,899

The aggregate remuneration of those employed by the Group's operations comprised:

	2017 £m	2016 £m
Wages and salaries	363.6	348.1
Social security costs	40.4	38.9
Pension costs	25.5	24.4
Share-based payments	14.8	16.8
Total	444.3	428.2

10. Finance costs

	2017 £m	2016 £m
Interest expense on subordinated liabilities	44.8	46.3
Net interest received on designated hedging instrument[1]	(8.0)	(8.0)
Unrealised loss / (gain) on designated hedging instrument[1]	10.4	(19.6)
Unrealised (gain) / loss on associated interest rate risk on hedged item[1]	(11.7)	17.8
Realised gain on associated interest rate risk on hedged item[1]	(11.3)	–
Premium paid to repurchase subordinated liabilities and associated transaction costs	77.4	–
Amortisation of arrangement costs and discount on issue of subordinated liabilities	2.2	0.7
Total	103.8	37.2

Note:

1. As described in note 18, on 27 April 2012 the Group issued subordinated guaranteed 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 designated hedging instrument to exchange the fixed rate of interest on the notes for a floating rate of three-month LIBOR plus a spread of 706 basis points, which increased to 707 basis points with effect from 29 July 2013. On 8 December 2017, the Group redeemed £250 million nominal value of the notes.

11. Earnings per share

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

Basic

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

	2017 £m	2016 £m
Earnings attributable to owners of the Company	434.0	278.8
Weighted average number of Ordinary Shares (millions)	1,366.1	1,368.7
Basic earnings per share (pence)	31.8	20.4

Diluted

Diluted earnings per share is calculated by dividing the earnings attributable to the owners of the Company by the weighted average number of Ordinary Shares 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.

	2017 £m	2016 £m
Earnings attributable to owners of the Company	434.0	278.8
Weighted average number of Ordinary Shares (millions)	1,366.1	1,368.7
Effect of dilutive potential of share options and contingently issuable shares (millions)	12.9	13.1
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	1,379.0	1,381.8
Diluted earnings per share (pence)	31.5	20.2

12. Net assets per share and return on equity

Net asset value per share is calculated as total shareholders' equity divided by the number of Ordinary Shares at the end of the period excluding shares held by employee share trusts.

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 at the end of the period excluding shares held by employee share trusts.

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

At 31 December	2017 £m	2016 £m
Net assets	2,715.1	2,521.5
Goodwill and other intangible assets[1]	(471.1)	(508.9)
Tangible net assets	2,244.0	2,012.6
Number of Ordinary Shares (millions)	1,375.0	1,375.0
Shares held by employee share trusts (millions)	(9.9)	(9.9)
Closing number of Ordinary Shares (millions)	1,365.1	1,365.1
Net asset value per share (pence)	198.9	184.7
Tangible net asset value per share (pence)	164.4	147.4

Note:

1. Goodwill has arisen on acquisition by the Group of subsidiary companies. Intangible assets are primarily comprised of software development costs.

Return on equity

The table below details the calculation of return on equity.

	2017 £m	2016 £m
Earnings attributable to owners of the Company	434.0	278.8
Opening shareholders' equity	2,521.5	2,630.0
Closing shareholders' equity	2,715.1	2,521.5
Average shareholders' equity	2,618.3	2,575.8
Return on equity	16.6%	10.8%

13. Reinsurance assets

	2017 £m	2016 £m
Reinsurers' share of general insurance liabilities	1,141.1	1,329.0
Impairment provision[1]	(59.9)	(50.7)
	1,081.2	1,278.3
Reinsurers' unearned premium reserve	97.3	93.5
Total	1,178.5	1,371.8

Note:

1. Impairment provision relates to reinsurance debtors allowing for the risk that reinsurance assets may not be collected or where the reinsurer's credit rating has been significantly downgraded and may have difficulty in meeting its obligations.

14. Financial investments

	2017 £m	2016 £m
Available-for-sale debt securities		
Corporate	4,170.5	4,183.7
Supranational	43.9	98.6
Local government	12.2	21.7
Sovereign	224.8	341.2
Total	4,451.4	4,645.2
Held-to-maturity debt securities		
Corporate	103.6	85.1
Total debt securities	4,555.0	4,730.3
Total debt securities		
Fixed interest rate[1]	4,540.1	4,709.6
Floating interest rate	14.9	20.7
Total	4,555.0	4,730.3
Loans and receivables		
Infrastructure debt	316.4	337.0
Commercial real estate loans	169.0	79.7
Total	5,040.4	5,147.0

Note:

1. The Group swaps a fixed interest rate for a floating rate of interest on its US Dollar, Euro and a small amount of its Sterling corporate debt securities by entering into interest rate derivatives. The hedged amount at 31 December 2017 was £1,591.5 million (2016: £1,593.6 million).

15. Cash and cash equivalents and borrowings

	2017 £m	2016 £m
Cash at bank and in hand	258.0	166.6
Short-term deposits with credit institutions[1]	1,100.6	999.5
Cash and cash equivalents	1,358.6	1,166.1
Bank overdrafts[2]	(54.1)	(55.3)
Cash and bank overdrafts[3]	1,304.5	1,110.8

Notes:

1. This represents money market funds with no notice period for withdrawal.
2. Bank overdrafts represent short-term timing differences between transactions posted in the records of the Group and transactions flowing through the accounts at the bank.
3. Cash and bank overdrafts disclosure note is included for the purposes of the consolidated cash flow statement.

The effective interest rate on short-term deposits with credit institutions for the year ended 31 December 2017 was 0.29% (2016: 0.45%) and average maturity was 10 days (2016: 10 days).

16. Share capital

	2017 Number millions	2016 Number millions	2017 £m	2016 £m
Issued and fully paid: equity shares				
Ordinary Shares of 10 $^{10}/_{11}$ pence each[1]	1,375	1,375	150.0	150.0

Note:

1. The shares have attached to them full voting dividend and capital distribution rights (including wind up); they do not confer any rights of redemption.

Employee trust shares

The Group satisfies share-based payments under the Group's share plans primarily through shares purchased in the market and held by employee share trusts.

At 31 December 2017, 9,945,473 Ordinary Shares (2016: 9,946,340 Ordinary Shares) were owned by the employee share trusts with a cost of £34.1 million (2016: £34.3 million). These Ordinary Shares are carried at cost and have a market value of £38.0 million (2016: £36.7 million).

17. Tier 1 notes

	2017 £m	2016 £m
Tier 1 notes	346.5	–

On 7 December 2017, the Group issued £350 million of fixed rate perpetual Tier 1 notes with a coupon rate of 4.75% per annum.

The Group has an optional redemption date of 7 December 2027. If the notes are not repaid on that date, a fixed rate of interest per annum will be reset. The notes are direct, unsecured and subordinated obligations of the issuer ranking pari passu and without any preference amongst themselves.

The Tier 1 notes are treated as a separate category within equity and the coupon payments are recognised outside of the profit after tax result and directly in shareholders equity.

The Group has the option to cancel the coupon payment which becomes mandatory upon breach or non-compliance with the Group SCR, a breach of the minimum capital requirement or where the Group has insufficient distributable reserves.

Proceeds of this issuance have primarily been used to fund the repurchase of £250 million subordinated guaranteed dated notes which had a market value of £326.8 million (see note 18).

18. Subordinated liabilities

	2017 £m	2016 £m
Subordinated guaranteed dated notes	264.7	539.6

The subordinated guaranteed dated notes with a nominal value of £500 million were issued on 27 April 2012 at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year designated hedging instrument to exchange the fixed rate of interest for a floating rate of three-month LIBOR plus a spread of 706 basis points which was credit value adjusted to 707 basis points with effect from 29 July 2013.

On 8 December 2017, the Group repurchased £250 million nominal value of the subordinated guaranteed dated notes for a purchase price of £330.1 million including accrued interest of £2.7 million and associated transaction costs of £0.6 million.

The remaining notes, with a nominal value of £250 million, have a redemption date of 27 April 2042 with the option to repay the notes on 27 April 2022. If the notes are not repaid on that date, the rate of interest will be reset at a rate of the six-month LIBOR plus 7.91%.

The Group has the option, in certain circumstances, to defer interest payments on the notes but to date has not exercised this right.

The notes are unsecured, subordinated obligations of the Group, and rank pari passu without any preference among themselves. In the event of a winding-up or of bankruptcy, they are to be repaid only after the claims of all other senior creditors have been met.

19. Insurance liabilities

	2017 £m	2016 £m
Insurance liabilities	4,225.7	4,666.6

Gross insurance liabilities

Accident year	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	Total £m
Estimate of ultimate gross claims costs:											
At end of accident year	3,393.4	3,823.3	3,941.7	2,698.1	2,372.7	2,184.0	2,094.5	2,118.1	2,157.7	2,217.3	
One year later	50.8	121.6	(117.1)	(99.3)	(163.3)	(117.6)	20.7	(30.0)	(86.7)		
Two years later	51.7	(37.0)	(99.1)	(94.6)	(118.9)	(153.0)	(38.4)	(143.5)			
Three years later	(36.7)	(14.0)	(50.3)	(89.3)	(49.3)	(21.0)	(144.9)				
Four years later	(16.7)	(101.5)	(105.5)	(60.9)	(9.9)	(102.1)					
Five years later	(55.5)	(38.8)	(57.7)	(21.2)	(79.2)						
Six years later	(45.7)	(80.8)	(25.9)	(60.3)							
Seven years later	(29.9)	(27.3)	(50.0)								
Eight years later	(16.2)	(14.0)									
Nine years later	(24.3)										
Current estimate of cumulative claims	3,270.9	3,631.5	3,436.1	2,272.5	1,952.1	1,790.3	1,931.9	1,944.6	2,071.0	2,217.3	
Cumulative payments to date	(3,181.5)	(3,469.5)	(3,303.7)	(2,153.9)	(1,843.0)	(1,610.0)	(1,526.7)	(1,469.7)	(1,442.4)	(1,050.6)	
Gross liability recognised in balance sheet	89.4	162.0	132.4	118.6	109.1	180.3	405.2	474.9	628.6	1,166.7	3,467.2
2007 and prior											679.2
Claims handling provision											79.3
Total											4,225.7

Net insurance liabilities

Accident year	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	Total £m
Estimate of ultimate net claims costs:											
At end of accident year	3,334.7	3,790.6	3,902.0	2,644.4	2,271.8	2,093.9	1,971.0	1,926.7	1,922.2	2,016.9	
One year later	52.0	70.0	(125.2)	(131.5)	(146.7)	(123.6)	(29.7)	(67.0)	(18.9)		
Two years later	15.9	(17.4)	(120.4)	(82.1)	(107.8)	(134.4)	(42.0)	(77.8)			
Three years later	(22.8)	(54.1)	(44.0)	(76.5)	(35.6)	(27.8)	(100.7)				
Four years later	(45.8)	(67.0)	(93.6)	(48.7)	(11.6)	(64.3)					
Five years later	(48.7)	(29.6)	(52.3)	(37.3)	(54.2)						
Six years later	(30.9)	(74.6)	(43.9)	(37.0)							
Seven years later	(24.5)	(38.2)	(24.8)								
Eight years later	(16.2)	(0.4)									
Nine years later	(13.0)										
Current estimate of cumulative claims	3,200.7	3,579.3	3,397.8	2,231.3	1,915.9	1,743.8	1,798.6	1,781.9	1,903.3	2,016.9	
Cumulative payments to date	(3,141.4)	(3,436.3)	(3,288.7)	(2,130.5)	(1,830.9)	(1,593.3)	(1,524.2)	(1,467.7)	(1,441.8)	(1,050.4)	
Net liability recognised in balance sheet	59.3	143.0	109.1	100.8	85.0	150.5	274.4	314.2	461.5	966.5	2,664.3
2007 and prior											400.9
Claims handling provision											79.3
Total											3,144.5

Movements in gross and net insurance liabilities

	Gross £m	Reinsurance £m	Net £m
Claims reported	2,732.2	(375.0)	2,357.2
Incurred but not reported	1,697.9	(546.9)	1,151.0
Claims handling provision	94.4	–	94.4
At 1 January 2016	4,524.5	(921.9)	3,602.6
Cash paid for claims settled in the year	(2,036.9)	18.8	(2,018.1)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,329.3	(235.4)	2,093.9
Arising from prior-year claims	(150.3)	(139.8)	(290.1)
At 31 December 2016	4,666.6	(1,278.3)	3,388.3
Claims reported	2,584.5	(388.3)	2,196.2
Incurred but not reported	2,002.8	(890.0)	1,112.8
Claims handling provision	79.3	–	79.3
At 31 December 2016	4,666.6	(1,278.3)	3,388.3
Cash paid for claims settled in the year	**(2,012.0)**	**14.0**	**(1,998.0)**
Increase / (decrease) in liabilities:			
Arising from current-year claims	**2,389.9**	**(200.3)**	**2,189.6**
Arising from prior-year claims	**(818.8)**	**383.4**	**(435.4)**
At 31 December 2017	**4,225.7**	**(1,081.2)**	**3,144.5**
Claims reported	**3,003.7**	**(742.5)**	**2,261.2**
Incurred but not reported	**1,142.7**	**(338.7)**	**804.0**
Claims handling provision	**79.3**	**–**	**79.3**
At 31 December 2017	**4,225.7**	**(1,081.2)**	**3,144.5**

Movement in prior-year net claims liabilities by operating segment

	2017 £m	2016 £m
Motor	**(275.5)**	(123.5)
Home	**(23.7)**	(75.9)
Rescue and other personal lines	**(6.8)**	(17.5)
Commercial	**(86.3)**	(49.8)
Total Ongoing	**(392.3)**	(266.7)
Run-off	**(43.1)**	(23.4)
Total	**(435.4)**	(290.1)

20. Unearned premium reserve

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2016	1,476.6	(89.5)	1,387.1
Net movement in the year	71.3	(4.0)	67.3
At 31 December 2016	1,547.9	(93.5)	1,454.4
Net movement in the year	**52.4**	**(3.8)**	**48.6**
At 31 December 2017	**1,600.3**	**(97.3)**	**1,503.0**

21. Related parties

Transactions between the Group's subsidiary undertakings, which are related parties, have been eliminated on consolidation and accordingly are not disclosed.

Full details of the Group's related party transactions for the year ended 31 December 2016 are included on page 178 of the Annual Report & Accounts 2016.

Corporate information

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

Statutory accounts information

The Annual Report & Accounts 2016 were signed on 6 March 2017 and were delivered to the Registrar of Companies following the Annual General Meeting held on 11 May 2017. The Annual Report & Accounts 2016 is available at: ara2016.directlinegroup.com

Glossary

Term	Definition and explanation
Adjusted diluted earnings per share	Adjusted diluted earnings per share is calculated by dividing the adjusted profit after tax of Ongoing operations by the weighted average number of Ordinary Shares during the period adjusted for dilutive potential Ordinary Shares (see page 42 alternative performance measures).
Adjusted profit after tax	Profit after tax is adjusted to exclude the Run-off segment and restructuring costs, and is stated after charging tax using the UK standard tax rate of 19.25%; (2016: 20.00%). See page 40 alternative performance measure.
Available-for-sale ("AFS") investment	Financial assets that are classified as available-for-sale. Please refer to the accounting policy note 1.12 on page 130 of the Annual Report and Accounts 2016.
Average written premium	Average written premium is the total written premium at inception divided by the number of policies.
Capital	The funds invested in the Group, including funds invested by shareholders and retained profits.
Claims frequency	The number of claims divided by the number of policies per year.
Claims handling provision (provision for losses and loss-adjustment expense)	Funds the Group sets aside to meet the estimated cost of settling claims and related expenses that the Group considers it will ultimately need to pay.
Combined operating ratio ("COR")	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. A ratio of less than 100% indicates profitable underwriting. Normalised COR adjusts loss and commission ratios for a normal level of major weather events in the period.
Commission expenses	Payments to brokers, partners and PCWs for generating business.
Commission ratio	The ratio of commission expense divided by net earned premium.
Current-year attritional loss ratio	The loss ratio for the current accident year, excluding the movement of claims reserves relating to previous accident years, and claims relating to major weather events in the Home segment.
Direct own brands	Direct own brands include Home and Motor under the Direct Line, Churchill and Privilege brands, Rescue under the Green Flag brand and Commercial under the Direct Line for Business brand.
Earnings per share	The amount of the Group's profit allocated to each Ordinary Share of the Company.
Expense ratio	The ratio of operating expenses divided by net earned premium.
Finance costs	The cost of servicing the Group's external borrowings.
Gross written premium	The total premiums from contracts that began during the period.
International Accounting Standards Board ("IASB")	A not-for-profit public interest organisation that is overseen by a monitoring board of public authorities. It develops IFRS: standards that aim to make worldwide markets transparent, accountable and efficient.
Incurred but not reported ("IBNR")	Funds set aside to meet the cost of claims for accidents that have occurred, but have not yet been reported to the Group. This includes an element of uplift on the value of claims reported. Where the Group has determined that the value currently held in reserves is not sufficient to meet the estimated ultimate costs of the claim is referred to as incurred but not enough reported ("**IBNER**").
In-force policies	The number of policies on a given date that are active and against which the Group will pay, following a valid insurance claim.
Insurance liabilities	This comprises insurance claims reserves and claims handling provision, which the Group maintains to meet current and future claims.
Investment income yield	The income earned from the investment portfolio, recognised through the income statement during the period, and divided by the average assets under management ("**AUM**"). This excludes unrealised and realised gains and losses, impairments, and fair value adjustments. The average AUM derives from the period's opening and closing balances for the total Group; see page 43 alternative performance measures.
Investment return	The return earned from the investment portfolio, including unrealised and realised gains and losses, impairments, and fair value adjustments.
Investment return yield	The return earned from the investment portfolio, recognised through the income statement during the period divided by the average AUM. This includes unrealised and realised gains and losses, impairments, and fair value adjustments. The average AUM derives from the period's opening and closing balances; see page 43 alternative performance measures.
Leverage	Tier 1 notes and financial debt (subordinated guaranteed dated notes) as a percentage of total capital employed.
Loss ratio	Net insurance claims divided by net earned premium.
Net asset value	The net asset value of the Group is calculated by subtracting total liabilities from total assets.
Net claims	The cost of claims incurred in the period less any claims costs recovered under reinsurance contracts. It includes claims payments and movements in claims reserves.
Net earned premium	The element of gross earned premium less reinsurance premium ceded for the period where insurance cover has already been provided.

Glossary continued

Term	Definition and explanation
Net investment income yield	The net investment income yield is calculated in the same way as investment income yield but includes the cost of hedging; see page 43 alternative performance measures.
Ongoing operations	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 costs.
Operating profit	The pre-tax profit that the Group's activities generate, including insurance and investment activity, but excluding finance costs.
Periodic payment order ("**PPO**")	These are claims payments as awarded under the Courts Act 2003. PPOs are used to settle large personal injury claims. They generally provide a lump-sum award plus inflation-linked annual payments to claimants who require long-term care
Prudential Regulation Authority ("PRA")	The PRA is a part of the Bank of England. It is responsible for regulating and supervising insurers and financial institutions in the UK.
Reinsurance	Contractual arrangements where the Group transfers part or all of the accepted insurance risk to another insurer.
Restructuring	Restructuring costs are costs incurred in respect of the business activities where the Group has a constructive obligation to restructure its activities.
Return on equity	Return on equity is calculated by dividing the profit attributable to the owners of the Company by average shareholders' equity for the period.
Return on tangible equity ("RoTE")	Return on tangible equity for 2017 is adjusted profit after tax from Ongoing operations excluding one-off costs in relation to the buy-back of subordinated liabilities, divided by the Group's average shareholders' equity, less goodwill and other intangible assets. Profit after tax is adjusted to exclude the Run-off segment and restructuring costs. It is stated after charging tax using the UK standard tax rate of 19.25% (2016: 20.0%). RoTE for comparative periods is adjusted profit after tax from Ongoing operations, divided by the Group's average shareholders' equity, less goodwill and other intangible assets. Profit after tax is adjusted to exclude the Run-off segment and restructuring and other one-off costs. See page 42 alternative performance measures.
Run-off	The segment where the Group no longer underwrites new business, but continues to meet its claims liabilities under existing contracts.
Solvency II	The capital adequacy regime for the European insurance industry, which became effective on 1 January 2016. It establishes capital requirements and risk management standards. It comprises three pillars: Pillar I, which sets out capital requirements for an insurer; Pillar II, which focuses on systems of governance; and Pillar III, which deals with disclosure requirements.
Solvency capital ratio	The ratio of solvency II own funds to the solvency capital requirement.
Total costs	Total costs comprise operating expenses and claims handling expenses for Ongoing operations.
Underwriting result profit / (loss)	The profit or loss from operational activities, excluding investment return and other operating income. It is calculated as net earned premium less net insurance claims and total expenses.

Appendix A – Alternative performance measures

The Group has identified Alternative Performance Measures ("**APMs**") in accordance with the European Securities and Markets Authority's published Guidelines. The Group uses APMs to improve comparability of information between reporting periods and reporting segments, by adjusting for either uncontrollable or one-off costs which impact the IFRS measures, to aid the user of the Annual Report in understanding the activity taking place across the Group. These APMs are contained within the main narrative sections of this document, outside of the financial statements and notes, and may not necessarily have standardised meanings for ease of comparability across peer organisations.

Further information is presented below, defined in the glossary on page 39 and reconciled to the most directly reconcilable line items in the financial statements and notes. Note 3 on page 28 of the consolidated financial statements presents a reconciliation of the Group's business activities on a segmental basis to the statutory income statement including Ongoing operations of the Group. All note references in the table below are to the notes to the consolidated financial statements on pages 27 to 38.

Group APM	Closest equivalent IFRS measure	Definition and / or reconciliation	Rationale for APM
Adjusted diluted earnings per share	Diluted earnings per share	Adjusted diluted earnings per share is defined in the glossary on page 39 and is reconciled on page 42.	This is a representation of the underlying earnings over the number of shares in issue adjusted for potential dilutions from the exercise of options and contingently issuable shares.
Current-year attritional loss ratio	Loss ratio	Current-year attritional loss ratio is defined in the glossary on page 39 and is reconciled to loss ratio (discussed below) on page 10.	Expresses claims performance in the current accident year in relation to net earned premium.
COR	Operating profit	COR is defined in the glossary on page 39. The constituent parts: operating profit – Ongoing operations is discussed below; and net earned premium (note 4).	This is a measure of underwriting profitability whereby a ratio of less than 100% represents an underwriting profit and a ratio of more than 100% represents an underwriting loss and excludes non-insurance income.
Investment income yield	Investment income	Investment income yield is defined in the glossary on page 39 and is reconciled on page 43.	Expresses a relationship between the investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Investment return yield	Investment return	Investment return yield is defined on page 39 and is reconciled on page 43.	Expresses a relationship between the investment return and the associated opening and closing assets net of any associated liabilities.
Loss ratio	Net insurance claims	Loss ratio is defined in the glossary on page 39 and is reconciled in note 3.	Expenses claims performance in relation to net earned premium.
Net investment income yield	Investment income	Net investment income yield is defined in the glossary on page 39 and is reconciled on page 43.	Expresses a relationship between the investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Operating profit from Ongoing operations	Operating profit	Operating profit from Ongoing operations is defined as operating profit (see glossary on page 40) less operating profit from Run-off segment plus restructuring costs (see note 3) and is reconciled on page 42.	This measure shows the underlying performance (before tax and finance costs) of the business activities without the impact of business that is in Run-off and restructuring costs.
Profit after tax from Ongoing operations	Profit after tax	Operating profit from Ongoing operations (as above) less finance costs and tax at standard rate and is reconciled on page 42.	This measure shows the underlying performance (after tax and finance costs) of the business activities without the impact of business that is in Run-off and restructuring costs.
RoTE	Return on Equity	RoTE is defined in the glossary on page 40 and is reconciled on page 42.	This shows underlying performance against a measure of equity that is more able to be compared with other companies.
Tangible equity	Equity	Tangible equity is defined as equity less intangible assets within the balance sheet and is reconciled on page 42.	This shows the equity excluding intangible assets for comparability with companies who have not acquired businesses or capitalised intangible assets.
Tangible net asset per share	Net assets per share	Tangible net asset per share is defined as tangible equity (as above) expressed as a value per share and is reconciled in note 12 on page 33.	This shows the equity excluding intangible assets per share for comparability with companies who have not acquired businesses or capitalised intangible assets.
Total costs from Ongoing operations	Operating expenses	Total costs from Ongoing operations is defined as operating expenses adjusted to remove restructuring costs and operating expenses charged to the Run-off segment (reconciled in note 9) plus claims handling expenses incurred in net insurance claims on Ongoing operations (note 7). This is reconciled on page 11.	This represents the total value of operating expenses including those allocated to the insurance claims line as claims handling expenses excluding business in Run-off and restructuring costs.

Appendix A – Alternative performance measures continued

Additionally, the current-year attritional loss ratio within the analysis by division section and total costs have also been identified as alternative performance measures, similarly reconciled to the financial statements and notes, on pages 10 and 11 respectively, and defined in the glossary.

Return on tangible equity ("RoTE")[1]

	Note[2]	2017 £m	2016 £m
Operating profit	3	642.8	390.2
Add back: restructuring costs	3	11.9	39.9
Exclude: operating profit from Run-off	3	(43.8)	(26.6)
Operating profit from Ongoing operations	3	610.9	403.5
Finance costs	10	(103.8)	(37.2)
Finance costs adjustment for one-off subordinated debt buy back		66.1	–
Adjusted profit before tax from Ongoing operations		573.2	366.3
Tax charge (using the UK standard tax rate of 19.25% and 20.0% respectively)		(110.3)	(73.3)
Adjusted profit after tax from Ongoing operations		462.9	293.0
Opening shareholders' equity		2,521.5	2,630.0
Opening goodwill and other intangible assets		(508.9)	(524.8)
Opening shareholders' tangible equity		2,012.6	2,105.2
Closing shareholders' equity		2,715.1	2,521.5
Closing goodwill and other intangible assets		(471.1)	(508.9)
Closing shareholders' tangible equity		2,244.0	2,012.6
Average shareholders' tangible equity[3]		2,128.3	2,058.9
Return on tangible equity		21.7%	14.2%

Adjusted diluted earnings per share[1]

At	Note[2]	2017 £m	2016 £m
Adjusted profit after tax from Ongoing operations		462.9	293.0
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	11	1,379.0	1,381.8
Adjusted diluted earnings per share (pence)		33.6	21.2

Notes:

1. See glossary on page 39 for definitions.
2. See notes to the consolidated financial statements.
3. Mean average of opening and closing balances.

Appendix A – Alternative performance measures continued

Investment income and return yields

	Notes	2017 £m	2016 £m
Investment income	5	167.1	167.9
Hedging to a sterling floating rate basis[1]	5	(27.0)	(17.1)
Net investment income		140.1	150.8
Net realised and unrealised gains excluding hedging	5	35.3	20.7
Investment return		175.4	171.5
Opening investment property		329.0	347.4
Opening financial investments		5,147.0	5,614.6
Opening cash and cash equivalents		1,166.1	963.7
Opening borrowings		(55.3)	(61.3)
Opening derivatives liability[2]		(5.8)	(45.7)
Opening investment holdings		6,581.0	6,818.7
Closing investment property		309.3	329.0
Closing financial investments	14	5,040.4	5,147.0
Closing cash and cash equivalents	15	1,358.6	1,166.1
Closing borrowings	15	(54.1)	(55.3)
Closing derivatives asset / (liability)[2]		55.1	(5.8)
Closing investment holdings		6,709.3	6,581.0
Average investment holdings		6,645.2	6,699.9
Investment income yield		2.5%	2.5%
Net investment income yield		2.1%	2.2%
Investment return yield		2.6%	2.6%

Notes:

1. Includes net realised and unrealised gains / (losses) of derivatives in relation to AUM.
2. See footnote 1 on page 13.

Additional information

We confirm that to the best of our knowledge:

1. the financial statements within the Annual Report & Accounts, from which the financial information within these Preliminary Results have 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 these Preliminary Results 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

Chief Executive Officer

26 February 2018

John Reizenstein

Chief Financial Officer

26 February 2018

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