

Audit Committee report



Andrew Palmer, Chair of the Audit Committee

Role and focus

The Committee is responsible for the oversight and challenge of the effectiveness of the Group's systems of financial control, financial and regulatory reporting and other internal controls. The Committee reviews the adequacy and effectiveness of the Group's internal financial controls and internal control systems, as well as the procedures for monitoring their effectiveness. It monitors the work of internal and external auditors and actuaries.

The Audit Committee's terms of reference are available on our website at: www.directlinegroup.com.

Membership and attendance

	Scheduled meetings ¹	Ad hoc meetings ¹
Committee Chair		
Andrew Palmer	6 of 6	1 of 1
Non-Executive Directors		
Jane Hanson	6 of 6	1 of 1
Glyn Jones ²	4 of 6	1 of 1
Clare Thompson	6 of 6	1 of 1

Other attendees include

- Chief Executive Officer
- Chief Financial Officer
- Chief Risk Officer
- Group Financial Controller
- General Counsel and Company Secretary
- Group Head of Audit
- External Auditor

Minimum number of meetings per annum

The Committee meets at least four times a year at appropriate times in the financial and regulatory reporting and audit cycle and otherwise as required.

What did the Committee say it would do in 2013?

- Provide oversight of the actuarial reporting process; a review of the Group's control environment and processes
- Provide oversight of the Group Audit programme of activity to ensure that Group Audit continues to meet the expectations of the Board and satisfy emerging regulatory and industry standards for internal audit
- Ensure the provision of training and development within the Group, particularly in relation to new legislation and regulation

What have we achieved?

- Reviewed the interim report for the half year ended 30 June 2013 issued in August and the interim management statements issued in May and November
- Reviewed the draft preliminary statement and draft Annual Report & Accounts for the year ended 31 December 2013, with particular focus on accounting policies and critical estimates and judgements to confirm that it is fair, balanced and understandable
- Reviewed a number of specific items including:
 - an update on flood insurance;
 - the planned migration of the Group's IT systems from RBS Group;
 - a consultation with the Chartered Institute of Internal Auditors on the role of Internal Audit functions;
 - reserving policy;
 - updates on the tender process relating to the appointment of external actuaries; and
 - the financial reporting control framework in a non-US Sarbanes Oxley ("SOX") environment following separation from RBS Group.
- Agreed the scope of the audit work to be undertaken by the external auditor and Group Audit
- Considered the adequacy of the resources available to Group Audit and the results of the effectiveness review of the function and concluded that they were adequate
- Monitored Group Audit's independent and objective reports regarding the appropriateness, effectiveness and sustainability of the Group's system of internal controls
- Reviewed regular reports of the work conducted by the external auditors and Group Audit and noted mitigating actions proposed by management where required
- Monitored key control issues reported by Group Audit on a quarterly basis with the aim of ensuring the Group's risk exposure is properly mitigated
- Considered plans and key assumptions relating to the Group's actuarial reserves, received regular updates regarding movements and emerging trends, and recommended the level of reserves to the Board each quarter

Notes:

1. Attendance is expressed as the number of meetings attended out of the number of meetings possible or applicable for the Director to attend.
2. Glyn Jones was unable to attend two scheduled Audit Committee meetings due to other commitments.

Committee reports continued

- Monitored the Group's compliance with statutory and regulatory requirements and made recommendations within the scope of the Committee's terms of reference
- Reviewed the appropriateness of all accounting policies including revenue recognition and those in relation to significant areas pertinent to changes taking place in the business, including provisions for restructuring costs
- Assessed the external auditor's performance
- As part of the annual review, the Committee recommended to the Board revisions to its terms of reference
- Considered the ability of the Company and its principal subsidiaries to operate on a going concern basis
- Reviewed the draft Audit Committee report for inclusion in the Annual Report & Accounts for the year ending 31 December 2013

What will we be focusing on in 2014?

In addition to its regular monitoring, challenge and oversight responsibilities, the focus for the Committee in 2014 is expected to include the following:

- Considering the impact of ongoing regulatory changes on the assumptions and judgements used in our reserves and in our reporting
- Providing oversight to ensure that the control environment for financial reporting is not impacted by the migration of our underlying systems
- Ensuring Group Audit adopts industry best practice in line with recently published guidance
- Overseeing the enhancement in the process for setting reserve margins
- Considering the potential rotation of the auditor

Frequency of meetings

During 2013, the Committee met on seven occasions, six of which were scheduled meetings, and one was an ad hoc meeting. The members' attendance record is set out on the previous page.

Committee expertise

Committee members bring considerable financial and accounting experience to the Committee's work. All members have past employment experience in either finance or accounting roles, or comparable experience in corporate activities, and are members of the Institute of Chartered Accountants in England and Wales.

The Board is satisfied that each of these members has recent and relevant financial experience, as recommended by the Code.

Reports to the Board

The Chair of the Committee submits a report to the subsequent scheduled meeting of the Board on the Committee's work.

Financial reporting control framework

RBS Group's shareholding in the Company fell to below 50% in March 2013. Prior to this, the Group had been operating a formal financial control framework including identification, cataloguing and testing of controls in line with requirements set out by SOX legislation. Following divestment, this no longer applied to the Group. However, as good governance practice, the Group has continued to adopt the embedded features of the existing SOX framework, albeit tailored to respond to the changes in the business control environment.

In formulating the approach for the new framework, the principles from the Committee of Sponsoring Organizations of the Treadway Commission framework have been followed. The approach aligns with our existing operational risk framework with assurance work undertaken across the business focusing on our key financial reporting controls. Reports are presented to the Committee every six months highlighting any deficiencies and mitigating action required.

Internal control

Group Audit carries out independent internal audit work.

The Group Head of Audit reports to the Chair of the Audit Committee and has functional reporting to the Chief Financial Officer.

Group Audit provides the Committee with independent and objective reports on the appropriateness, effectiveness and sustainability of the Group's risk management, systems of internal control, governance frameworks and processes. The Group's statement of internal controls can be found on page 64.

The key control issues that Group Audit reports to management and to the Committee are monitored on a quarterly basis with the aim of ensuring the related risk exposures have been properly mitigated.

Reserves

The Committee approves annual plans for reviews of reserves, informed by internal and external emerging issues. It also considers an appropriate balance between internal and external actuarial review. Consultants appointed to provide validation of actuarial reviews are subject to approval by the Committee. During the year, an open tender process was conducted and the Committee approved the appointment of a professional services company to carry out the external actuarial review for the year ended 31 December 2013.

At least half-yearly, the Committee reviews and challenges the key assumptions and judgements, the emerging trends, movements and analysis of uncertainties underlying the assessment of the actuarial best estimate reviews.

Simultaneously with this review, the Committee also considers and challenges the appropriateness of proposals made by the Chief Financial Officer for management best estimate reserves for booking, informed both by actuarial analysis, wider commercial and risk management insights and principles of consistency from period to period.

Following their review of actuarial best estimate and management best estimate reserves, the Committee proposes the respective reserves to the Board.

Financial reporting

The review process undertaken by the Committee prior to the publication of the Group's financial statements focuses on the Group's critical accounting policies and practices, and on any changes and decisions that require a major element of judgement, unusual transactions, clarity of disclosures and significant audit adjustments. In addition, the Committee reviews the going concern assumption, compliance with accounting standards and obligations under applicable laws, regulations and governance codes and makes appropriate recommendations to the Board.

In addition to the focus on matters relating to reserving, issues considered by the Committee in 2013 and the judgements that were made included:

- the overall presentation of the financial statements to ensure fairness and balance and, in particular, the presentation of adjusted performance, including the appropriateness of restructuring and other one-off costs;
- reports on the assumptions underlying the provisions made for redundancy and onerous leases;
- the assessments made for goodwill impairment and confirmed the carrying value remained supportable;
- the judgements made in respect of tax, in particular the carrying value of any deferred tax assets and liabilities recognised; and
- the carrying value of the investments held by the Group and the need for any impairment provisions.

External audit

The Committee plays a key role in managing the relationship with the Group's external auditor, Deloitte LLP. The external auditor provides some non-audit services, primarily in the provision of audit-related assurance services. The Group's Audit / Non-Audit Services Minimum Standard ensures that the independence and objectivity of the external auditor are not impaired.

Both audit and non-audit services provided by the Group's external auditor are closely monitored:

- the Committee formally approves a list of audit and non-audit services in advance of each financial year in line with the Auditing Practices Board's Ethical Standard 5;
- all permitted services must be approved before any work commences and applications for approval must be submitted on a prescribed form, signed by the relevant member of the Executive Committee;

- the Chair of the Committee approves non-audit services costing less than £100,000, while the Committee approves services costing £100,000 or more; and
- the Committee receives an annual report on all services provided during the year and their related costs.

The Committee will review annually and where appropriate recommend updates to the Minimum Standard to ensure alignment with the latest standards and practice in establishing, maintaining and monitoring the independence and objectivity of auditors.

The key issues and areas of focus during 2013

The external auditor provided updates to the Committee on the following key issues during 2013:

- reserve valuation;
- investment valuation;
- reinsurance asset valuation;
- revenue recognition;
- transformation projects; and
- planned migration of the Group's IT systems to the Capgemini platform.

Fees payable to the auditor

During the year ended 31 December 2013, Deloitte LLP's fees for audit services and other services supplied were £2.2 million.

In accordance with the Group's Audit / Non-Audit Services Minimum Standard, all services were approved prior to work commencing and each of the non-audit services was confirmed to be permissible for the external auditor to undertake. The Committee approved fees of £0.1 million payable to Deloitte LLP for services not related to audit work, which accounted for 4.5% of total fees paid to the external auditor in the year.

A breakdown of fees paid to the auditor for the year ended 31 December 2013 is set out below:

Total fees for audit and other services	£2.2 million	
Audit fees	£2.1 million	95.5%
Non-audit fees	£0.1 million	4.5%

The non-audit fees of £0.1 million related to audit-related assurance services.

The Committee and Board remain satisfied that the provision of non-audit services by Deloitte LLP has not compromised Deloitte's independence as the Company's external auditor.

Auditor performance and independence

The performance of the external auditor is assessed every year, including its independence and objectivity and the effectiveness of the external audit process. The effectiveness review includes regular questioning of the external auditor during Committee meetings.

The Committee reviews the external audit plan and receives reports from Deloitte LLP on its own policies and procedures regarding independence and quality control, including an annual confirmation of independence in line with industry standards. The Committee concluded that the performance of the external auditor and the effectiveness of the audit process were satisfactory.

Re-appointment of auditor

The Committee intends to undertake a formal review on a regular basis to assess whether the external audit should be re-tendered. Deloitte LLP, the external auditor, has been the Group's auditor since 2000. Prior to listing in 2012, the Group was audited as a division of RBS Group.

The Committee is recommending to the Board that Deloitte LLP be re-appointed as auditor of the Company. A resolution for the re-appointment of Deloitte LLP as auditor of the Company will be put to a shareholder vote at the AGM on 15 May 2014.

The new UK Corporate Governance Code requires FTSE 350 companies to put the audit services contract out to tender at least once every 10 years, to enable the Committee to compare the quality and effectiveness of the services provided by the incumbent auditor with those of other audit firms. Transitional arrangements provided by the Financial Reporting Council ("FRC") indicate the Company should tender the audit, at the latest, at the time of the next audit partner rotation. The latter is currently scheduled following the 2015 year end.

We may, however, put the audit out to tender at any time before this date. There are no contractual obligations restricting our choice of external auditor and no auditor liability agreement has been entered into. Equally, any recommendation to re-appoint Deloitte LLP as auditor of the Company is dependent on continued satisfactory performance.

Evaluation of the Committee

The annual evaluation of the Committee's effectiveness was initiated by the Chairman of the Board and undertaken by Edis-Bates Associates, as external facilitators. The evaluation concluded that the Committee continued to operate effectively, and the Committee will consider the results and recommended actions resulting from the evaluation in 2014. Further details of the effectiveness review can be found on page 63.

This report was reviewed and approved by the Board on 25 February 2014.



Andrew Palmer, Chair of the Audit Committee

Board Risk Committee report



Jane Hanson, Chair of the Board Risk Committee

Role and focus

The Board Risk Committee provides oversight and advice to the Board in relation to current and potential future risk exposures of the Group and future risk strategy. It recommends risk appetite and tolerance to the Board and promotes a risk awareness culture within the Group.

The Board Risk Committee's terms of reference are available on our website at: www.directlinegroup.com.

Membership and attendance

	Scheduled meetings ¹	Ad hoc meetings ^{1,2}
Committee Chair		
Jane Hanson	6 of 6	3 of 3
Non-Executive Directors		
Andrew Palmer	6 of 6	3 of 3
Clare Thompson	6 of 6	3 of 3
Priscilla Vacassin	6 of 6	3 of 3

Other attendees include

- Chief Executive Officer
- Chief Financial Officer
- Chief Risk Officer
- General Counsel and Company Secretary
- Group Head of Audit

Minimum number of meetings per annum

The Committee meets at least four times a year at appropriate times in the risk and regulatory reporting cycle.

Notes:

1. Attendance is expressed as the number of meetings attended out of the number of meetings possible or applicable for the Director to attend.
2. The Committee met jointly with the Remuneration Committee on 30 September 2013.

What did the Committee say it would do in 2013?

- Foster a culture which is aligned to appropriate outcomes for the customer
- Deliver a mature and embedded conduct risk framework
- Consider and recommend for approval by the Board:
 - the Group's risk appetite, framework and tolerance levels for current and future strategy; and
 - the design and implementation of risk management and measurement strategies across the Group.

What have we achieved?

- Reviewed and challenged the following, receiving reports as standing agenda items:
 - significant risks and any other specific matters regarding the Group's risks, received from the Chief Risk Officer and Risk and Compliance functions;
 - the High Level Controls and System of Governance document;
 - legal and regulatory issues; and
 - whistle-blowing issues, statistics and trends.
- Reviewed the comprehensive Individual Capital Adequacy Standards Plus ("ICAS+") submission including the draft in development Own Risk and Solvency Assessment ("ORSA")
- Reviewed, challenged and recommended to the Board the high-level risk appetite and the supporting statements
- Considered the results of the stress tests and scenario analysis completed in 2013 and the material risk assessment undertaken by the Risk function
- Received the annual report from the Money Laundering Reporting Officer
- Reviewed and challenged the new Conduct Risk Policy, agreed our Conduct Risk appetite statements and monitored Key Risk Indicators ("KRIs")
- Reviewed and recommended the new Compliance, Whistle-blowing and Customer Conduct policies to the Board for approval
- Approved the Risk function's target operating model, adjusted to align with the business transformation plan, and to differentiate clearly between the roles and responsibilities across the three lines of defence model
- Reviewed the Direct Line Group tax strategy for consistency with risk appetite
- Reviewed the governance framework of the Group and in particular the High Level Controls and System of Governance document, which was recommended to the Board and approved
- Reviewed and approved the Enterprise-wide Risk Management ("ERM") strategy and framework document

- Reviewed, in conjunction with the Remuneration Committee, the incentive arrangements in the customer facing areas
- As part of the annual review, the Committee recommended to the Board revisions to its terms of reference
- Reviewed the draft risk management report and the Board Risk Committee report for inclusion in the Annual Report & Accounts for the year ending 31 December 2013

What will we be focusing on in 2014?

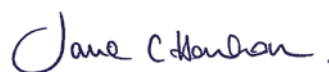
In addition to its regular monitoring, challenge and oversight responsibilities, the focus for the Committee in 2014 is expected to include the following:

- Guiding the continued development of an embedded risk and control culture which reinforces adaptability, flexibility and improving efficiency, while overseeing alignment of culture to appropriate customer outcomes
- Challenging our level of preparedness for external changes and driving business improvement of processes and frameworks
- Overseeing preparations for changes in market, legal and regulatory environments, including emerging risks, the Group's approach to periodic payment orders and preparations for Solvency II
- Continuing the pro-active governance, oversight and challenge of risk and control across the Group
- In readiness for greater capability in a digital world, overseeing and monitoring processes currently being embedded in the business
- Reviewing and overseeing operational risk management in the context of significant change programmes
- Overseeing a review of the maturity and effectiveness of the Risk Management Committee

Evaluation of the Committee

The annual evaluation of the Committee's effectiveness was initiated by the Chairman of the Board and undertaken by Edis-Bates Associates, as external facilitators. The evaluation concluded that the Committee continued to operate effectively, and the Committee will consider the results and recommended actions resulting from the evaluation in 2014. Further details of the effectiveness review can be found on page 63.

This report was reviewed and approved by the Board on 25 February 2014.



Jane Hanson, Chair of the Board Risk Committee

Corporate Social Responsibility Committee report



Jane Hanson, Chair of the Corporate Social Responsibility Committee

Role and focus

The remit of the Committee is to ensure that the Group conducts its business in a responsible manner, including in relation to health and safety, environmental, corporate social responsibility, social and ethical matters. The Committee also oversees the allocation of charitable donations and community involvement.

Membership and attendance

	Scheduled meetings ¹	Ad hoc meetings ¹
Committee Chair		
Jane Hanson	4 of 4	1 of 1
Committee members		
Paul Geddes	4 of 4	1 of 1
Clare Thompson	4 of 4	1 of 1
Tom Woolgrove	4 of 4	1 of 1

Other attendees include

- Human Resources Director
- General Counsel and Company Secretary
- Director of Communications
- Head of Public Affairs and Sustainability

Minimum number of meetings per annum

The Committee meets at least four times a year.

What did the Committee say it would do in 2013?

- Review the Group's overall Corporate Social Responsibility ("CSR") strategy, measures, policies and compliance
- Review performance and priorities against both internal targets and relevant external benchmarking indices
- Review the extent, effectiveness and transparency of external reporting
- Consider and recommend the Group's positioning on relevant emerging CSR issues
- Oversee the Group's compliance with its health and safety statutory and regulatory requirements and overseeing the embedding of a health and safety culture across the Group

Note:

1. Attendance is expressed as the number of meetings attended out of the number of meetings possible or applicable for the Director to attend.

What have we achieved?

- Scrutinised and challenged standing reports relating to key focus areas of the Committee as follows:
 - priorities and targets on key CSR matters;
 - health and safety, including consideration of updates on the 2013 plan, health & safety 'dashboards' detailing performance against plan and compliance with policies and procedures;
 - workplace policies and engagement; and
 - community engagement activities.
- Monitored progress by Human Resources and the employee network, Diversity Network Alliance, in achieving the key objectives of raising diversity awareness through training, and collecting management information
- Performed the annual review of relevant Direct Line Group policies and procedures and oversaw compliance with them
- Analysed and set the Health & Safety plan for 2014
- Determined the Group's position on emerging CSR issues
- Agreed the Group's approach to responsible investment and identified activities to support our CSR strategy
- Discussed and agreed the 2014 CSR strategy and sustainability targets
- As part of the annual review, the Committee recommended to the Board revisions to its terms of reference
- Reviewed the draft Corporate Social Responsibility report and the Corporate Social Responsibility Committee report for inclusion in the Annual Report & Accounts for the year ending 31 December 2013

What will we be focusing on in 2014?

In addition to its regular monitoring, challenge and oversight responsibilities, the focus for the Committee in 2014 is expected to include the following:

- Sustaining and measuring the Group's CSR progress and impact, continuing to embed CSR into our business strategy and operations
- Engaging with external stakeholders, to shape our future CSR strategy and identifying emerging issues
- Reviewing and recommending the 2015 CSR strategy, plan and targets
- Reviewing the effectiveness of the Group's CSR communications
- Encouraging employee engagement in CSR and community programmes

Evaluation of the Committee

The annual evaluation of the Committee's effectiveness was initiated by the Chairman of the Board and undertaken by Edis-Bates Associates, as external facilitators. The evaluation concluded that the Committee continued to operate effectively, and the Committee will consider the results and recommended actions resulting from the evaluation in 2014. Further details of the effectiveness review can be found on page 63.

This report was reviewed and approved by the Board on 25 February 2014.

Jane Hanson, Chair of the Corporate Social Responsibility Committee

Investment Committee report



Glyn Jones, Chair of the Investment Committee

Role and focus

The role of the Investment Committee is to oversee the management and performance of the investment strategy of the Group.

Membership and attendance

	Scheduled meetings ¹	Ad hoc meetings ¹
Committee Chairs		
Andrew Palmer ²	3 of 3	1 of 1
Glyn Jones ^{3,5}	3 of 3	–
Committee members		
Jane Hanson	3 of 3	1 of 1
Clare Thompson ^{4,5}	3 of 3	–

Other attendees include

- Chief Executive Officer
- Chief Financial Officer
- Chief Risk Officer
- Director of Investment Management and Treasury
- General Counsel and Company Secretary

Minimum number of meetings per annum

The Committee meets at least three times a year.

What did the Committee say it would do in 2013?

- Consider changes to the existing asset benchmark composition for the Group’s investment portfolio with the aim of improving the expected risk-adjusted returns, taking into account the Group’s investment risk appetite set by the Board
- Use the internal capital model to support asset strategy decisions by understanding and monitoring the capital and solvency implications
- Review the liquidity requirements of the business and consider the adequacy of liquidity available to meet such needs from the investment portfolio

- Review the merits of derivative and asset strategies proposed to mitigate risks associated with long-term liabilities
- Monitor the selection and implementation process for any new asset classes approved for the investment portfolio

What have we achieved?

- Reviewed a major asset and liability management study on UK Insurance Limited, particularly in the context of a low interest rate environment. The study used the internal capital model to examine the capital consequences of asset allocations proposed
- Recommended to the Board the inclusion of a new asset class in the U K Insurance Limited investment portfolio and oversaw the subsequent implementation of the asset class into the portfolio
- Determined an appropriate liquidity policy for the investment portfolio and how liquidity needs could continue to be met in a stressed scenario
- Agreed changes to the risk management framework underpinning investment activity, in line with risk appetite set by the Board on the recommendation of the Board Risk Committee
- Considered reports from the Director of Investment Management and Treasury covering, inter alia key market developments, financial performance from investment activity, performance of external fund managers and the custodian, and compliance with risk and exposure limits set
- Agreed oversight and support arrangements in respect of the international businesses regarding treasury and investment activities
- Reviewed the findings and recommendations from the internal audit of the Investment and Treasury function and monitored resolution of the actions arising
- Considered how investment activities should support the Company’s corporate social responsibility agenda
- Examined the investment returns forecast for the 2014-2017 period
- As part of the annual review, the Committee recommended to the Board revisions to its terms of reference
- Reviewed members’ training requirements for 2014
- Reviewed the draft Investment Committee report for inclusion in the Company’s Annual Report & Accounts for the year ended 31 December 2013

Notes:

1. Attendance is expressed as the number of meetings attended out of the number of meetings possible or applicable for the Director to attend.
2. Andrew Palmer stepped down as Chair of the Committee on 28 March 2013 and remained a member of the Committee.
3. Glyn Jones was appointed a member and Chair of the Committee on 28 March 2013.
4. Clare Thompson was appointed a member of the Committee on 28 March 2013.
5. Glyn Jones and Clare Thompson attended a meeting of the Committee on 14 February 2013 before being appointed members of the Committee.

What will we be focusing on in 2014?

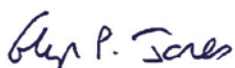
In addition to its regular monitoring, challenge and oversight responsibilities, the focus for the Committee in 2014 is expected to include the following:

- Finalising the appropriate combination of assets and the use of derivatives, if deemed appropriate, to back the Group's long-term liabilities (PPOs) with the benefit of the November 2013 European agreement on Omnibus II (Solvency II)
- Within the Board's risk appetite, seeking to reduce further the excess liquidity above stressed requirements within the U K Insurance Limited portfolio and reinvesting this in assets offering an illiquidity premium and / or better risk adjusted returns
- Monitoring the pace of economic recovery and the tapering of quantitative easing and the resulting impact on interest rates, credit spreads and asset values and then reviewing the implications for the positioning of the Group's investment portfolio
- Receiving an asset and liability management study covering the investment portfolios of the International division

Evaluation of the Committee

The annual evaluation of the Committee's effectiveness was initiated by the Chairman of the Board and undertaken by Edis-Bates Associates, as external facilitators. The evaluation concluded that the Committee continued to operate effectively and the Committee will consider the results and recommended actions resulting from the evaluation in 2014. Further details of the effectiveness review can be found on page 63.

This report was reviewed and approved by the Board on 25 February 2014.



Glyn Jones, Chair of the Investment Committee

Nomination Committee report



Mike Biggs, Chair of the Nomination Committee

Role and focus

The Nomination Committee is responsible for considering and making recommendations to the Board regarding the appointment and re-appointment of Directors. It also makes recommendations regarding the membership and chairmanship of the Board Committees.

The Nomination Committee's terms of reference are available on our website at: www.directlinegroup.com.

Membership and attendance

	Scheduled meeting	Ad hoc meeting ¹
Committee Chair		
Mike Biggs	1 of 1	1 of 1
Non-Executive Directors		
Glyn Jones	1 of 1	1 of 1
Andrew Palmer	1 of 1	1 of 1

Other attendees include

- Chief Executive Officer
- General Counsel and Company Secretary

Minimum number of meetings per annum

As required, but not less than once a year.

Frequency of meetings

The Committee meets at least once a year to consider the Board composition and membership of the principal Committees and to consider the suitability of all Directors standing for re-election at the AGM. The Committee will also meet as required to consider candidates for appointment to the Board.

Changes to the Board

Mark Catton resigned from the Board on 25 April 2013 when RBS Group reduced its shareholding in Direct Line Group below 50%, whereupon RBS Group's entitlement to nominate Directors under the Relationship Agreement with the Company reduced from two to one. Mr Catton rejoined the Board on 1 October 2013 when Bruce Van Saun resigned in order to take up an appointment with RBS Group in America. As RBS Group are entitled to nominate a Director to the Board under the terms of their Relationship Agreement with the Company, it was not appropriate to engage an external search agency nor to use

Note:

1. Attendance is expressed as the number of meetings attended out of the number of meetings possible or applicable for the Director to attend.

open advertising to fill the vacancy on Mr Van Saun's resignation. Mr Catton will step down as a Director when RBS Group's holding in the Company falls below 20%.

Board Appointment and Reappointment Process

No new Directors were appointed during 2013. The Committee does, however, have a pre-established Board appointment process. It includes the use of independent external search consultants, an evaluation of the balance of skills, diversity, independence and knowledge on the Board and establishment of target criteria for the appointment of new Directors. Details of the latter are shown on page 61 of this Report.

In advance of the proposed re-election of Directors at the 2013 AGM, the Committee reviewed the independent status of Non-Executive Directors. It was concluded that Ms Hanson, Mr Jones, Mr Palmer, Ms Thompson and Ms Vacassin were independent within the meaning of the UK Corporate Governance Code. Mr Biggs was independent on his appointment as Chairman. Mr Van Saun and Mr Catton, being RBS Group nominated Directors, did not meet the independence criteria of the Code though both had demonstrated a sufficient level of Board challenge to be considered independent in character and by judgement. Accordingly, it was recommended to the Board and Shareholders that all serving Directors be re-appointed at the 2013 AGM.

Diversity

The Group seeks to hire the best candidates for all positions at all levels throughout the business, irrespective of gender, including candidates at Board level. With three female independent Non-Executive Directors, 33% of the current Board is female, which is a greater percentage than that recommended by the Davies' Report on Boardroom Diversity. However, both the Nomination Committee and Board recognise the benefits of gender diversity and will ensure that this is taken into account when considering any particular appointment. Accordingly, this is embedded in the Nomination Committee's terms of reference. Work on encouraging the promotion of women to senior and executive management roles within the business will continue.

Please refer to page 63 for the Group's approach to diversity, including gender diversity.

Terms of reference

As part of the annual review, the Committee recommended to the Board revisions to its terms of reference.

Evaluation of the Committee

The annual evaluation of the Committee's effectiveness was initiated by me as Chairman, and undertaken by Edis-Bates Associates as external facilitators. The evaluation concluded that the Committee has not since the IPO had to deal with the usual workload of such a committee, given the short period since the IPO. In addition, the only changes to the Board in 2013 were changes to the RBS Group-nominated Directors, which RBS Group was entitled to do pursuant to the Relationship Agreement between RBS Group and the Company. One of the actions arising from the Nomination Committee performance evaluation was the need for greater focus on succession planning, which has been incorporated in the Committee's forward agenda for 2014.

This report was reviewed and approved by the Board on 25 February 2014.



Michael N Biggs, Chair of the Nomination Committee

Remuneration Committee report



Priscilla Vacassin, Chair of the Remuneration Committee

Role and focus

The Committee is responsible for setting and oversight of the Group's remuneration policy. It also makes recommendations to the Board regarding the remuneration arrangements of the Company's Executive Directors and senior executives.

The Remuneration Committee's terms of reference are available on our website at: www.directlinegroup.com.

Membership and attendance

	Scheduled meetings ¹	Ad hoc meetings ^{1,2}
Committee Chair		
Priscilla Vacassin	7 of 7	3 of 3
Non-Executive Directors		
Mike Biggs ³	6 of 7	3 of 3
Andrew Palmer	7 of 7	3 of 3
Clare Thompson	7 of 7	3 of 3

Other attendees include

- Chief Executive Officer
- Human Resources Director
- General Counsel and Company Secretary
- Director of Performance and Reward
- FIT Remuneration Consultants LLP (independent adviser)

The Committee works closely with the Chairs of the Board Risk Committee and the Audit Committee.

Meeting frequency

The Committee meets at least four times a year.

Notes:

1. Attendance is expressed as the number of meetings attended out of the number of meetings possible or applicable for the Director to attend.
2. The Committee met jointly with the Board Risk Committee on 30 September 2013.
3. Mike Biggs was unable to attend a scheduled meeting of the Committee due to another commitment.

What did the Committee say it would do in 2013?

- Consider the 2013 remuneration and incentive plan arrangements within the context of the pay review budget for 2013 and the outcomes from the annual performance review
- Approve the grants of awards under the Group's share schemes
- Oversee the roll-out of the all-employee Buy-As-You-Earn ("BAYE") scheme
- Determine the share ownership guidelines for members of the Executive Committee
- Review the possible outcomes of the 2013 Annual Incentive Plan ("AIP") and the structure of the 2014 AIP in light of the experience in 2013

What have we achieved?

- After consultation with the Chief Risk Officer and the Board Risk Committee, approved the outcomes under the 2012 AIP and made awards under the Company's deferred share incentive arrangements
- Reviewed the overall remuneration policy to ensure it continues to support the Company's strategic objectives going forward
- Determined the share ownership guidelines and reviewed compliance against these by the Executive Directors and members of the Executive Committee
- Developed extensive payment gateways for the AIP which requires the Committee to be satisfied that it is appropriate to permit payment of a bonus or at a given level
- Reviewed and approved the overall 2013 salary budget for Direct Line Group, including proposed salaries for Executive Directors, members of the Executive Committee and other strategic leaders
- Agreed the high level principles and key terms of the incentive plan arrangements for 2013 and rolled out the BAYE scheme in the United Kingdom and Italy
- Approved the Direct Line Group's termination policy
- Reviewed the approach to malus and clawback
- Reviewed the implications for the 2013 Directors' remuneration report of changes in regulations introduced by the Department for Business, Innovation and Skills
- Obtained advice from the Board Risk Committee on risk weightings and implemented adjustments to be applied to performance objectives and remuneration arrangements
- Determined the implications for remuneration arising from the evolution of the Group's strategy through liaison with the Audit Committee and Finance function
- Oversaw the review of incentive arrangements in the customer facing areas of the business following the publication of FCA guidance in conjunction with the Board Risk Committee

- Reviewed the proposed approach to salary benchmarking for Executive Directors, the Executive Committee and other strategic leaders
- Considered the effectiveness of the performance of FIT Remuneration Consultants LLP during 2013 and agreed to re-appoint them as independent external advisers to the Committee for 2014
- As part of the annual review, the Committee recommended to the Board revisions to its terms of reference
- Reviewed the draft Remuneration Committee report and the Directors' remuneration report for inclusion in the Company's Annual Report & Accounts for the year ending 31 December 2013

What will we be focusing on in 2014?

In addition to its regular monitoring, challenge and oversight responsibilities, the focus for the Committee in 2014 is expected to include the following:

- Greater alignment between reward and shareholder value creation
- Differentiation between average and great performance
- Ensuring that short-term results are not driven at the expense of maximising shareholder value
- Ensuring that reward is predicated upon satisfied and well served customers
- Ensuring that there is an appropriate level of oversight and balancing risk and reward in all of our schemes

Evaluation of the Committee

The annual evaluation of the Committee's effectiveness was commissioned by the Chairman of the Board and undertaken by Edis-Bates Associates, as external facilitators. The evaluation concluded that the Committee continued to operate effectively, and the Committee will consider the results and recommended actions resulting from the evaluation in 2014. Further details of the effectiveness review can be found on page 63.

This report was reviewed and approved by the Board on 25 February 2014.



Priscilla Vacassin, Chair of the Remuneration Committee

Relations with shareholders

We consider that actively engaging with our shareholders is fundamental to our business. We believe that ensuring an active dialogue and ongoing engagement is vital to keeping in touch with opinions, providing us with the opportunity to address any questions and concerns in a proactive way.

The Executive Directors frequently meet with investors. The Chairman, Senior Independent Director and Non-Executive Directors are available to attend meetings with major shareholders at the shareholders' request so that they have the opportunity to discuss governance and strategy with shareholders and ensure that any particular shareholder views are communicated to the Board. The Board is also kept aware of shareholder views by the Company's corporate brokers who regularly attend Board meetings for this purpose.

The Board is also given the opportunity to understand the views of major shareholders through analysts' reports and broker briefings.

What did we do in 2013?

Roadshows

- 4 trips to the US targeting investors in New York, Boston, San Francisco and Chicago
- 1 trip to Canada
- 1 trip to Copenhagen
- 1 trip to Dublin
- 3 roadshows in London
- 2 visits to Edinburgh

Conferences

Morgan Stanley European Financials, London¹

Autonomous conference, London

Goldman Sachs European Financials, Brussels¹

JP Morgan small mid cap conference, London

Keefe, Bruyette & Woods conference, London

Bank of America Merrill Lynch conference, London¹

2013 Stock broker briefings

March

Royal Bank of Canada

May

Morgan Stanley and Goldman Sachs

June

August

Nomura

September

Keefe, Bruyette & Woods and Numis

November

Canaccord

Note:

1. The conferences where the Chief Executive Officer gave a brief presentation to all delegates

What are we focusing on in 2014?

We will continue to provide detailed disclosures on the Group's financial performance and strategic plans and host a number of events to foster engagement. The Group recognises the importance of maintaining an active dialogue with our shareholders, target investors and other important insurance sector investors. Planned activities for 2014 include:

- Presentations of our financial results
- Investor road shows in the UK, Europe, the United States and Canada
- Attending key conferences to enable communication with a large number of existing and target investors in a time efficient manner
- Briefings with investors and stockbrokers to convey key messages and performance and strategy

What arrangements are we making for the Annual General Meeting?

The Notice of the AGM will be sent to shareholders well in advance of the meeting. We will propose all items requiring shareholder approval under separate resolutions.

We will provide proxy appointment forms for each resolution, with the option for shareholders to vote for, or against, or to withhold their vote. We have instructed our registrars, Computershare Investor Services plc, to ensure that all valid proxy appointments are properly recorded and counted.

We will announce the result of the poll as soon as practical after the meeting and also post the result on our website after that date. The proxy form and announcement of the results explicitly state that a vote withheld is not a vote in law and will therefore not be counted in the calculation when deciding whether the resolution has been passed.

We anticipate that all Directors will attend the AGM and that the Chairs of the Audit, Board Risk, Corporate Social Responsibility, Investment, Nomination and Remuneration Committees will be available to answer questions.

What is the procedure at the AGM?

Following presentations by members of the Board, voting on the resolutions at the AGM will be conducted on a poll. Shareholders' proxy votes can be submitted electronically through the Company Registrar's website. Further details can be found in the Notice of AGM.

2013 & 2014 AGMs – key highlights

2013 AGM

Held on 6 June 2013 at The Auditorium, Allen & Overy LLP, One Bishops Square, London E1 6AD.

- Full Director attendance
- 1,250 million to 1,258 million votes cast for each resolution (83% of issued share capital)
- All Directors were elected or re-elected to the Board, receiving at least 99% of the votes cast in favour
- Remuneration report resolution passed, with 98.84% in favour
- Highest votes in favour – 99.75% to authorise political donations and expenditure
- Lowest votes in favour – 98.84% to approve the Remuneration report

2014 AGM

To be held on 15 May 2014 at The Auditorium, Allen & Overy LLP, One Bishops Square, London E1 6AD.

- All Directors are expected to stand for re-election to the Board
- Each Director has been formally evaluated by the Nomination Committee before standing for re-election
- The Board believes that each Director is effective and demonstrates commitment to his or her role
- There will be a vote on the Directors' remuneration policy.