

# Directors' report

The Directors present their report for the financial year ended 31 December 2013.

## Strategic report

The Company has chosen, in accordance with section 414c(II) of the Companies Act 2006, and as noted in this Directors' report, to include certain additional matters in its Strategic report that would otherwise be required to be disclosed in this Directors' report.

Disclosure and Transparency Rule 4.1.5(2) requires this Annual Report & Accounts to include a management report. The information that fulfils this requirement can be found in the Strategic report on pages 2 to 49.

The subsidiary and associated undertakings which principally affect the profits or net assets of the Group in the year are listed in note 19 to the consolidated financial statements.

The forward-looking statements disclaimer is set out on page 179.

## Corporate governance statement

The information that fulfils the requirements of the corporate governance statement for the purposes of Disclosure and Transparency Rule 7.2 can be found in this Directors' report and in the corporate governance report on pages 56 to 75, which is incorporated into this Directors' report by reference.

## Post-balance sheet events and likely future developments

Details of events after the statement of financial position date are contained in note 40 to the consolidated financial statements and form part of this report.

## Dividends

The Board is recommending a final dividend of 8.4 pence per share to shareholders, which, subject to shareholder approval, will be paid on 20 May 2014 to all holders of Ordinary Shares on the Register of members at close of business on 14 March 2014.

In addition, the Company paid a special interim dividend of 4.0 pence per share in December and the Board is now declaring a second special interim dividend of 4.0 pence per share. Both these special interim dividends relate to items in 2013 that were not expected at the start of the year. The second special interim dividend will be paid on 20 May 2014 to all holders of Ordinary Shares on the Register of members at close of business on 14 March 2014.

## Directors

Details of the Company's rules on the appointment and term of appointment of Directors are given on pages 61 to 62.

## Remuneration of Directors

The Remuneration report starting on page 76 forms part of the Directors' report and includes details of the nature and amount of each element of the remuneration (including share options) of each of the Directors.

## Secretary

Details of the Company Secretary of Direct Line Insurance Group plc, including his qualifications and experience, are set out on page 55.

## Directors' indemnities

The Articles of the Company permit it to indemnify the officers of the Company (and the officers of any associated company) against liabilities arising from the conduct of Company business to the extent permitted by law. Accordingly, the Company executed deeds of indemnity for the benefit of each Director in respect of liabilities that may attach to them in their capacity as Directors of the Company or of associated companies. These indemnities are qualifying third-party indemnities as defined by section 234 of the Companies Act 2006. No amount was paid under any of these indemnities during the year.

The Company also purchased directors' and officers' liability insurance during the year, which provides appropriate cover for legal actions brought against its Directors.

## Authorisation of conflicts of interest

The Company's Articles of Association permit the authorisation of a Director's potential conflict of interest or duty. Such authorisations may be given by the remaining Directors who are independent of the potential conflict.

The Board has approved a number of authorisations in this manner. Notwithstanding such authorisation, the Board continues to ensure that any actual conflict of interest or duty, should it arise, is dealt with appropriately, which will usually be by arranging that the Director takes no part in the relevant Board or Committee discussion or decision.

At no time during the year did any Director hold a material interest in any contract of significance with the Company or the Group other than the Relationship Agreement with RBS Group, the indemnity provision described above and service contracts between each Executive Director and the Company.

## Share capital and control

The issued and fully paid share capital of the Company is 1,500,000,000 Ordinary Shares of 10 pence each.

During the AGM held on 6 June 2013, the Directors were authorised to:

- allot shares in the Company up to an aggregate nominal amount of £50,000,000, or grant rights to subscribe for or to convert any security into shares;
- allot shares up to an aggregate nominal amount of £100,000,000, for the purpose of a rights issue; and
- make market purchases of up to 150,000,000 shares of the Company (representing approximately 10% of the Company's issued share capital at the time).

These authorities have not been used to date and shareholders will be asked to renew them at the 2014 AGM. Details are contained in the Notice of AGM.

Following the IPO on 16 October 2012, the Ordinary Shares have a premium listing on the London Stock Exchange. As at the date of this report, 28.5% of the Company's issued shares are held by The Royal Bank of Scotland Group plc.

Details of the Company's share capital and shares under option at 31 December 2013 are given in notes 27 and 33 of the consolidated financial statements which form part of this report.

The Company held no Treasury Shares during the year or at the date of this report.

The rights and obligations attaching to the Company's Ordinary Shares, together with the powers of the Company's Directors, are set out in the Company's Articles of Association, which can be obtained from the Company's website, [www.directlinegroup.com](http://www.directlinegroup.com). Unless expressly specified to the contrary in the Articles of Association, they may only be amended by a special resolution of the Company's shareholders at a general meeting.

Details of Directors' remuneration, service contracts, employment contracts and interests in the shares of the Company are set out in the Directors' remuneration report on pages 76 to 99.

#### Relationship Agreement with RBS Group

Under the terms of a Relationship Agreement between the Company and RBS Group, RBS Group has the right to nominate Directors to the Board of the Company; whilst RBS Group held over 50% of the shares of the Company RBS Group was entitled to nominate two Directors and such Directors were Bruce Van Saun and Mark Catton.

Following the reduction of RBS Group's shareholding below 50% on 13 March 2013, RBS Group became entitled to nominate one rather than two Directors and Mark Catton accordingly resigned on 26 April 2013. On the resignation of Bruce Van Saun on 1 October 2013 on account of his work for RBS Group moving to the United States, Mark Catton re-joined the Board as RBS Group's nominated Director in place of Bruce Van Saun.

Under the terms of the agreement, after ceding control of the Company, RBS Group may only nominate one Director until such time as its shareholding reduces below 20%.

With the exception of the Relationship Agreement, there is no arrangement or understanding with any shareholder, customer, supplier, or any other external party, providing the right to appoint a Director or a member of the Executive Committee.

#### Restrictions on the transfer of shares

The Relationship Agreement in place between the Company and RBS Group contains certain restrictions on the transfer of the Ordinary Shares registered in the name of RBS Group.

In addition, there are restrictions on the transfer of the Ordinary Shares under the Company's employee share incentive plans while the shares are subject to the plan rules. Where, under an employee share incentive plan operated by the Company, participants are the beneficial owners of shares but not the registered owners, the voting rights are normally exercised at the discretion of the participants.

Other than those specified above, there are no restrictions on the voting rights attached to the Company's Ordinary Shares or the transfer of securities in the Company. There are no special rights with regard to control of the Company attached to the Company's Ordinary Shares. The Company is not aware of any agreements between holders of shares that may result in restrictions on the transfer of shares or voting rights.

#### Significant agreements

A number of agreements may take effect, alter or terminate upon a change of control of the Company including following a takeover bid, for example commercial contracts and distribution agreements. None is considered to be significant in terms of its impact on the business of the Group as a whole.

- The Relationship Agreement between the Company and RBS Group remains in force until such time as the RBS Group's shareholding reduces below 20% of the issued share capital of the Company. There are also provisions which provide the RBS Group with the right automatically to terminate the Relationship Agreement if the Company ceases to be listed, or if it passes a resolution to wind up, or if an administration order is made or it makes an arrangement with creditors. There are no provisions in the Relationship Agreement which allow RBS Group to terminate the agreement in the event of a change of control of Direct Line Group
- All of the Company's employee share incentive plans contain provisions relating to a change of control. Outstanding awards would typically vest and become exercisable on a change of control, subject to the satisfaction of any performance conditions, and normally with an additional time based pro-rata reduction where performance conditions apply

#### Substantial shareholdings

In accordance with the provisions of chapter 5 of the Disclosure and Transparency Rules of the Financial Conduct Authority, the following shareholder has provided the Company with notice of interests in the Company's voting rights.

Shareholder	31 December 2013	25 February 2014 <sup>1</sup>
The Royal Bank of Scotland Group plc <sup>2</sup>	28.50%	28.50%

#### Notes:

1. The interests of RBS Group indicated above are held directly.
2. Information provided to the Company pursuant to the Disclosure and Transparency Rules is publicly available via the regulatory information services and on the Company's website.

#### Employee consultation

The Group's statement on our employees is set out in the Strategic report on page 46. In summary, we encourage open, honest and transparent communication and dialogue with employees.

We have well-established Employee Representative Bodies ("ERBs") that comprise elected representatives of employees across our business. ERBs help shape initiatives by helping us share and discuss proposals and initiatives which affect our future and advise the Executive Committee regarding employee matters.

These bodies are consulted as part of future change programmes, and in particular about collective redundancies and TUPE transfers. They complement our existing communication processes and represent their constituents' interests.

On 26 June 2013, the Company announced proposals to improve its operational efficiency as part of its business transformation plan.

These proposals resulted in approximately 3,200 roles being put at risk. The Group ensured meaningful consultation took place with elected representatives regarding ways to avoid, reduce or mitigate the impact of proposed reductions in the number of roles.

Employees can also raise issues and ideas through "BEST Quest" – an intranet based communication tool which facilitates on-line information sharing. We will be phasing this out and replacing it with Yammer; a business social networking tool which will help reinforce some of our core values such as 'working together' 'say it like it is' and 'bring all of yourself to work' and reduce the impact of geographic and organisational barriers to communication.

The Group values the diversity of its employees and is committed to creating a working environment that is inclusive of all. The Group embraces people's differences in order to attract and retain talent and seeks to enable employees to reach their potential; these differences include but are not limited to age, belief, disability, ethnic or national origin, gender, gender identity, marital or civil partnership status, political opinion, race, religion and sexual orientation. These commitments extend to recruitment and selection, training, career development, flexible working arrangements, promotion and performance appraisal.

Numerical data relating to the gender diversity of the Board, senior executives and the employees may be found on page 47.

### Employees with disabilities

As an organisation we are committed to ensuring that diversity is promoted across all areas of our business. At recruitment we make adjustments to facilitate applications and the selection process and provide guidance and where necessary additional training for interviewers.

Our Diversity Network Alliance has a 'strand' which focuses on matters important to our employees with a disability and to identify areas that we can improve upon. To facilitate continued employment we make reasonable adjustments to the working environment/equipment, the role or role requirements and ensure that the same opportunities are available to all.

### Political contributions

The Group made no political donations during the year (2012: nil).

### Governmental regulation

To comply with European Union ("EU") state aid requirements, RBS Group agreed to cede control of Direct Line Group by the end of 2013 and divest its entire interest by the end of 2014. The initial minority tranche of the divestment of Direct Line Group, by way of a public flotation, was effected on 16 October 2012 and RBS Group ceded control of Direct Line Group on 13 March 2013 and reduced its shareholding further to 28.5% on 27 September 2013.

### Greenhouse gas emissions

The Group has followed the 2013 UK Government environmental reporting guidance for greenhouse gas ("GHG") emissions, used the UK Government's greenhouse gas conversion factors and adopted the financial-control approach. GHG emissions are classified as either direct or indirect, and are divided into Scope 1 and Scope 2 emissions.

Direct GHG emissions are those from sources that are owned or controlled by the Group. Indirect GHG emissions are those that are a consequence of the activities of the Group, but that occur at sources owned or controlled by another organisation. The Group has considered the six main GHGs, reported in CO<sub>2</sub>e tonnes equivalent and have set 2013 as the base year. The Group has included emissions from all of its overseas subsidiaries. It has not included emissions associated with its investment portfolio.

- Scope 1 – direct emissions including fuels used in office buildings, accident repair centres and owned vehicles
- Scope 2 – indirect emissions resulting from the generation of electricity purchased for office buildings and accident repair centres

The Group's total GHG emissions for 2013 were 30,624 tonnes (see table below). This primarily comprised of emissions from purchased electricity and natural gas, diesel fuel and refrigerant gas used.

In addition to total emissions, the Group also monitors emissions per £ million of net earned premium. In 2013, this was 8.7 tonnes per £ million of net earned premium. This is a measure of how efficiently insurance products are provided and allows comparison between insurance companies.

The GHG emissions data has been externally verified by Ecometrica. The verification statements can be found on the Group's website ([www.directlinegroup.com](http://www.directlinegroup.com)).

Further information on the Group's approach to energy and the environment can be found in the corporate social responsibility report on page 44.

### Greenhouse gas emissions – total Group

For the year ended 31 December 2013	CO <sub>2</sub> e tonnes
Scope 1 direct	8,424
Scope 2 indirect	22,200
<b>Total gross emissions</b>	<b>30,624</b>
Emissions per £ million of net earned premium	8.7

### Financial instruments

The Group's companies use financial instruments to manage certain types of risk, including those relating to foreign currency exchange, cash flow, liquidity and interest rates. Details of the objectives and management of these instruments are contained in the Risk management and Capital management sections on pages 22 to 27 and 42. An indication of the exposure of Group companies to such risks is also contained in note 3 to the consolidated financial statements.

### Going concern

The Group has sufficient financial resources to meet its financial needs including the management of a mature portfolio of insurance risk. The Directors believe that the Group is well positioned to manage its business risks successfully in the current economic environment.

The finance review on pages 34 to 43 describes the Group's capital management strategy, which covers how it measures its regulatory and economic capital needs and how capital

is deployed. The financial position of the Group is also covered in that section, including a commentary on cash and investment levels, reserves, currency management, insurance liability management, liquidity and borrowings. In addition, note 3.2 to the consolidated financial statements describes capital management needs and policies and note 3 covers underwriting, market, liquidity and credit risks which may affect the Group's financial position.

After making due enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they have adopted the going concern basis in preparing this Annual Report & Accounts.

### Statement of disclosure of information to auditors

Each Director at the date of the approval of this Annual Report & Accounts confirms that:

- so far as the Director is aware, there is no relevant audit information of which Deloitte LLP, the Company's external auditor, is unaware; and
- the Director has taken all the steps that he or she ought to have taken as a Director to make himself or herself aware of any relevant audit information and to establish that Deloitte LLP is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

### Auditor

Deloitte LLP has expressed its willingness to continue in office as external auditor. A resolution to reappoint the firm will be proposed at the forthcoming AGM.

### Directors' responsibility statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare such financial statements for each financial year. Under that law, the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the EU and Article 4 of the International Accounting Standard ("IAS") Regulation and have also chosen to prepare the Parent Company financial statements under IFRSs as adopted by the EU. Under company law, the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, IAS 1 requires that Directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors, whose names and functions are listed on pages 52 to 53 confirm, that to the best of their knowledge:

- the financial statements, prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Strategic report (given on pages 2 to 49) includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

### Statement of the Directors in respect of the Annual Report & Accounts

The Directors confirm that they consider that the Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Group's performance, business model and strategy.

In arriving at this conclusion, the Board was supported by a number of processes which included:

- the Annual Report & Accounts were drafted by management with overall governance and co-ordination provided by a steering group comprised of a team of cross-functional senior management to ensure consistency across sections;
- a verification process was undertaken to ensure that the content was factually accurate;
- drafts of the Annual Report & Accounts were reviewed by members of the Executive Committee;
- an advanced draft was reviewed by the Company's Disclosure Committee and legal advisers; and
- the substantially final draft was reviewed by the Audit Committee prior to consideration by the Board.

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

By order of the Board

Paul Geddes,  
Chief Executive Officer  
25 February 2014

John Reizenstein,  
Chief Financial Officer  
25 February 2014