

# Good progress towards targets



Mike Biggs, Chairman

**"The Board is encouraged by the progress made on the Group's transformation plan and endorses management's actions to drive efficiency in the current competitive markets.**

**"Over the longer term, the Board believes that a continued focus on our strategic priorities should generate sustainable value."**

2013 represented another significant year for Direct Line Group. In the first full year of being listed on the London Stock Exchange, the Group achieved the 2013 combined operating ratio<sup>1</sup> ("COR") and cost targets set at the time of the initial public offering ("IPO") in October 2012. This resulted in a 16.0% RoTE from ongoing operations<sup>2</sup>, ahead of its long-term target. This has been achieved despite competitive market conditions and demonstrates the improved levels of performance the Group's transformation plan is delivering.

Our shareholders have also seen a 15.3% increase in the share price to 249.6 pence per share in the year to 31 December 2013. In addition, we paid shareholders dividends totalling 16.2 pence per share during 2013. As at the date of this report (25 February 2014) the share price is 261.0 pence.

## **Strategy update**

During 2013, the Group has continued to focus on delivering the strategic plan established in 2010 to transform Direct Line Group into 'Britain's best retail general insurer'. We have made good progress in 2013 across each of our strategic priorities and have plans for further transformation in the future.

Looking to 2014, we will continue to focus on delivering for our customers, in particular by using technology to enhance customer experience. More details of this and other strategic priorities can be found in the Chief Executive Officer's review.

We continue to target a RoTE from ongoing operations<sup>2</sup> of 15%. In addition, we have set specific targets for 2014, being a total cost base<sup>3</sup> of approximately £1,000 million and a COR in Commercial of less than 100%. Overall, we currently expect a COR for the Group of between 95% and 97% in 2014. These assume a normal level of claims from weather events and large losses.

## **Dividend and capital management**

Through our progressive dividend policy, we aim to increase the dividend annually in real terms. The Board is recommending a final dividend of 8.4 pence per share to shareholders. If approved, the full year regular dividend of 12.6 pence per share would represent a 5.0% growth on the pro forma full year dividend<sup>4</sup> of 2012 (12.0 pence per share) and is in line with this policy.

In addition, we paid a special interim dividend of 4.0 pence per share in December and we are 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. First, the sale of our closed life insurance operation, Direct Line Life Insurance Company Limited (the "Life business"), and secondly, better than expected profit from the Run-off segment and the sale of Tracker. Due to the one-off nature of these items, the Board believes it is appropriate in this instance to return this capital to shareholders.

The Board considers that the Group is currently strongly capitalised with a risk-based capital coverage ratio at the upper end of its risk-based capital coverage target range and an 'A' rating with stable outlook from its credit rating agencies.

In determining this position, the Board has considered a number of factors that may positively and negatively affect the Group's capital position over the next 12 months. The Board will continue to review this position as clarity improves on these factors and the Group makes further progress with its transformation plan. More details can be found on page 42.

### Relationship with RBS Group

Our ongoing relationship with RBS Group is principally set out in two key agreements, the Relationship and Transitional Services Agreements. The Relationship Agreement sets out that Direct Line Group is to carry on its business independently of RBS Group and entitles RBS Group to nominate a Director for appointment to the Board. The agreement will terminate once RBS Group holds less than 20% of Direct Line Insurance Group plc (the "Company") shares. Under the Transitional Services Agreement, RBS Group will continue to provide IT and certain other services to Direct Line Group for a transitional period of up to 36 months following the IPO in October 2012.

Subsequent to the IPO, RBS Group undertook two further placings in 2013 of 551.6 million Ordinary Shares in the Company. These represented 36.8% of the total share capital and generated additional gross proceeds of £1,135.8 million for RBS Group. Following the placings, RBS Group's shareholding in the Company was 28.5%.

### Board changes and effectiveness

Following RBS Group's reduction in its shareholding in the Company to below 50%, and in accordance with the terms of the Relationship Agreement, Mark Catton stepped down from the Board on 26 April 2013. On 1 October 2013, Bruce Van Saun stepped down from the Board to focus on other projects for RBS Group and Mark Catton was reappointed. May I take this opportunity to thank Bruce for the insights and value he brought to the Board during his time as a Director. I would also like to extend this gratitude more generally to all of our Non-Executive Directors for their dedication to the Group.

The Board and its Committees undertook formal evaluations of their performance in 2013. The Company engaged the services of an external facilitator, who met with me as Chairman to agree the structure, scope and content of the evaluations. The individual Directors were subject to a review of their effectiveness and I have met with each Director to provide feedback on a one-to-one basis. Committee Chairs also received feedback on the performance of the Committees.

### Summary

I have been very impressed by the commitment of our employees whenever our customers need their support. In a challenging year, they have remained determined to help our customers get back on their feet after an accident or an event in their lives. The Group is only as good as its people and everyone has contributed to this success, and I would like to thank employees and senior management for everything that has been achieved in 2013.



Michael N Biggs, Chairman

#### Notes:

1. See note 1 on page 2
2. See note 3 on page 2
3. See note 2 on page 2
4. See note 5 on page 3