Group performance

Achieved our combined operating ratio[1] target of 98% and this contributed to a return on tangible equity[2] 16.0%, ahead of our long-term target of 15.0%.

Operating profit from ongoing operations[1] improved by 14.2% to £526.5 million (2012: £461.2 million) and COR[1] by 3.1 percentage points to 96.1% (2012: 99.2%). These were driven by an improved underwriting profit, including higher prior-year reserve releases of £435.1 million (2012: £322.0 million), and were partially offset by lower investment return and instalment and other income. A lower loss ratio[1], reflecting our continued choice to focus on value of business over volume and helped by pricing and claims efficiencies, together with lower costs contributed to the improved underwriting result and COR. Benefiting from the capital actions taken in 2012 and the improved operating performance, the Group achieved a RoTE for ongoing operations[2] of 16.0% (2012: 11.5% and pro forma[3] 13.4%). Total Group profit before tax delivered of £423.9 million (2012: £249.1 million).

Summary income statement

For the year ended 31 December	**2013 £m**	2012 £m
Ongoing operations[1]		
Gross written premium	**3,826.6**	3,990.6
Net earned premium	**3,520.6**	3,708.7
Underwriting profit	**138.2**	28.2
Instalment and other operating income	**180.2**	198.3
Investment return	**208.1**	234.7
Operating profit – ongoing operations[1]	**526.5**	461.2
Run-off segment	**63.6**	6.1
Restructuring and other one-off costs	**(140.5)**	(189.5)
Operating profit	**449.6**	277.8
Finance costs	**(37.7)**	(28.7)
Profit on disposal	**12.0**	–
Profit before tax	**423.9**	249.1
Adjusted earnings per share – diluted (pence)[4]	**25.0**	21.8
Basic earnings per share (pence)	**20.9**	12.3
Return on tangible equity – ongoing operations[2]	**16.0%**	11.5%
Pro forma return on tangible equity – ongoing operations[3]	**n/a**	13.4%
Return on equity – total Group	**11.1%**	5.7%

Ongoing operating profit by division[1]

For the year ended 31 December	**2013 £m**	2012 £m
Motor	**347.7**	261.8
Home	**106.2**	93.3
Rescue and other personal lines	**46.5**	84.4
Commercial	**9.5**	2.2
International	**16.6**	19.5
Total	**526.5**	461.2

Notes:
1. See note 1 on page 2
2. See note 3 on page 2
3. See note 4 on page 2
4. See note 6 on page 3

Personal lines

"UK Personal Lines delivered good results within a competitive market and a changing regulatory landscape. We continue to develop compelling customer propositions, deepen customer relationships and enhance our capability."

Tom Woolgrove, Managing Director of Personal Lines

Motor

Highlights

- Retained position as Britain's leading personal motor insurer with a 14% share of in-force policies[1]
- Improvement in risk selection and claims capability contributing to reserve releases and reduced loss ratio
- COR improved significantly by 8.4 percentage points
- Operating profit up 32.8%, despite significant reduction in other operating income
- Laid the foundations for DLG Legal Services

Performance highlights

	2013	2012
In-force policies (thousands)	**3,762**	4,050
Gross written premium	**£1,421.1m**	£1,623.5m
Loss ratio	**65.1%**	74.6%
Commission ratio	**2.5%**	2.0%
Expense ratio	**25.6%**	25.0%
Combined operating ratio	**93.2%**	101.6%
Operating profit	**£347.7m**	£261.8m

Market

In the UK, an economic recovery appears to have been taking hold, and it is expected to gather pace[2]. Consistent with this, car registrations recorded their highest monthly total for many years in September[3], while higher petrol prices are anticipated from oil price inflation.

The motor insurance market in the UK was again highly competitive, with another year of insurance premium deflation. PCW sales continue to rise and their media advertising remains high. Customers are shopping around more and there is a greater market focus towards retention and cross-selling products. There has also been a relatively benign claims experience during 2012 and 2013, alongside the positive effects of a series of government interventions to reduce the costs of bodily injury claims. In particular, a package of reforms, including the Legal Aid, Sentencing and Punishment of Offenders ("LASPO") Act measures and the banning of legal referral fees, were introduced during 2013.

These reforms are intended to reduce the average cost of bodily injury claims, largely due to lower legal costs. However, it is too early to say whether they will also have a material benefit in terms of the frequency of bodily injury claims. Furthermore, improved fraud detection capabilities are expected to help reduce false declarations of driving experience and convictions. Also, the FCA continues to review all aspects of conduct risk through a series of thematic reviews, including motor legal expenses insurance, which we, and our distribution partners, continue to engage with proactively.

Following the implementation of the EU Gender Directive, some young drivers, particularly males, have seen reductions in premiums. The growth of telematics has supported this, as drivers of all ages and genders are able to receive discounts. This follows installation of a device to their car or the download of a smartphone app, and the display of safer driving behaviour.

Performance

Given the highly competitive market, we continued to make choices to optimise value and prioritise underwriting margin over volume growth. Furthermore, the results reflected previous actions taken to reduce risk and manage claims costs, which together contributed to significant prior-year reserve releases. We have enhanced our pricing engines, delivered claims efficiencies and improved our customer propositions, including the roll-out of telematics propositions. These have helped to successfully manage the business through a period of regulatory change.

Gross written premium of £1,421.1 million fell 12.5% compared with 2012, as we maintained pricing discipline. Average premium per policy was down over the year by approximately 7% due to market competitiveness, the channel shift to PCWs and a reduction in risk mix, but also our focus on value and retaining customers. We seek to pass on lower premiums to customers based on our observed claims experience and during 2013 reduced motor prices by 3%. In-force policies were also slightly lower.

There was an improvement in underwriting result driven by the attritional loss ratio and reserve releases, as a result of actions taken on pricing and claims. These reserve releases, which were higher than expected, were driven by both small and large bodily injury claims. The expense ratio rose by 0.6 percentage points following reduced net earned premium, which more than offset the lower cost base. However, the significant improvement in the operating profit was partially offset by reduced other income, from the cessation of solicitors' referral fee income, and a lower investment return. In February 2014, the Group sold its stolen vehicle recovery business, Tracker. Operating loss from this business was £1.4 million in 2013.

Outlook

The UK motor market remained highly competitive in the first quarter of 2014 and gross written premium is expected to be approximately 10% lower than the same period in 2013. We continue to focus on protecting underwriting margins, rather than prioritise policy volumes. During 2014, we aim to develop initiatives to support our strategic priorities further including the rolling out of new customer websites, enhancing our trading capability, evolving our telematics-based propositions and continuing to evolve technical pricing sophistication.

Notes:

1. Direct Line Group including partner brands: RBS, NatWest, Nationwide, Prudential and Egg © GfK NOP Financial Research Survey (FRS) 6 months ending October 2013, 15,260 adults interviewed for motor insurance.
2. Bank of England
3. Society for Motor Manufacturers and Traders

Home

Highlights

- Retained position as one of Britain's largest home insurers with a 17% share of in-force policies[1]
- Continued to improve our technical pricing models, which contributed to increased retention in 2013
- Customer initiatives rolled out, such as the claims' home estimation tool
- Improvement in the COR by 2.8 percentage points to 93.8%, following fewer claims from major weather events

Performance highlights

	2013	2012
In-force policies (thousands)	**3,719**	4,239
Gross written premium	**£943.1m**	£989.0m
Loss ratio	**53.9%**	58.4%
Commission ratio	**19.6%**	16.2%
Expense ratio	**20.3%**	22.0%
Combined operating ratio	**93.8%**	96.6%
Operating profit	**£106.2m**	£93.3m

Market

The UK housing market remained flat for the majority of 2013, and ongoing limited mortgage availability has caused an increase in the number of people renting. Lower disposable incomes have also driven price sensitivity. However, there have been indications of a UK economic recovery.

Britain's home insurance market size has been stable, but become more competitive, with new business premiums reducing in the year[2]. PCWs' shares of sales are growing, albeit from a lower base than Motor, and have facilitated the growth of lesser known brands, as well as increasing price competitiveness. Retail banking distribution arms continue to review branch sales processes. Meanwhile, there is growth in the adoption of new technology by customers, including the use of mobile technology and online servicing. Providers are maximising customer value, increasing cross-selling activity and retention capabilities. A lack of mortgage demand has contributed to providers finding other routes to source new customers. In the flat housing market, the increase in the renter population is causing a decline in the demand for combined building and contents covers.

The Association of British Insurers ("**ABI**") and the UK Government arrived at the Flood Re solution, which is intended to ensure the availability of affordable home insurance in the highest flood risk affected parts of Britain. As with the motor market, the FCA continues to review all aspects of conduct risk through a series of thematic reviews, which we continue to engage with proactively.

Performance

The Home business experienced another strong result in 2013, which benefited from lower weather claims than 2012, despite the significant flooding and storm claims in December. Customer retention improved on last year as we optimised technical-pricing models. The product range was also rationalised from 30 products to three across the brand portfolio to simplify the customer proposition. The number of policies sold through the PCW channel increased by 8.0% on last year. Promising initial results have been experienced from the launch of the Home estimation tool, which allows more accurate assessment of claims to facilitate speedier claims adjustment and payment.

Gross written premium of £943.1 million declined by 4.6%, reflecting competitive market conditions. In-force policies fell by 12.3% since the start of the year, mainly as a result of the removal of Home Response[3] policies (around 420,000) from certain packaged bank accounts no longer sold through partners. Excluding this effect, the underlying in-force policies were broadly similar year-on-year.

The loss ratio improved, reflecting fewer claims from major weather events and continued reserve releases. On an underlying current-year attritional basis, it was in line with last year at 51.3%. The commission ratio rose due to profit-share payments reflecting higher profitability of partnership business, mainly as a result of the lower loss ratio. Underwriting profit improved on last year mainly due to the fewer claims from major weather events. The expense ratio improved by 1.7 percentage points due to cost improvements across the Group. Overall, operating profit improved by 13.8%, reflecting fewer major weather events across 2013 in the UK.

Outlook

In a competitive UK home market, we continue to focus on maintaining our underwriting performance through further pricing and claims initiatives. Adverse weather conditions experienced in the fourth quarter of 2013 have continued in the first quarter of 2014 resulting in further storm damage and severe flooding. While it is too early to assess with accuracy, the Group's preliminary estimate for the cost of Home claims from this event up to 22 February 2014 is in the range of £70 to £90 million. This compares to an expectation in an average year of £80 million of claims from major weather events.

Notes:

1. Direct Line Group including partner brands: RBS, NatWest, Nationwide, Prudential and Egg © GfK NOP Financial Research Survey (FRS) 6 months ending October 2013, 15,922 adults interviewed for home insurance.
2. Consumer Intelligence
3. Insurance policy giving customers access to vetted tradesmen for home emergencies and repairs.

Rescue and other personal lines

Highlights

- New customer Rescue propositions and refreshed Green Flag marketing campaigns
- Gross written premium broadly stable at £383.4 million reflected rise in direct sales offset by reduced cross sales
- Loss ratio increased and operating profit reduced due to the non-repeat of 2012 one-offs, primarily in the legacy creditor book
- Completed sale of the Life business for £62 million enabling payment of a special interim dividend

Performance highlights

	2013	2012
In-force policies (thousands)	**8,801**	9,431
Gross written premium	**£383.4m**	£389.8m
Loss ratio	**60.1%**	50.9%
Commission ratio	**7.5%**	6.0%
Expense ratio	**24.8%**	25.8%
Combined operating ratio	**92.4%**	82.7%
Operating profit	**£46.5m**	£84.4m

Market

The economic trends are the same as in the Motor and Home operating reviews.

The roadside assistance market is similarly showing signs of recovery, with the overall market size increasing. Three major providers, including Green Flag, account for the majority of the market and competition is increasing, with service and price being important aspects for customers. Products are bought direct from providers, as part of linked motor sales, as part of packaged bank accounts, and via PCWs.

The pet population and market penetration rates remain stable; however, average premiums have been rising. The premiums increase in recent years is due to higher claims severity, driven by treatment and drug advances, while price competition continues to increase. Insurance providers are focused on recommendations by, and distribution through, vets as an important channel to customers; however, PCW visits are gradually increasing. The travel insurance market has been stable, and characterised by high volumes and penetration rates, the latter being the uptake of insurance by travellers. Medical claims represent the largest component of claims severity and continue to grow, followed by cancellation claims. Distribution is moving away from travel agents and brokers, with travel insurance being offered through packaged bank accounts and PCWs.

Performance

We focused on new Rescue customer propositions and a refreshed marketing campaign, with Green Flag's one hour response commitment, which aimed to differentiate the brand. A positive contribution continued to be received from the pet insurance line, while the travel business experienced a loss due to increased claims frequencies from packaged bank accounts. In November, we completed the sale of the closed Life business for £62 million, and returned the proceeds of sale to shareholders by way of a special interim dividend in December.

Gross written premium of £383.4 million was broadly stable to last year. This reflected increased direct sales of Green Flag products offset by reduced linked sales. Pet gross written premium increased by 3.7% from rate increases and travel gross written premium decreased by 0.8% driven by volume decreases.

Underwriting profit reduced to £27.9 million from last year while the loss ratio increased 9.2 percentage points as 2012 benefited from positive one-offs relating to legacy creditor business. The expense ratio improved by 1.0 percentage point due to cost improvements across the Group, partially offset by increased Green Flag marketing costs. Overall, operating profit decreased to £46.5 million following the non-repeat of certain one-offs, primarily in the legacy creditor business, which benefited 2012. Of the total operating profit, £38.1 million was delivered by Rescue and £6.4 million by the closed Life business. The Rescue contribution was £9 million lower than in 2012, due to the increased marketing spend and the non-repeat of certain one-off items.

Outlook

Rescue and other personal lines continues to represent an opportunity to create value for the Group, and meet customers' broader insurance needs. Investment in distribution and propositions will support further contribution, offset by the disposal of the Life business, and lower Creditor premiums as the business runs off.

Commercial

"With a continued focus on the SME sector, we have improved our COR for the third year running. We are on track to achieve a sub-100% COR in 2014, helped by driving our efficiencies and delivering improvements in our underwriting."

Jon Greenwood, Managing Director of Commercial

Highlights

- Continued to grow in-force policies, particularly in Direct Line for Business
- Gross written premium up 8.9% to £474.5 million
- Continued roll-out of NIG's broker eTrading platform 'The Hub' to new products
- Continue to rationalise the back office, improve efficiency and streamline the operating model
- Improvement in operating profit of £7.3 million, despite adverse weather in the fourth quarter and a high level of large losses

Performance highlights

	2013	2012
In-force policies (thousands)	**583**	466
Gross written premium	**£474.5m**	£435.6m
Loss ratio	**62.3%**	63.1%
Commission ratio	**21.2%**	21.6%
Expense ratio	**23.3%**	23.5%
Combined operating ratio	**106.8%**	108.2%
Operating profit	**£9.5m**	£2.2m

Market

UK economic growth has continued to strengthen in 2013 and optimism is increasing about the general business situation. Interest rates remain at low levels, reducing investment returns. There has been some evidence of insurers exiting historically unprofitable business.

Insurers are also seeking to reduce costs and there have been instances of insurers reviewing their regional structures and branch networks. Furthermore, there is a desire for brokers and insurers to adopt e-trading solutions for SME and micro-sized businesses, in order to reduce costs and speed up the underwriting process.

Performance

We continued to grow in-force policies, particularly in Direct Line for Business. NIG's full cycle broker e-trading platform 'The Hub' continued to be rolled out across the year to new products. Where business has been migrated to the new platform, broker take up has been encouraging. We have established two online newspaper partnerships aimed towards small businesses and social media channels have been introduced to interact directly with customers. Proposition development continues to be a strength for Direct Line for Business, with a number of new initiatives launched. Furthermore, to streamline our operating model, we separated our trading and operational functions, and restructured the regional functions to enhance new business focus and improve efficiency.

Gross written premium increased by 8.9% compared to 2012 due to the transfer of the van business from the Motor division and growth in Direct Line for Business. In 2013, some components of the portfolio were de-risked.

The COR improved by 1.4% to 106.8%; however, when normalised for weather this would have been 103.7%, showing good progress towards the 2014 target. The loss ratio improved modestly by 0.8 percentage points to 62.3% despite higher than normal claims relating to weather events, the majority of which were in the fourth quarter, and a high level of large losses. We continued to experience reserve releases, similar to the level of 2012, but remain prudently reserved. An improvement in current-year loss ratio was led by an improvement in the underwriting profit of £3.5 million. A marginal improvement in the expense ratio of 0.3 percentage points reflected cost improvements across the Group. The regional restructure undertaken in Commercial was implemented in the second half of the year and is expected to deliver cost savings in 2014. Overall, operating profit increased by £7.3 million to £9.5 million for the year.

Outlook

Normalising the 2013 performance for claims from weather events, the division made progress towards its 2014 COR target of sub-100%. Actions taken during 2013 on pricing, risk selection and the cost base are expected to continue to flow through in 2014 and the division's target for this year is unchanged. This assumes a normal level of claims from weather-related events and large losses. Up to 22 February 2014, approximately £20 million of such claims have been received.

International

"The International division has continued to develop in line with our plans. We maintained profit in Italy and increased gross written premium in Germany, where profitability was affected by hailstorms."

Jamie Brown, Managing Director of International

Highlights

- In-force policies grew by 10.1% on 2012 and now exceed 1.6 million
- Gross written premium, in local currency, grew by 4.9% reflecting strong growth in Germany offset by a modest decline in Italy
- Loss ratio improved marginally by 0.8 percentage points despite £8 million of higher than normal hailstorm claims in Germany
- Implemented ClaimCenter in Italy and continue to evolve technology to deliver efficient digital platform

Performance highlights

	2013	2012
In-force policies (thousands)	**1,610**	1,462
Gross written premium	**£604.5m**	£552.7m
Loss ratio	**77.3%**	78.1%
Commission ratio	**15.8%**	12.1%
Expense ratio	**10.8%**	13.1%
Combined operating ratio	**103.9%**	103.3%
Operating profit	**£16.6m**	£19.5m

Market

Italy's economy continued to decline in 2013. In 2014, it is expected gradually to return to growth[1]. Household consumption is stagnant[1] and the number of new car registrations is declining[2]. The number of road accidents, injuries and deaths has contributed to a reduction of claims frequency, which has led to a decrease in average price of around 5%[3].

Recent insurance sector reforms, especially the ending of a requirement for policyholders to advise their insurer if they do not wish to renew their motor policies, together with the increase in PCWs, has increased the level of switching. This increases the potential market for Direct Line, while also increasing the number of our customers who shop around at renewal. Going forward, we expect growth in the number of customers accessing insurance products via smartphone and tablet devices.

The economic conditions in Germany are different, with the recovery continuing[4] and growth expected to rise slightly faster[4]. Household consumption continues to strengthen[4] and the number of registered vehicles is rising, while petrol costs decline[4]. Motor average premiums, which have risen over the previous two years, are expected to remain stable, taking account of claims inflation[5]. The severe hailstorms in June and July 2013 may result in increased average premiums.

In Italy, the use of telematics to collect information at the claims stage is already fairly extensive. As a consumer proposition it is continuing to develop. We have a number of pilots to understand how best to operate in this area. In Germany, the first introduction has recently occurred.

Performance

We continue to focus on extracting value from the Italian and German businesses. Growth arose from Germany where we benefited from positive market conditions allowing our efficient platform to enable us to grow our share of year-end business without significant additional cost. We remain cautious in Italy given the uncertain economic environment and competitive conditions. We implemented ClaimCenter in Italy and continue to evolve technology to deliver an efficient digital platform. Italy, Germany and the UK continued to share and leverage best practice, for example on claims processes and telematics.

In-force policies grew by 10.1% and gross written premium increased by 4.9% in local currency terms. These were driven by Germany where we expanded our share of business renewing on 1 January 2013. PCWs, while still small in both markets, continued to grow their share of new business. Direct Line is present on PCWs in both countries.

The COR remained broadly stable at 103.9%, with higher than normal hailstorm claims in Germany which resulted in a COR of 109.8%, offset by lower claims frequency in Italy with a COR of 101.6%. The loss ratio in Germany similarly reflects the £8 million of claims relating to the severe hailstorms. A higher commission ratio was attributable to a change in mix towards PCWs and partners. Total operating profit of £16.6 million was split £14.1 million from Italy and £2.5 million from Germany. Operating profit, in local currency, was €20.4 million a decrease of 16.7% on the previous year (2012: €24.5 million).

Outlook

In Italy, more competitive market conditions and increased customer switching during 2013 have lowered premium growth expectations for 2014. With this more cautious stance, we will continue to focus on creating value through improving operating and pricing efficiency. Germany has once again experienced a good start to the year, which has increased in-force policies to approximately 628,000 at the end of January 2014. Following average premium rate increases over the last two years, an increase in competition is now expected to place pressure on average premiums.

Notes:
1. Instituto Nazionale di Statistica
2. Automobile Club Italia
3. Associazione Nazionale fra le Imprese Assicuratrici
4. Bundesministerium der Finanzen
5. Gesamtverband der Deutschen Versicherungswirtschaft