This announcement contains inside information.

Direct Line Insurance Group plc

Trading update

18 July 2022

Direct Line Insurance Group plc ("the Group") is today providing an update on current trading and outlook.

Penny James, Chief Executive Officer, said:

"Today's trading update follows a period of heightened volatility across the UK motor insurance market, in which we have seen claims inflation in motor in the first half of 2022 spike above the levels assumed in our pricing. As a result, we are revising our combined operating ratio target range for 2022 to 96-98%.

We have already taken actions including increasing prices and deploying new pricing capability to restore margins, which mean we expect our 2023 combined operating ratio will improve to around 95% and we reiterate our medium-term target range of 93-95%.

This, combined with our diversified business model, our strong balance sheet and our continuing actions to further improve resilience, gives us confidence in the sustainability of our regular dividends for this year and as we look ahead."

Current trading

The motor insurance market experienced significant levels of severity inflation in H1, primarily resulting from higher used car prices, and amplified by higher third party claims costs, longer repair times and inflation in the cost of car parts. Market premium inflation has continued to lag the increases in claims inflation.

Whilst the Group has been pricing claims inflation over the last 12 months, experience has been in excess of the levels assumed. The Group now estimates overall motor claims severity inflation for 2022 of around 10%.

As a result, the H1 2022 current year motor loss ratio is now expected to be in the region of 86%. Due to conservative reserving during 2021, the Group's prior year reserve releases in the first half remain in line with expectations.

The Group's other business units are performing largely in line with expectations, demonstrating the benefit of the Group's diversified business model. Overall, the Group expects a combined operating ratio for the first half of 2022 of around 96.5%, normalised for weather, and gross written premium of approximately £1,520 million.

2022 outlook

The Group has taken action in the second quarter to restore margins through increased prices to reflect higher than expected claims inflation. In addition, the Group has recently launched an updated motor risk pricing model which it believes materially improves risk selection.

Given the higher current year loss ratio, the Group now expects the full year 2022 combined operating ratio to be in the range of 96% to 98%, normalised for weather.

Costs

The Group continues to target significant cost reductions across the business. In 2022, the Group expects to reduce operating expenses in absolute terms, despite market wide inflation, to between £690 million and £700 million. For 2023, the Group is targeting operating expenses in the region of £670 million. Given the increase in amortisation and market levies over the period this represents a £76 million (15%) reduction in controllable expenses from 2021 to 2023.

The Group continues to target a 20% expense ratio, but given the reduction in motor market average premiums since the target was set, predominantly driven by structurally lower claims frequency, it is now unlikely this will be achieved in 2023.

2023 combined operating ratio outlook and over the medium term

Following the trading actions already taken and continued strong cost control referred to above, the Group expects a combined operating ratio of around 95% for 2023 (normalised for weather) and to return to a target range of 93% to 95% over the medium term.

Investment return outlook

Recent rises in interest rates have increased the Group's yield outlook. Whilst the Group still expects 2022 net investment income yield to be around 1.7%, based on current reinvestment rates and maturity profile it expects this to increase to around 2.2% in 2023.

Dividend and capital management

The Group believes its balance sheet and outlook for capital generation in the medium term remains strong due to pricing and operational improvements arising from the Group's transformation programme.

In the first half of 2022, the solvency capital ratio has reduced by an estimated 7 percentage points due to the mark to market effect of widening credit spreads on the Group's investment portfolio, albeit this is expected to pull to par over time. Based on this and other movements in the first half of the year, the Group estimates a solvency capital ratio at 30 June of around 150% assuming an unchanged interim dividend of 7.6 pence per share.

The Board understands the importance of the regular dividend to shareholders and notes that the current solvency ratio is comfortably within the risk appetite range of 140% to 180%. The Group is confident in the sustainability of its regular dividends and is continuing to take action to both improve returns and further increase resilience given macro-economic uncertainty, including reducing credit exposure and, as previously disclosed, is considering the use of strategic reinsurance.

In the light of the current market environment, the Board has decided not to launch the second £50 million tranche of the £100 million share buyback programme announced earlier in the year.

The Group will publish its 2022 half year report on Tuesday 2 August.

The person responsible for arranging for the release of this announcement on behalf of the Company is Neil Manser, Chief Financial Officer.

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Forward-looking statements disclaimer

Certain information contained in this document, including any information as to the Group's strategy, plans or future financial or operating performance, constitutes "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "aims", "ambition", "anticipates", "aspire", "believes", "continue", "could", "estimates", "expects", "guidance", "intends", "may", "mission", "outlook", "over the medium term", "plans", "predicts", "projects", "propositions", "seeks", "should", "strategy", "targets", "will" or "would" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in several places throughout this document and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, among other things: the Group's results of operations, financial condition, prospects, growth, strategies, the industry in which the Group operates and the Group's approach to climate-related matters. Examples of forward-looking statements include financial targets which are contained in this document specifically with respect to; return on tangible equity, solvency capital ratio, combined operating ratio, percentage targets for current-year contribution to operating profit, prior-year reserve releases, cost reductions, reduction in expense ratio, investment income yield, net realised and unrealised gains, capital expenditure and, risk appetite range; and targets, goals and plans relating to climate and the Group's approach and strategy in connection with climate-related risks and opportunities. By their nature, all forward-looking statements involve risk and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future and/or are beyond the Group's control and/or they rely on assumptions that may or may not transpire to be correct. Forward-looking statements are not guaranteeing future performance.

The Group's actual results of operations, financial condition and the development of the business sector in which the Group operates may differ materially from those suggested by the forward-looking statements contained in this document, for example directly or indirectly as a result of, but not limited to:

- United Kingdom ("**UK**") domestic and global economic business conditions;
- the direct and indirect impacts and implications of the coronavirus Covid-19 pandemic on the economy, nationally and internationally, on the Group, its operations and prospects, and on the Group’s customers and their behaviours and expectations;
- the Trade and Cooperation Agreement between the UK and the European Union ("**EU**") regarding the terms, following the end of the Brexit transition period, of the trading relationships between the UK and the EU and its implementation, and any subsequent trading and other relationship arrangements between the UK and the EU and their implementation;
- the terms of trading and other relationships between the UK and other countries following Brexit;
- the impact of the FCA pricing practices report and the rules and regulations arising as a result of that report and of responses by insurers, customers and other third parties and of interpretations of such rules by any relevant regulatory authority;
- market-related risks such as fluctuations in interest rates, exchange rates and credit spreads, including those created or exacerbated by the Russian invasion of Ukraine;
- the policies and actions and/or new principles, rules and/or changes to, or changes to interpretations of principles, rules and/or regulations, of regulatory authorities and bodies (including changes made directly or indirectly as a result of Brexit or related to capital and solvency requirements or related to the Ogden discount rate or rates or made in response to the Covid-19 pandemic and its impact on the economy and customers) and changes to law and/or understandings of law and/or legal interpretation following the decisions and judgements of courts;
- the impact of competition, currency changes, inflation and deflation;

- the timing, impact and other uncertainties of future acquisitions, disposals, partnership arrangements, joint ventures or combinations within relevant industries; and
- the impact of tax and other legislation and other regulation and of regulator expectations, interventions, enforcements, fines and requirements and of court, arbitration, regulatory or ombudsman decisions, judgements and awards (including in any of the foregoing in connection with the Covid-19 pandemic) in the jurisdictions in which the Group and its affiliates operate.

In addition, even if the Group's actual results of operations, financial condition and the development of the business sector in which the Group operates are consistent with forward-looking statements contained in this document, those results or developments may not be indicative of results or developments in subsequent periods.

The forward-looking statements contained in this document reflect knowledge and information available as of the date of preparation of this document. The Group and the Directors expressly disclaim any obligations or undertaking to update or revise publicly any forward-looking statements, whether because of new information, future events or otherwise, unless required to do so by applicable law or regulation. Nothing in this document constitutes or should be construed as a profit forecast.

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