MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Direct Line's IFSR at A1, stable outlook

27 April 2022

London, April 27, 2022 - Moody's Investors Service (Moody's) has today affirmed the A1 insurance financial strength rating (IFSR) on U K Insurance Limited (UKI) – the main operating subsidiary of Direct Line Insurance Group plc (DLG or Group) and the A3 (hyb) rating on the backed subordinated debt issued by DLG. The outlook remains stable.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The rating affirmation reflects DLG's (1) consistently strong return on capital and underwriting results; (2) strong position in the UK personal lines general insurance market; (3) conservative investment portfolio and low financial leverage. These very good financial fundamentals more than offset the Group's limited geographic diversity and dependence on the very competitive, highly regulated and dynamic UK personal motor and home insurance markets, which has contributed to the contraction in DLG's premiums base over the past five years.

DLG's performance has been strong with a five-year average (2021-2017) return on capital (ROC) ratio of 11% and a reported 91% combined ratio (COR) for the same period. The rating agency expects the Group to continue to meet its 93-95% COR and 15% return on tangible equity targets, notwithstanding the adverse impact of the Financial Conduct Regulator's Pricing Practice Reforms (PPR) in the motor and home segments. More positively, the Group's post tax-profit will benefit from lower restructuring costs, as DLG continues the roll-out of its technology and business transformation programs.

From a market position perspective, Moody's expects DLG to remain one of the leading personal lines general insurers in the UK with a growing commercial business focused on small-to-medium enterprises. The rating agency expects the Group's premiums to remain broadly flat in 2022 as growth in commercial is offset by a decline in personal lines - impacted by PPR. This follows a 7% reduction in gross written premiums to £3.2 billion over the last five years.

Beyond 2022, Moody's expects the Group to report premium growth as DLG utilises its new digital platforms and tech-enabled underwriting capabilities. DLG's partnership with Motability Operations Ltd will also expand the Group's motor customer base by around 15% from 2023, whilst adding further scale to DLG's claims management service.

Regarding the other financial fundamentals, the rating agency considers DLG's financial flexibility as very good. Adjusted financial leverage as at the year ended 31 December 2021 (YE2021) stood at 19% with earnings coverage remaining very strong at 12x over the past five years. Leverage will fall slightly during 2022 following the redemption of the remaining £250 million guaranteed Tier 2 subordinated notes to around 15% after taking into account the final dividend and 2022 share buyback program.

The A1 IFS rating and stable outlook also incorporate Moody's expectation that DLG's regulatory solvency ratio will reduce towards the mid-point of the Group's target range of 140%-180% following the Tier 2 debt repayment, from 176% (post dividend and planned share buybacks) as at YE2021.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Positive rating pressure could arise from a combination of: 1) enhanced capital adequacy with gross underwriting leverage below 2x and Solvency II coverage above 200%; 2) average ROC (Moody's definition) through the cycle above 15% and a reported combined ratio consistently around 90%; 3) adjusted financial leverage consistently below 10%; and 4) continued profitable development of non-motor businesses.

Conversely, negative rating pressure could arise from: 1) a material reduction in premiums resulting in a material loss of market share; 2) average return on capital through the cycle below 8%; 3) adjusted financial leverage in excess of 25% with earnings coverage below 8x; and/or 4) meaningful deterioration in capital adequacy as reflected in the Group's Solvency II ratio falling sustainably below 160%.

LIST OF AFFECTED RATINGS

U K Insurance Limited:

..Affirmation:

Insurance financial strength rating, affirmed at A1

..Outlook Action:

Outlook remains Stable

Direct Line Insurance Group plc:

..Affirmation:

Backed subordinated debt rating, affirmed at A3 (hyb)

Subordinated debt rating, affirmed at Baa1 (hyb)

Preferred Stock Non-cumulative, affirmed at Baa3 (hyb)

..Outlook Action:

Outlook remains Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Property and Casualty Insurers Methodology published in September 2021 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1254163. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody’s key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody’s Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody’s Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody’s general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288235.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody’s affiliates outside the EU and is endorsed by Moody’s Deutschland GmbH, An der Welle 5, Frankfurt am Main 60322, Germany, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody’s office that issued the credit rating is available on www.moodys.com.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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