



**Direct Line Insurance Group plc**  
**Preliminary results for the year ended 31 December 2012**

**28 February 2013**

**Financial highlights**

- 9.3% increase in operating profit from ongoing operations<sup>1</sup> to £461.2 million with all five divisions profitable in 2012
- Return to underwriting profit with a combined operating ratio<sup>2</sup> of 99.2%, an improvement of 2.6 percentage points
- Return on tangible equity<sup>3</sup> of 11.5% and pro forma return on tangible equity<sup>3</sup> of 13.4%
- Final dividend of 8 pence per share, implying a pro forma annual payout of 55% of post-tax earnings from ongoing operations. From 2013, aim to raise the dividend annually in real terms

**Strategic highlights**

- Good progress made towards achieving 15% return on tangible equity target
- New and extended major partnership agreements and expanded presence of Churchill and Privilege to the four major UK price comparison websites
- Delivered benefits through claims and pricing transformation plans contributing to a 3.1 percentage point improvement in the loss ratio to 67.1%
- Announced plans relating to 70% of £100 million gross annual cost saving target with advanced plans for remainder of the proposed savings
- Improved balance sheet efficiency by raising £500 million of long-term subordinated debt and paying £1 billion of dividends to RBS Group pre-IPO. Capital position remains strong with risk based capital coverage of 145% post-final dividend

**Paul Geddes, CEO of Direct Line Group, commented**

"We have made good progress since the beginning of our transformation plan and our 2012 performance is further evidence that we have made the right strategic decisions and are executing our plans well, with an increase in operating profit from ongoing operations of 9.3% to £461.2 million.

"However, there is no room for complacency as we face a competitive market, particularly in UK motor, where there are also expected to be significant legal reforms. Our transformation plans target further benefits and we have made substantial progress on our target to achieve £100 million of gross annual cost savings in 2014. We will maintain our firm focus on value and underwriting discipline, consistent with achieving our 98% combined operating ratio target for 2013."

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Notes:

1 Ongoing operations

Ongoing operations include Direct Line Group's (the "Group") ongoing segments: Motor, Home, Rescue and other personal lines, Commercial and International. It excludes Run-off and Restructuring and other one-off costs.

2 Combined operating ratio

Combined operating ratio ("COR") is the sum of net insurance claims, commission and other operating expenses expressed as a percentage of net earned premium. The ratio excludes instalment income, other operating income and investment income.

3 Return on tangible equity ("RoTE")

Return on tangible equity is adjusted profit after tax, from ongoing operations, divided by the Group's average tangible shareholders' equity. Profit after tax is adjusted to exclude Run-off operations and Restructuring and other one-off costs and is stated after charging tax (using the UK standard tax rate). Pro forma RoTE is based on RoTE but assumes that the capital actions taken by the Group (£1 billion dividend payment and £500 million long-term subordinated debt issue) occurred on 1 January 2012.

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### Forward-looking statements

Certain information contained in this announcement including any information as to the Group's strategy, plans or future financial or operating performance constitute "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "aims", "anticipates", "believes", "estimates", "expects", "intends", "may", "plans", "predicts", "projects", "seeks", "should", "targets" or "will" 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 a number of places throughout this announcement and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, amongst other things: the Group's results of operations, financial condition, prospects, growth, strategies and the industry in which the Group operates. Examples of forward-looking statements include financial targets which are contained in this announcement specifically with respect to RoTE, the Group's COR, the COR for the Group's Commercial business, and cost savings.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future or are beyond the Group's control. Forward-looking statements are not guarantees of 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 announcement, including but not limited to, UK domestic and global economic business conditions, market-related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory authorities (including changes related to capital and solvency requirements or the Ogden discount rate), the impact of competition, currency changes, inflation, deflation, the timing impact and other uncertainties of future acquisitions or combinations within relevant industries, as well as the impact of tax and other legislation and other regulation 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 the 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 announcement speak only as of the date of this announcement. The Group expressly disclaims any obligations or undertaking to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, unless required to do so by applicable law, regulation or accounting standard, or the Listing Rules or the Disclosure and Transparency Rules of the Financial Services Authority ("FSA"). Nothing in this announcement should be construed as a profit forecast.

## Financial summary

	Quarter ended 31 December		Year ended 31 December	
	2012 £m	2011 £m	2012 £m	2011 £m
Gross written premium - ongoing operations	905.4	951.3	3,990.6	4,124.9
Net earned premium - ongoing operations	918.4	964.1	3,708.7	3,890.9
Underwriting profit/(loss)	19.8	(16.9)	28.2	(72.3)
Instalment and other income	51.5	57.7	198.3	255.5
Investment return	42.0	43.3	234.7	238.7
<b>Operating profit – ongoing operations</b>	<b>113.3</b>	<b>84.1</b>	<b>461.2</b>	<b>421.9</b>
Run-off	7.9	(12.4)	6.1	(23.9)
Restructuring and other one-off costs	(52.6)	(23.4)	(189.5)	(54.0)
<b>Operating profit</b>	<b>68.6</b>	<b>48.3</b>	<b>277.8</b>	<b>344.0</b>
Finance and other costs	(8.4)	(0.6)	(28.7)	(1.1)
<b>Profit before tax</b>	<b>60.2</b>	<b>47.7</b>	<b>249.1</b>	<b>342.9</b>
Tax charge	(17.7)	(22.0)	(64.8)	(93.9)
<b>Profit for the year</b>	<b>42.5</b>	<b>25.7</b>	<b>184.3</b>	<b>249.0</b>
Of which ongoing operations <sup>1</sup>	<b>79.2</b>	<b>61.4</b>	<b>326.5</b>	<b>308.1</b>
<b>Key metrics</b>				
Loss ratio	66.9%	61.1%	67.1%	70.2%
Commission ratio	10.5%	17.5%	9.1%	10.1%
Expense ratio	20.5%	22.8%	23.0%	21.5%
Combined operating ratio	97.9%	101.4%	99.2%	101.8%
Investment income yield	1.8%	2.1%	2.0%	2.3%
Investment return	1.9%	1.7%	2.8%	2.6%
Basic earnings per share (pence)			12.3	16.6
Adjusted earnings per share (pence) <sup>2</sup>			21.8	20.5
Return on tangible equity			11.5%	10.0%
Pro forma return on tangible equity			13.4%	n/a
Net asset value per share (pence)			189.1	240.9
Tangible net asset value per share (pence)			161.0	216.5

<sup>1</sup> Excludes Run-off operations and Restructuring and other one-off costs (using UK standard tax rate)

<sup>2</sup> Adjusted to exclude Run-off operations and Restructuring and other one-off costs and based on weighted average number of ordinary shares in issue during the period (using UK standard tax rate)

## Chief Executive Officer's review

### Overview of financial performance

We have made good progress against our business transformation plan and delivered an operating profit from ongoing operations of £461.2 million for 2012, an increase of 9.3% compared to 2011 (£421.9 million). All divisions were profitable in 2012 and on a pro forma basis the return on tangible equity was 13.4%.

### The Group's transformation plan

In the midst of tough economic and competitive conditions, we have delivered a clear turnaround in performance, most visibly a £667 million improvement in operating profit from ongoing operations since 2010. We have maintained a focus on underwriting for profit by methodically reducing our level of risk, taking stringent steps to improve our pricing capability, and exiting lines of business that have proven unprofitable.

Since the beginning of our transformation plan in 2010, we have taken action to improve our capital efficiency and to benefit from our scale by consolidating four underwriting entities into one, U K Insurance Limited. We received an 'A' credit rating from Standard & Poor's and an 'A2' credit rating from Moody's, issued £500 million of long-term subordinated debt and prior to the IPO returned £1 billion in dividends to RBS Group.

As a result of these actions, we have strengthened and improved our business, making good progress towards achieving our strategic targets.

With the first part of our transformation plan, to return to profit, complete, we have redefined our strategic plan through five key pillars: distribution, pricing, claims, costs, and Commercial and International.

**Distribution:** We renewed existing strategic partnerships, including Nationwide and RBS Group, and secured new ones, notably Sainsbury's Bank. We also launched our Churchill and Privilege motor and home products on comparethemarket.com, which means we have a presence on the four major UK price comparison websites ("PCWs").

**Pricing:** Since 2010, we have de-risked the motor portfolio and re-priced to reflect the risk and cost of bodily injury claims, particularly with younger drivers and certain postcodes. We built capability through implementing a new pricing model and rating engine across the Motor and Home divisions, contributing to significant improvements in our loss ratio performance.

**Claims:** We have undergone a significant transformation in our claims function, including a strategic investment in a new claims system, ClaimCenter, which is now operational for the majority of new Motor and Home claims. The benefits are being realised through improved claims processes, including shorter settlement times for customers and improved legal case management.

**Costs:** The first phase of our cost reduction programme focused on our operational cost base. We reduced the number of our sites from 32 locations to 16 and delivered 15% efficiency savings across the UK. In August 2012, we announced the target of gross annual cost savings of £100 million in 2014. To date we have announced plans relating to 70% of the target with advanced plans for the remaining savings.

**Commercial and International:** We are working towards reducing our costs and improving operational efficiency in Commercial, targeting a COR below 100% in 2014. In International, we are leveraging our UK expertise in pricing and claims as well as driving through operational efficiencies to produce returns consistent with our strong market position as a leading direct motor insurer in both Italy and Germany.

### **Priorities for 2013**

During 2013 we aim to make progress towards delivering the strategic financial targets we set out at the time of the IPO. In particular, we aim to deliver a 98% combined operating ratio in 2013 and to make progress towards our £100 million gross annual cost savings target.

We aim to achieve this by, for example, deploying the capability built in our pricing and claims functions over the last couple of years and, in 2013, we aim to supplement this by prioritising our distribution and cost initiatives.

To enhance our distribution, we are already fine-tuning our propositions with the implementation of new offers and pricing structures adapted to the evolving needs of our customers. We will continually monitor the business to ensure we are addressing the needs of our customers, the competitiveness of the markets in which we operate, the engagement of our staff and the returns expected by our shareholders.

### **Separation from RBS Group**

Following the implementation of a comprehensive programme of initiatives, we are now operating on a substantially standalone basis from RBS Group. These initiatives included appointing the Direct Line Group Board of Directors, harmonising employee service contracts, developing a standalone risk and compliance department, and agreeing an arm's length Transitional Service Agreement ("TSA") with RBS Group for residual services. We have also recently appointed Capgemini to support the migration of our IT as well as to design, deliver and run a new IT infrastructure to support the business.

### **Listing on the London Stock Exchange**

In October, we successfully completed our IPO on the London Stock Exchange. RBS Group sold 520.8 million ordinary shares in Direct Line Group, representing 35% of our issued share capital, generating gross proceeds of £911 million for RBS Group. In December, Direct Line Group became a constituent of the FTSE 250 Index.

### **Regulatory environment**

We are operating in an industry that is preparing for substantial regulatory change. With the ongoing debates in the motor market surrounding referral and legal fees, the increase in whiplash claims and the implementation of the gender directive, we aim to be leaders through this period of change and lobby for reform to provide the best outcome for our customers and shareholders.

### **Outlook**

The UK personal lines market remains competitive. In this environment, the Group will continue its strategy of disciplined underwriting that prioritises maintaining margin over volume. We expect to see improvements to the loss ratio in 2013 as investments in pricing and claims capabilities, together with the improved risk profile of the underwriting portfolio, especially in Motor and Commercial, are recognised. In 2014 we expect to have delivered the £100 million gross annual cost savings and we will continue to look at our expense base as market conditions evolve. Overall we continue to target a 98% COR for ongoing operations in 2013.

The UK motor market is expected to remain particularly competitive during 2013. The full effect of the move to gender neutral pricing, the package of upcoming legal reforms and the referral of the UK motor insurance market to the Competition Commission are still to be felt. We support the direction of the overall package of the legal reforms and continue to engage proactively with key stakeholders. Overall we believe that, taken together, the effect of the package of civil justice reforms should be at least 'net neutral' for the Group in the medium term. However, there remains considerable uncertainty about the details and timing of the reforms. We will continue to prepare for a range of outcomes.

Investment markets remain tough with continued low reinvestment yields and therefore, within our risk appetite, we are planning various actions intended to mitigate pressures on investment returns. We will continue to invest in the business with the objective of both sustaining our leadership position and meeting our 15% return on tangible equity target.

We have made great strides since the beginning of our transformation journey in 2010. I am extremely grateful for the hard work, dedication and expertise demonstrated by our people, and I am excited about developing the business even further for the next phase of our journey.

## Finance review

In 2012 the Group demonstrated good earnings momentum coupled with active capital management. We aim to continue to focus on producing strong, sustainable returns for shareholders.

### Operating profit – ongoing operations

Operating profit	Quarter ended 31 December		Year ended 31 December	
	2012 £m	2011 £m	2012 £m	2011 £m
Underwriting profit/(loss)	19.8	(16.9)	28.2	(72.3)
Instalment and other operating income	51.5	57.7	198.3	255.5
Investment return	42.0	43.3	234.7	238.7
<b>Operating profit</b>	<b>113.3</b>	<b>84.1</b>	<b>461.2</b>	<b>421.9</b>

Overall operating profit from ongoing operations of £461.2 million was a 9.3% increase on 2011 (2011: £421.9 million). A significant improvement in the underwriting result, primarily relating to pricing actions, improvements to risk mix and the Group's claims transformation plan, was more than offset by lower instalment and other operating income. Investment return was broadly in line with 2011 and was supported by higher realised investment gains.

In the fourth quarter of 2012, operating profit from ongoing operations increased by 34.7% to £113.3 million driven primarily by an improvement in underwriting result.

### In-force policies and gross written premium

In-force policies (thousands)	At 31 December	
	2012	2011
Motor	4,050	4,107
Home	4,239	4,308
Rescue and other personal lines	9,431	9,151
Commercial	466	422
International	1,462	1,387
<b>Total</b>	<b>19,648</b>	<b>19,375</b>

In-force policies for ongoing operations increased by 1.4% during 2012 to 19.6 million. The increase related primarily to Rescue and other personal lines and arose mainly from travel policies from packaged bank accounts. Motor and Home in-force policies were broadly stable during the period.

Commercial continued to grow in-force policies through Direct Line for Business ("DL4B") which focuses on small and medium enterprises and micro businesses. After a period of strong growth in 2011, International's growth rate slowed to 5.4% with growth coming from both the Italian and German operations.

Gross written premium	Quarter ended		Year ended	
	31 December		31 December	
	2012	2011	2012	2011
	£m	£m	£m	£m
Motor	341.8	396.9	1,623.5	1,734.8
Home	237.6	253.4	989.0	1,031.3
Rescue and other personal lines	86.5	51.0	389.8	350.2
Commercial	102.1	105.8	435.6	438.6
International	137.4	144.2	552.7	570.0
<b>Total</b>	<b>905.4</b>	<b>951.3</b>	<b>3,990.6</b>	<b>4,124.9</b>

Gross written premiums of £3,990.6 million fell 3.3% compared with the prior year (2011: £4,124.9 million). This was predominantly driven by Motor, due to the full year effect of de-risking the portfolio in 2011 and a continued focus on disciplined underwriting. Home gross written premium fell 4.1% compared with 2011, due primarily to increased competition for new business volumes.

Gross written premium for Commercial was broadly flat, reflecting the growth of lower average premium business through DL4B, partially offset by the exit of a number of unprofitable schemes.

International gross written premium of £552.7 million was 3.0% lower than the previous year (2011: £570.0 million) as a result of adverse exchange rate movements during 2012. Gross written premium in local currency terms increased by 3.9%, broadly in line with the increase in in-force policies.

Gross written premiums of £905.4 million in the fourth quarter fell 4.8% compared to 2011 (2011: £951.3 million). Reductions in Motor and Home were partially offset by higher premium in Rescue and other personal lines.

### Underwriting profit

Combined operating ratio	Year ended	
	31 December	
	2012	2011
	£m	£m
Loss ratio	67.1%	70.2%
Commission ratio	9.1%	10.1%
Expense ratio	23.0%	21.5%
<b>Combined operating ratio</b>	<b>99.2%</b>	<b>101.8%</b>

The Group's COR improved by 2.6 percentage points to 99.2% (2011: 101.8%) resulting in an increase in underwriting result to £28.2 million (2011: loss of £72.3 million). This was primarily the result of a 3.1 percentage point improvement in the loss ratio, reflecting actions taken to improve risk selection and the implementation of the claims transformation programme. In addition, a lower commission ratio reflected the non-repeat of a payment made to RBS Group in 2011 under a historic profit share arrangement. Offsetting these improvements was a modest increase in the expense ratio as a result of lower net earned premium and a number of one-off items. These included an increase in the final recharge from RBS Group in the first half of the year and parallel running costs reflecting the build-out of corporate functions prior to separation from RBS Group on 1 July 2012.



The improvement in the loss ratio was despite the wettest year in England and the second wettest in the UK since records began and a number of larger than normal fire claims in Commercial in the first half of 2012. Claims relating to weather events in Home totalled £105 million (2011: £20 million) and were £25 million more than would be expected in a normal year.

Prior year reserve releases increased to £322.0 million (2011: £188.8 million) equivalent to 8.7% of net earned premium (2011: 4.9% of net earned premium).

<b>Current year attritional loss ratio</b>	<b>Year ended 31 December</b>	
	<b>2012</b>	<b>2011</b>
Reported loss ratio	<b>67.1%</b>	70.2%
Prior year reserve releases	<b>8.7%</b>	4.9%
Weather events – Home	<b>(2.8%)</b>	(0.5%)
<b>Current year attritional loss ratio</b>	<b>73.0%</b>	<b>74.6%</b>

The Group views the current year attritional loss ratio as a good indicator of underlying performance as it excludes prior year reserve movements and claims from weather events in the Home division.

Overall the current year attritional loss ratio reduced by 1.6 percentage points in 2012 reflecting progress made in improving the underlying performance of the Group.

<b>Combined operating ratio: divisional analysis</b>	<b>Reported basis Year ended 31 December</b>		<b>Current year basis Year ended 31 December</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Motor	<b>101.6%</b>	105.6%	<b>112.3%</b>	113.4%
Home	<b>96.6%</b>	95.1%	<b>100.5%</b>	90.1%
Rescue and other personal lines	<b>82.7%</b>	86.3%	<b>88.9%</b>	99.8%
Commercial	<b>108.2%</b>	112.3%	<b>122.2%</b>	122.1%
International	<b>103.3%</b>	107.6%	<b>112.1%</b>	109.8%
<b>Total</b>	<b>99.2%</b>	<b>101.8%</b>	<b>107.9%</b>	<b>106.7%</b>

The COR improved in all divisions compared with 2011, with the exception of Home which was impacted by worse than average claims from weather events.

In Motor, the 4.0 percentage point improvement in COR reflects management actions to improve the risk profile of the book as well as higher releases of reserves from prior years. These releases were driven by favourable bodily injury experience for recent accident years partly attributable to improved pricing, better risk selection and benefits arising from the Group's claims transformation programme. Following these actions, inflation rates for small bodily injury claims continue to be favourable relative to actuarial expectations.

The Home COR of 96.6% was 1.5 percentage points higher than full year 2011 as a result of a number of offsetting items. Overall the Home loss ratio was stable with higher weather related claims being offset by reserve releases from prior years. The attritional current year loss ratio was broadly in line with 2011. In the fourth quarter of 2012, the Group reduced its estimate for claims arising from weather events in the first three quarters of the year. The expense ratio was higher reflecting the trends seen at the Group level.

The Rescue and other personal lines COR improved by 3.6 percentage points compared to 2011, driven by a reduction in the commission ratio following the non-repeat of a profit commission payment in 2011. The 2012 result continued to benefit from prior year reserve releases related to the run-off of the legacy creditor book. Future results of the division are not expected to benefit from similar reserve releases.

The Commercial COR improved by 4.1 percentage points to 108.2% for 2012. This was driven by a reduction in the expense ratio together with loss ratio improvements. The improvements in loss ratio reflect underwriting actions taken to improve attritional performance as well as the continued release of prior year reserves. This was partially offset by a number of larger than normal fire claims in the first half of 2012.

International's COR improved by 4.3 percentage points compared with 2011 as a result of an improved loss ratio reflecting reserve releases from prior years, particularly in respect of large bodily injury claims in Italy. An improved expense ratio, partly reflecting higher reinsurance commissions received in 2012, was offset by a higher commission ratio attributable to a change in mix towards PCW and partnership business.

Prior year reserve releases/(additions)	Year ended	
	31 December	
	2012	2011
	£m	£m
Motor	174.3	138.2
Home	37.4	(48.5)
Rescue and other personal lines	23.9	52.8
Commercial	56.2	38.4
International	30.2	7.9
<b>Total</b>	<b>322.0</b>	<b>188.8</b>

In total, prior year releases of £322.0 million (2011: £188.8 million) reflected positive run-off across the ongoing portfolio.

#### Operating expenses

	Half year ended		Year ended	
	31 December	30 June	31 December	31 December
	2012	2012	2012	2011
	£m	£m	£m	£m
Staff costs	156.8	156.0	312.8	288.6
Marketing	82.4	120.7	203.1	203.5
Management fees	-	129.2	129.2	240.0
Depreciation	8.2	4.9	13.1	10.4
Amortisation and impairment of other intangible assets	26.4	14.3	40.7	29.8
Other operating expenses	109.2	46.7	155.9	65.3
<b>Total operating expenses</b>	<b>383.0</b>	<b>471.8</b>	<b>854.8</b>	<b>837.6</b>

The expense ratio increased by 1.5 percentage points to 23.0% due to lower net earned premium and a modest increase in operating expenses.

Ongoing operating expenses of £854.8 million rose by £17.2 million from the prior year (2011: £837.6 million), with the increase principally driven by a number of one-off items including an increase in the final recharge from RBS Group in the first half of 2012 and parallel running costs reflecting the establishment of corporate functions prior to separation from RBS Group on 1 July 2012.

From 1 July 2012 the Group no longer paid a recharge to RBS Group and this was replaced by directly paying third party suppliers for the majority of services previously provided by RBS Group. Consequently, expenses previously reported under management fees are now reflected within their relevant line items. The Group continues to pay RBS Group for transitional IT infrastructure, the costs of which are included within other operating expenses.

Staff costs and other operating expenses increased in 2012 as a direct result of separation from RBS Group, whereas RBS Group management fees fell by 46.2%, all of which were incurred in the first half of 2012.

Operating expenses including claims handling costs increased by 0.5% to £1,145.1 million. The Group is targeting gross annual savings of £100 million in costs and claims handling expenses in 2014 relative to the level in 2011 (2011: £1,134.0 million). Savings associated with this plan are expected to begin to be recognised in 2013.

### Instalment and other operating income

	Year ended 31 December	
	2012	2011
	£m	£m
Instalment income	125.4	138.5
Other operating income	72.9	117.0
<b>Instalment and other operating income – ongoing</b>	<b>198.3</b>	<b>255.5</b>
TPF tariff income (non-repeatable)	-	(21.9)
<b>Underlying instalment and other operating income</b>	<b>198.3</b>	<b>233.6</b>

Instalment and other operating income from ongoing operations reduced by 22.4% primarily as a result of the cessation of fee income in Motor relating to managing certain elements of the run-off of Tesco Personal Finance ("TPF") business. All policies relating to TPF have now expired and this income will not be repeated. On an underlying basis, instalment and other operating income fell 15.1%.

Instalment income of £125.4 million reduced by £13.1 million compared to prior year (2011: £138.5 million) as a result of lower average in-force policies during 2012 and changes to risk mix from previous years. Penetration rates for instalment income remain good.

### Breakdown of underlying other income

	Year ended 31 December	
	2012	2011
	£m	£m
Solicitors' referral fee income	21.1	27.9
Vehicle replacement referral income	17.2	21.9
Revenue from vehicle recovery and repair services	25.9	39.3
Fee income from insurance intermediary services	1.9	3.4
Other income	6.8	2.6
<b>Underlying other income</b>	<b>72.9</b>	<b>95.1</b>
TPF tariff income (non-repeatable)	-	21.9
<b>Other operating income</b>	<b>72.9</b>	<b>117.0</b>

Reductions in solicitors' referral fee income and vehicle replacement referral income have primarily reflected a reduction in non-fault claims volumes. This reflects reduced accident frequency which has also benefited claims costs over the period. The reduction in revenue from vehicle recovery and repair services has resulted from fewer repairs relating to third-party claims and lower revenues at the tracker recovery business.

## Investment return

Total investment return was £281.8 million, in line with 2011, as an increase in realised gains and reduction in impairments offset lower investment income. For ongoing operations, investment return was £234.7 million, 1.7% lower than 2011.

During 2012, total funds under management decreased by 13.8% to £9.4 billion. Key reasons for the reduction include the payment of dividends and repayment of intra-group loans totalling £1,235 million to RBS Group and the acquisition of Direct Line Germany from RBS Deutschland for £120 million. This was partially offset by the issuance of £500 million of long-term subordinated debt.

	Total Group		Ongoing operations	
	Year ended 31 December		Year ended 31 December	
	2012	2011	2012	2011
	£m	£m	£m	£m
Investment income	199.3	243.6	179.9	210.9
Net realised and unrealised gains	82.5	38.3	54.8	27.8
<b>Total investment return</b>	<b>281.8</b>	<b>281.9</b>	<b>234.7</b>	<b>238.7</b>

Investment income was £199.3 million, an 18.2% decrease on 2011, mainly as a result of the decrease in assets under management, low reinvestment yields in the UK and higher cash holdings during the year. Elevated cash holdings during the year arose from extensive portfolio restructuring and the need to hold cash in advance of the capital management activities.

Net realised and unrealised gains recognised in 2012 were £82.5 million compared with £38.3 million in 2011.

	Total Group		Ongoing operations	
	Quarter ended 31 December		Quarter ended 31 December	
	2012	2011	2012	2011
	£m	£m	£m	£m
Investment income	44.6	56.3	42.2	49.6
Net realised and unrealised losses taken to income statement	(0.4)	(9.1)	(0.2)	(6.3)
<b>Total investment return</b>	<b>44.2</b>	<b>47.2</b>	<b>42.0</b>	<b>43.3</b>

Total investment return in the fourth quarter of 2012 of £44.2 million was 6.4% lower than 2011. For ongoing operations, investment return in the fourth quarter of 2012 was £42.0 million, 3.0% lower than 2011.

Investment yields – Total Group	Quarter ended 31 December		Year ended 31 December	
	2012	2011	2012	2011
Investment income	1.8%	2.1%	2.0%	2.3%
Investment return	1.9%	1.7%	2.8%	2.6%

The investment income yield on the total portfolio for 2012 was 2.0%, a decrease from the 2.3% earned in 2011. The investment return was 2.8% compared with 2.6% in 2011.

Income on invested assets	Year ended		Year ended	
	31 December 2012		31 December 2011	
	Asset allocation	Income	Asset allocation	Income
Corporate bonds	48.4%	2.8%	41.5%	3.2%
Government bonds	28.2%	1.6%	32.1%	2.0%
Cash and cash equivalents	22.0%	0.8%	25.8%	0.7%
Investment property	1.4%	4.4%	0.6%	8.6%
<b>Total</b>	<b>100.0%</b>	<b>2.0%</b>	<b>100.0%</b>	<b>2.3%</b>

In late 2012, the Group increased its weighting to corporate bonds whilst reducing holdings in cash and government bonds. A new commercial property portfolio was also established and is targeted to grow to up to 5% of investment assets.

Corporate, sovereign, local government and supranational debt securities account for 76.6% of the portfolio, of which 41% are rated as 'AAA' and a further 49% rated as 'A' or 'AA'. Exposure to European economies such as Spain, Italy and Ireland is minimal, with these countries accounting for only 1.0% of the aggregate bond portfolio. There are no investment holdings in Portugal or Greece.

The average duration of total investment assets was 1.8 years, with the breakdown being UK 1.7 years, Italy 2.8 years and Germany 2.5 years (2011: average on total assets 2.2 years, UK 2.1 years, Italy 2.3 years and Germany 2.6 years).

Reinvestment rates on corporate bonds remain low with current reinvestment yields of approximately 1.6%. Taken with current yields on cash and government bonds and expected yields on property, the blended reinvestment rate at the target asset mix is approximately 1.6%. This does not take into account the effect of forward yields or a number of management actions which are expected to augment returns.

### Operating profit/(loss) by division

	Year ended	
	31 December	
	2012	2011
	£m	£m
Motor	261.8	254.8
Home	93.3	111.9
Rescue and other personal lines	84.4	63.3
Commercial	2.2	(12.4)
International	19.5	4.3
<b>Total</b>	<b>461.2</b>	<b>421.9</b>

All divisions were profitable in 2012 and with the exception of Home, which was impacted by worse than average claims from weather events, experienced profit growth in 2012 compared with 2011.

### Run-off

The Run-off segment, which includes the exited personal lines broker and TPF businesses, made a profit of £6.1 million in 2012 compared with a loss of £23.9 million in 2011. Reserve releases for 2012 were £67.5 million, the majority of which were due to TPF.

The Group has agreed with TPF the level of final reserves to be retained by the Group in respect of the run-off of remaining claims under TPF policies and finalised certain other

matters arising out of the expiry of the distribution arrangements. Following determination of the reserves, the risks and rewards of the run-off for this line of business were transferred to the Group. Subsequently the £258.5 million loan was repaid to TPF on 8 January 2013.

### **Restructuring and other one-off costs**

Restructuring and other one-off costs rose to £189.5 million in 2012, up from £54.0 million in 2011. Costs associated with the Group's separation and divestment from RBS Group were £148.9 million with the remainder relating mainly to the Group's cost savings programme.

Restructuring and other one-off costs for 2013 are estimated to be approximately £140 million. Approximately £70 million relates to one-off costs associated with the cost savings programme and a further £70 million relates to IT migration. The total one-off cost of IT migration continues to be estimated at around £100 million with the remaining £30 million expected to be incurred in 2014.

### **Finance costs**

Finance costs increased to £28.7 million (2011: £2.7 million), primarily reflecting interest on the £500 million of long-term subordinated debt issue in April 2012.

### **Taxation**

The effective tax rate for 2012 was 26.0% (2011: 27.4%) and benefited from lower UK corporate tax rates. The effective tax rate was 1.5 percentage points higher than the UK standard tax rate due to higher earnings from the International operations, which have a higher corporate tax rate, and higher levels of disallowable expense in part relating to separation and divestment. This was partially offset by a credit in International for prior periods.

### **Profit for the year and return on tangible equity**

Profit for the year amounted to £184.3 million (2011: £249.0 million). RoTE increased to 11.5% (2011: 10.0%) as a result of both the improved operating result from ongoing operations and the capital actions taken to improve the efficiency of the Group's capital position. Had the £1 billion dividend to RBS Group and issue of £500 million long-term subordinated debt taken place prior to the start of the year, the return on tangible equity, on a pro forma basis, would increase to 13.4%.

### **Earnings per share**

Basic and diluted earnings per share of 12.3 pence fell 25.9% compared with 2011 reflecting the increase in restructuring and other one-off costs which more than offset the increase in operating profit from ongoing operations.

Adjusted basic and diluted earnings per share, which excludes run-off and restructuring and other one-off costs, increased by 6.3% to 21.8 pence.

### **Dividends**

Prior to the IPO in October 2012, £1 billion of dividends were paid to RBS Group. These dividends formed part of the capital actions taken to improve the capital efficiency of the Group.

A final dividend of 8 pence per share (2011: nil) has been proposed. On the basis that the final dividend represents two-thirds of the total annual distribution, the full-year pro forma

dividend of 12 pence per share would represent a payout ratio of 55% of earnings from ongoing operations, in line with the policy set out at the time of the IPO. From 2013, the Group aims to raise the dividend annually in real terms.

The final dividend will, subject to shareholder approval, be paid on 11 June 2013 to all holders of ordinary shares on the Register of Members at close of business on 8 March 2013.

## Net asset value

The net asset value at 31 December 2012 was £2,831.6 million (31 December 2011: £3,612.8 million) with tangible net asset value of £2,410.1 million (31 December 2011: £3,247.0 million). This equates to 189.1 pence and 161.0 pence per share respectively as at 31 December 2012 (31 December 2011: 240.9 pence and 216.5 pence, respectively).

The reduction in net asset value and tangible net asset value primarily relates to the £1 billion of dividends paid to RBS Group during 2012. Adding back these dividends, net asset value per share rose by 6.3% in 2012 and tangible net asset value per share rose by 5.2% in 2012.

## Capital position

The Group is well capitalised with an Insurance Group Directive (“IGD”) surplus of £1.8 billion and an IGD coverage ratio of 279.4% as at 31 December 2012 (2011: 319.0%). The Group also has a risk based capital coverage ratio of 151.4% as at 31 December 2012 (2011: 169.5%). Adjusting for the proposed final dividend, the risk based capital coverage ratio would be 145.4%.

The Group has an overall target of holding capital resources in the range of 125% to 150% of the risk based capital requirement.

The table below sets out the consolidated capital position as at 31 December 2012 and 2011.

	Year ended 31 December	
	2012	2011
<b>Consolidated statutory solvency capital</b>		
Shareholders' equity	2,831.6	3,612.8
Goodwill and other intangible assets	(421.5)	(365.8)
Regulatory adjustments	(73.5)	(25.6)
<b>Total Tier 1 capital</b>	<b>2,336.6</b>	<b>3,221.4</b>
Upper Tier 2 capital <sup>1</sup>	—	258.5
Lower Tier 2 capital <sup>2</sup>	495.5	—
Regulatory adjustments	(23.7)	(37.2)
<b>Total regulatory capital</b>	<b>2,808.4</b>	<b>3,442.7</b>
<b>Insurance Group Directive</b>		
IGD required capital <sup>3</sup>	1,005.0	1,079.1
IGD excess solvency	1,803.4	2,363.6
IGD coverage ratio	279.4%	319.0%
Risk based capital coverage ratio	151.4%	169.5%

<sup>1</sup> 2011 includes the undated subordinated loan from TPF £255 million and £3.5 million of solvency capital provided by TPF in relation to the TPF life insurance business, both of which the Group repaid in January 2013. As such it has been excluded from Tier 2 capital as at 31 December 2012.

<sup>2</sup> Includes that element of the subordinated dated notes applicable for regulatory capital purposes.

<sup>3</sup> Based on the IGD for the Group and adjusted to include the capital requirement for Direct Line Versicherung AG acquired on 2 April 2012.

The above regulatory numbers are estimated based on preliminary regulatory returns for 31 December 2012.

The table below sets out the Group's financial leverage ratio as at 31 December 2012 and 2011:

	<b>Year ended 31 December</b>	
	<b>2012</b>	<b>2011</b>
Shareholders' equity	<b>2,831.6</b>	3,612.8
Undated subordinated loan <sup>1</sup>	<b>258.5</b>	258.5
Subordinated dated notes	<b>529.0</b>	—
Long term borrowings	—	246.4
<b>Total financial debt</b>	<b>787.5</b>	<b>504.9</b>
<b>Total capital employed</b>	<b>3,619.1</b>	<b>4,117.7</b>
Financial leverage ratio <sup>2</sup>	<b>21.8%</b>	12.3%

<sup>1</sup> Repaid in January 2013.

<sup>2</sup> Total financial debt as a percentage of total capital employed.

Following the repayment of the undated subordinated loan, the financial leverage ratio on a pro forma basis, excluding the undated subordinated loan, as at 31 December 2012 would have been 15.7%.

### **Credit ratings**

Standard & Poor's and Moody's Investors Service provide insurance financial strength ratings for U K Insurance Limited, the Group's principal UK general insurance underwriter. U K Insurance is currently rated 'A' (strong) with a stable outlook by Standard & Poor's and 'A2' (good) with a stable outlook by Moody's.



## **Risk management**

Sections of this document contain forward looking statements which by their nature are subject to significant risks and uncertainty. Actual results, performance and achievements may be materially different from those expressed in such statements.

Our business operates in a highly regulated and politically sensitive sector. Changes in the external environment arising from changes in legislation, regulation, tax laws or other requirements can have material consequences.

In addition, there are a number of factors that may cause actual results, performance or achievements to differ from expectations, including the impact of catastrophic events, unexpected operational losses, loss of talent and key personnel, not meeting cost savings targets, not meeting financial targets for the COR, not meeting investment return targets, an inability to optimise distribution effectiveness or to differentiate our brands, an inability to implement price changes in accordance with strategy or in a timely fashion and the possibility that the benefits of the new claims system delivers less value than anticipated.

Further, despite the successful separation from RBS Group there is a TSA in place with RBS Group, the effectiveness of which has yet to be determined.

### **Key Group risk factors**

The Group writes products that are subject to a number of uncertainties and risks. It is a key role of Risk to ensure that these risks have been identified, measured and considered throughout the business. This section outlines the principal risks factors that the Group is exposed to and the activities in place to manage them.

Principal risks	Impact	Management and mitigation
<p><b>Strategic risk</b> The economic climate could put at risk our ability to meet our strategic objectives in the areas of distribution, pricing, claims, costs, Commercial and International.</p> <p>We may fail to execute our ongoing strategic transformation plan, and the expected benefits of that plan may not be achieved at the time or to the extent expected, or at all.</p>	<p>The value of the Group decreases resulting in a lack of shareholder confidence.</p>	<ul style="list-style-type: none"> <li>• Constant monitoring and management of agreed strategic targets</li> <li>• Monitoring of cost savings to ensure they remain on track</li> <li>• Investment in brand awareness, and improved pricing and claims models</li> <li>• Upgrading and enhancement of numerous operational processes and systems</li> </ul>
<p><b>Underwriting and pricing risk</b> We are subject to the risk that inappropriate business could be written (or not specifically excluded) and inappropriate prices charged. This includes catastrophe risk arising from losses due to unpredictable natural and man-made events affecting multiple covered risks particularly given the concentration of our Home business in the UK.</p>	<p>Adverse loss experience impacting current year and future year business performance.</p>	<ul style="list-style-type: none"> <li>• Underwriting guidelines for all business transacted, restricting the types and classes of business that may be accepted</li> <li>• Exception reports and underwriting monitoring tools</li> <li>• Internal quality assurance programmes</li> <li>• Pricing policies by product line and by brand</li> <li>• Analysis of comprehensive data to refine pricing</li> <li>• Insurance governance forums whose remit include examination of data</li> <li>• Central control of policy wordings</li> <li>• Purchase of catastrophe reinsurance to limit the exposure</li> <li>• Quarterly analysis of all property portfolios to determine expected maximum losses</li> <li>• Investment in enhanced external data to mitigate exposures (for example, flood, individual underwriting risk through Geospatial)</li> </ul>

Principal risks	Impact	Management and mitigation
<p><b>Reserving risk</b> Due to the uncertain nature and timing of the risks to which we are exposed, we cannot precisely determine the amounts that we will ultimately pay to meet the liabilities covered by the insurance policies written.</p>	<p>Adverse development in prior year reserves resulting in a financial loss.</p>	<p>Technical reserves are estimated by:</p> <ul style="list-style-type: none"> <li>• A range of actuarial and statistical techniques, with projections of ultimate claims cost involving assumptions across a range of variables, including estimates of trends in claims frequency and average claim amounts based on facts and circumstances at a given point in time</li> <li>• Making assumptions on other variable factors including; the legal, social, economic and regulatory environments; Ogden discount rate and the process by which it is set; results of litigation; and the extent and terms on which Periodical Payment Orders are made by the Courts. Other factors considered include rehabilitation and mortality trends, business mix, consumer behaviour, market trends, underwriting assumptions, risk pricing models, inflation in medical care costs, future earnings inflation and other relevant forms of inflation, the performance and operation of reinsurance assets and future investment returns</li> <li>• Stress and scenario testing</li> <li>• Management’s best estimate of reserves being equal to or in excess of the actuarial best estimate</li> </ul>
<p><b>Operational risk</b> The risks of direct or indirect losses resulting from inadequate or failed internal processes, fraudulent claims or from systems and people, or from external events including changes in the competitor, regulatory or legislative environments. In particular we have IT systems risk, as the Group is highly dependent on the use of third party information technology, software, data and service providers.</p>	<p>Adverse events with potential financial, reputational, legal and customer impacts.</p>	<ul style="list-style-type: none"> <li>• We have upgraded and enhanced many of our operational processes and systems, including the claims system and fraud detection system. This includes enhancing our Enterprise Risk Management Framework to integrate risk, business and capital strategies</li> <li>• We maintain a robust internal control environment</li> <li>• We have developed a bespoke risk capture, management and reporting system</li> <li>• Migration of IT onto a new, enhanced platform</li> </ul>

Principal risks	Impact	Management and mitigation
<p><b>Investment risk</b></p> <p><b>Market risk</b> – the risk of adverse financial impact due to changes in fair values of future cash flows of instruments held in the investment portfolio as a result of changes in interest rates, credit spread, foreign exchange rates and property values.</p> <p><b>Credit risk</b> – the risk of exposure if another party fails to perform its financial obligations, including failing to perform them in a timely manner.</p> <p><b>Liquidity risk</b> – the risk of maintaining insufficient financial resources to meet business obligations as and when they fall due.</p>	<p>Adverse movements due to asset value reduction, mismatch in assets and liabilities, and default of third parties.</p> <p>Inability to meet cashflows under stress.</p>	<p>Our investment portfolio is managed and controlled, through:</p> <ul style="list-style-type: none"> <li>• Investment Strategy and Guidelines proposed to the Board by the Investment Committee and monitored by the Asset and Liability Committee</li> <li>• Diverse holding of types of assets including geographies, sectors and credit ratings</li> <li>• Utilisation of risk reduction techniques, for example hedging</li> <li>• Stress testing and scenario analysis</li> </ul>
<p><b>Counterparty risk</b></p> <p>We partner with many suppliers and the failure of any of these to perform their financial obligations or perform them in a timely manner could result in a financial loss. The principal area of counterparty risk is our use of reinsurance against catastrophe risk.</p>	<p>Loss due to default of banks, reinsurers, brokers or other third parties.</p>	<ul style="list-style-type: none"> <li>• Credit limits are set for counterparties, particularly banks</li> <li>• Requirement of minimum credit ratings for reinsurers</li> <li>• Broker credit exposures are monitored by the business.</li> </ul>

Principal risks	Impact	Management and mitigation
<p><b>Regulatory risk</b> Changes in law and regulations are not identified, understood, or are inappropriately and incorrectly interpreted, or adopted, or business practices are not efficiently modified. Further there is a risk that current legal or regulatory requirements are not complied with. For example, in the beginning of 2012, the FSA imposed a £2.17 million fine on the Group in relation to complaint file alterations.</p>	<p>Customer impact, financial loss and regulatory censure.</p> <p>Regulatory sanction, legal action or revenue loss.</p>	<ul style="list-style-type: none"> <li>• We have a constructive and open relationship with our regulators and other official bodies (for example, the Ministry of Justice, Office of Fair Trading), in addition to specific risk management tools and resources to minimise our exposure to regulatory risk</li> </ul>
<p><b>Conduct risk</b> The risk of failing to deliver the appropriate treatment for our customers throughout all stages of the customer journey, and that our people fail to behave with integrity.</p>	<p>Potential customer detriment, financial loss and regulatory censure and sanction.</p>	<ul style="list-style-type: none"> <li>• Our organisational culture prioritises the consistent approach towards customers and the interests of customers are at the heart of how we operate</li> <li>• We have developed a robust customer conduct risk management framework, to minimise our exposure to conduct risk</li> </ul>
<p><b>Brand and reputational risk</b> We are dependent on the strength of our brands, our reputation with customers and distributors in the sale of products and services. We have entered into various strategic partnerships that are important to the marketing, sale and distribution of our products.</p>	<p>Loss of brand value negatively impacts our ability to retain and write new business.</p>	<ul style="list-style-type: none"> <li>• Our brand and reputation risk is regularly reviewed by various governance committees</li> <li>• A key focus for us is to build our brands business through marketing whilst regularly monitoring performance using a range of brand metrics</li> <li>• We seek to offer a superior service to customers and to treat customers fairly in line with FSA principles</li> </ul>

As long as RBS Group remains a significant shareholder, there are certain risks that apply to the RBS Group and, should they arise, may have an adverse impact on our business. For example, RBS Group will continue to exert substantial influence over us while it has a substantial shareholding; RBS Group could face the risk of full nationalisation or other resolution procedures; our contractual arrangements may be impacted by events that occur within RBS Group; and RBS Group is subject to a variety of risks as a result of implementing the state aid restructuring plan which could adversely affect us. RBS Group has a legal obligation to divest its controlling interest in the Group by the end of 2013 and completely divest by the end of 2014 and the manner and exact timing of any divestment is uncertain.

## Consolidated income statement

For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Gross earned premium		4,048.5	4,522.9
Reinsurance premium ceded		(326.5)	(269.9)
<b>Net earned premium</b>		<b>3,722.0</b>	<b>4,253.0</b>
Investment return	3	281.8	281.9
Instalment income	4	125.4	145.0
Other operating income	4	73.3	95.1
<b>Total income</b>		<b>4,202.5</b>	<b>4,775.0</b>
Insurance claims	5	(2,875.3)	(3,160.6)
Insurance claims recoverable from reinsurers	5	451.0	193.1
<b>Net insurance claims</b>		<b>(2,424.3)</b>	<b>(2,967.5)</b>
Commission expenses		(452.9)	(518.9)
Operating expenses		(1,047.5)	(944.6)
<b>Total expenses</b>		<b>(1,500.4)</b>	<b>(1,463.5)</b>
<b>Operating profit</b>		<b>277.8</b>	<b>344.0</b>
Finance costs		(28.7)	(2.7)
Gain on disposal of subsidiary		—	1.6
<b>Profit before tax</b>		<b>249.1</b>	<b>342.9</b>
Tax charge		(64.8)	(93.9)
<b>Profit for the year</b>		<b>184.3</b>	<b>249.0</b>
<b>Profit attributable to:</b>			
Owners of the Company		184.3	249.0
Non-controlling interests		—	—
		<b>184.3</b>	<b>249.0</b>
Earnings per share			
– basic (pence)	6	12.3	16.6
– diluted (pence)	6	12.3	16.6

## Consolidated statement of comprehensive income

For the year ended 31 December 2012

	2012 £m	2011 £m
<b>Profit for the year</b>	<b>184.3</b>	<b>249.0</b>
<b>Other comprehensive income</b>		
Actuarial loss on defined benefit plan	(3.4)	(0.6)
Exchange differences on translation of foreign operations	(2.4)	(3.5)
Fair value gain on available-for-sale investments	109.9	183.8
Less: realised net gains on available-for-sale investments	(89.5)	(52.3)
	<u>14.6</u>	<u>127.4</u>
Tax credit / (charge) on other comprehensive income	1.9	(36.8)
<b>Other comprehensive income for the year</b>	<b>16.5</b>	<b>90.6</b>
<b>Total comprehensive income for the year</b>	<b>200.8</b>	<b>339.6</b>
<b>Total comprehensive income attributable to:</b>		
Owners of the Company	200.8	339.6
Non-controlling interests	—	—
	<u>200.8</u>	<u>339.6</u>

## Consolidated balance sheet

As at 31 December 2012

	Notes	2012 £m	2011 £m
<b>ASSETS</b>			
Goodwill and other intangible assets		421.5	365.8
Property, plant and equipment		92.4	46.9
Investment property		128.9	69.5
Reinsurance assets		1,102.0	741.6
Deferred tax assets		22.5	26.9
Current tax assets		5.5	—
Deferred acquisition costs		327.6	310.5
Insurance and other receivables		1,164.0	1,252.9
Prepayments, accrued income and other assets		82.6	92.2
Derivative financial instruments		37.5	0.1
Retirement benefit asset		2.5	2.6
Financial investments	7	7,801.5	9,480.3
Cash and cash equivalents	8	1,508.4	1,379.8
Assets held for sale		1.0	1.0
<b>Total assets</b>		<b>12,697.9</b>	<b>13,770.1</b>
<b>EQUITY</b>			
Shareholders' equity		2,831.6	3,612.8
Non-controlling interest		—	258.5
<b>Total equity</b>		<b>2,831.6</b>	<b>3,871.3</b>
<b>LIABILITIES</b>			
Subordinated liabilities		787.5	—
Insurance liabilities	9	6,398.5	6,509.0
Unearned premium reserve	9	1,872.9	1,931.6
Borrowings		90.9	317.9
Derivative financial instruments		6.5	—
Trade and other payables including insurance payables		654.6	910.2
Deferred tax liabilities		20.9	12.1
Current tax liabilities		34.5	218.0
<b>Total liabilities</b>		<b>9,866.3</b>	<b>9,898.8</b>
<b>Total equity and liabilities</b>		<b>12,697.9</b>	<b>13,770.1</b>



## Consolidated statement of changes in equity

For the year ended 31 December 2012

	Share capital £m	Employee trust shares £m	Capital redemption reserve £m	Revaluation reserve £m	Non-distributable reserve £m	Foreign exchange translation reserve £m	Retained earnings £m	Total shareholders equity £m
Balance at 1 January 2011	1,500.0	—	100.0	41.9	197.6	5.4	1,378.7	3,223.6
Profit for the year	—	—	—	—	—	—	249.0	249.0
Other comprehensive income	—	—	—	94.7	—	(3.5)	(0.6)	90.6
Transfer from non-distributable reserve	—	—	—	—	(167.3)	—	167.3	—
Capital contribution <sup>1</sup>	—	—	—	—	—	—	55.9	55.9
Movement in net assets of Direct Line Versicherung AG <sup>2</sup>	—	—	—	0.5	—	4.5	(11.3)	(6.3)
<b>Balance at 31 December 2011</b>	<b>1,500.0</b>	<b>—</b>	<b>100.0</b>	<b>137.1</b>	<b>30.3</b>	<b>6.4</b>	<b>1,839.0</b>	<b>3,612.8</b>
Profit for the year	—	—	—	—	—	—	184.3	184.3
Other comprehensive income	—	—	—	21.7	—	(2.4)	(2.8)	16.5
Dividends	—	—	—	—	—	—	(1,000.0)	(1,000.0)
Transfer to non-distributable reserve	—	—	—	—	32.9	—	(32.9)	—
Capital contribution <sup>1</sup>	—	—	—	—	—	—	30.9	30.9
Movement in net assets of Direct Line Versicherung AG <sup>2</sup>	—	—	—	—	—	1.0	(9.2)	(8.2)
Share based payments	—	(5.0)	—	—	—	—	0.3	(4.7)
Issue of own shares	150.0	—	—	—	—	—	—	150.0
Own shares redeemed	(1,500.0)	—	1,350.0	—	—	—	—	(150.0)
<b>Balance at 31 December 2012</b>	<b>150.0</b>	<b>(5.0)</b>	<b>1,450.0</b>	<b>158.8</b>	<b>63.2</b>	<b>5.0</b>	<b>1,009.6</b>	<b>2,831.6</b>

<sup>1</sup> See basis of preparation (note 1).

<sup>2</sup> The movements in net assets of Direct Line Versicherung AG ceased on 2 April 2012 (note 1).

	Non-controlling interest £m
Balance at 1 January 2011 and 31 December 2011	258.5
Transfer to subordinated liabilities	(258.5)
<b>Balance at 31 December 2012</b>	<b>—</b>

## Consolidated cash flow statement

For the year ended 31 December 2012

	Notes	2012 £m	2011 £m
<b>Net cash used by operating activities before investment of insurance assets</b>		<b>(966.0)</b>	(359.8)
Cash generated from investment of insurance assets		<u>2,004.8</u>	38.8
<b>Net cash generated from / (used by) operating activities</b>		<b><u>1,038.8</u></b>	<b><u>(321.0)</u></b>
<b>Cash flows from investing activities</b>			
Proceeds on disposal of property, plant and equipment		–	1.2
Purchases of property, plant and equipment		<b>(63.7)</b>	(7.5)
Purchases of intangible assets		<b>(96.6)</b>	(119.8)
Net cash flows from disposal of subsidiary		–	(0.1)
Cash flows from net investment hedges		<u>6.1</u>	–
<b>Net cash used by investing activities</b>		<b><u>(154.2)</u></b>	<b><u>(126.2)</u></b>
<b>Cash flows from financing activities</b>			
Dividends paid		<b>(1,000.0)</b>	–
Repayments of borrowings		<b>(246.4)</b>	(205.5)
Proceeds on issue of subordinated debt		<b>493.0</b>	–
Finance costs		<b>(16.1)</b>	–
Purchase of employee trust shares		<b>(5.0)</b>	–
Proceeds from borrowings		<u>–</u>	205.0
<b>Net cash used by financing activities</b>		<b><u>(774.5)</u></b>	<b><u>(0.5)</u></b>
<b>Net increase / (decrease) in cash and cash equivalents</b>		<b>110.1</b>	<b>(447.7)</b>
Cash and cash equivalents at the beginning of the year	8	<b>1,309.6</b>	1,763.5
Effect of foreign exchange rate changes		<u>(2.2)</u>	(6.2)
<b>Cash and cash equivalents at the end of the year</b>	8	<b><u>1,417.5</u></b>	<b><u>1,309.6</u></b>

## Notes to the consolidated financial statements

### 1. Accounting policies

#### Basis of preparation

The results for the year ended 31 December 2012 have been prepared using International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”) and endorsed by the European Union. The results in this preliminary announcement have been prepared in accordance with IFRS applicable at 31 December 2012 and have been taken from the Group’s Annual Report & Accounts, which will be available on the Company’s website in due course.

The consolidated financial statements are prepared on the historical cost basis except for available-for-sale financial assets, investment property and derivative financial instruments, which are measured at fair value.

The Group’s consolidated financial statements are presented in pounds sterling, which is the functional currency of the Group.

The Group in its current structure was formed on 2 April 2012 when Direct Line Insurance Group plc (the “**Company**”) acquired Direct Line Versicherung AG from a fellow subsidiary of The Royal Bank of Scotland Group plc (“**RBS Group**”). Therefore the basis of preparation represents a reorganisation of entities under common control, which is outside the scope of IFRS 3, ‘Business Combinations’. Accordingly, as permitted by IAS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’, it has been accounted for as a group reconstruction as described in Financial Reporting Standard 6, ‘Acquisitions and Mergers’. The consolidated financial statements have been prepared as if the transaction that gave rise to the formation of the Group had taken place at the beginning of the comparative period. Under these principles, the consolidated financial statements have been prepared as if the Company were the holding company of Direct Line Versicherung AG from 1 January 2011, the date of the beginning of the comparative period.

As part of the divestment from RBS Group, the way in which expenses incurred by RBS Group on behalf of the Group changed. Up until 30 June 2012, only some of these expenses were recharged to the Group by RBS Group. From 1 July 2012, some of the services previously provided by RBS Group have been brought in-house and so the expense is now incurred directly by the Group and reflected in expenses in the income statement; other services are still provided by RBS Group under TSAs and the expense of these is charged to the Group. In order to aid comparability, the Group’s accounting policy has been changed so that all expenses are included within the income statement. For the avoidance of doubt, this includes external costs incurred by the Group and costs incurred by RBS Group, irrespective of whether RBS Group recharged them to the Group. In the case of expenses incurred by RBS Group and not recharged to the Group, a capital contribution has been credited to retained earnings in the statement of changes in equity to reflect this contribution from a shareholder. In addition there was a further contribution of £6.3 million in respect of overseas taxation. The comparatives for the year ended 31 December 2011 have been prepared on the same basis.

## **Notes to the consolidated financial statements (continued)**

### **1. Accounting policies (continued)**

The effect of the above on the Group profit for the year ended 31 December 2012 was to decrease profit after tax by £30.9 million, (31 December 2011: £55.9 million) with an equal and opposite credit in the statement of changes in equity. There was no impact on net assets as at 1 January 2011 or 31 December 2011, and accordingly no balance sheet as at 1 January 2011 has been provided.

After making due enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they have adopted the going concern basis in preparing the financial statements, from which these summary financial statements have been extracted.

### **Adoption of new and revised standards**

There have been no new or revised standards adopted in the year.

#### **1.1 Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Company and the entities that are controlled by the Group as at 31 December 2012 and 2011. Control exists when the Group has the power to govern the financial and operating policies of an entity. In assessing if the Group controls another entity, the existence and effect of the potential voting rights that are currently exercisable or convertible are considered.

Where necessary, adjustments have been made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. The policies set out below have been applied consistently throughout the years ended 2012 and 2011 to items considered material to the consolidated financial statements.

A subsidiary acquired is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated financial statements at fair value.

All intercompany transactions, balances, income and expenses between Group entities are eliminated on consolidation. The consolidated financial statements are prepared using consistent accounting policies.

### **Principal accounting policies**

There have been no significant changes to the Group's principal accounting policies as set out on pages 183 to 194 of the historical financial information, included in the Group's prospectus dated 28 September 2012. The policies have been applied consistently throughout the periods presented to items considered material to the preliminary results announcement.

## Notes to the consolidated financial statements (continued)

### 2. Segmental analysis

The following is an analysis of the Group's revenue and results by reportable segment for the year ended 31 December 2012:

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	International £m	Total ongoing £m	Run-off £m	Restructuring and other one- off costs £m	Total Group £m
Gross written premium	1,623.5	989.0	389.8	435.6	552.7	3,990.6	10.8	—	4,001.4
Gross earned premium	1,677.8	1005.2	402.5	433.2	510.3	4,029.0	19.5	—	4,048.5
Reinsurance premium ceded	(48.6)	(54.4)	(19.7)	(30.4)	(167.2)	(320.3)	(6.2)	—	(326.5)
<b>Net earned premium</b>	<b>1,629.2</b>	<b>950.8</b>	<b>382.8</b>	<b>402.8</b>	<b>343.1</b>	<b>3,708.7</b>	<b>13.3</b>	<b>—</b>	<b>3,722.0</b>
Investment return	140.0	34.1	7.5	29.4	23.7	234.7	47.1	—	281.8
Instalment income and other operating income	148.1	26.5	10.7	5.9	7.1	198.3	0.4	—	198.7
<b>Total income</b>	<b>1,917.3</b>	<b>1,011.4</b>	<b>401.0</b>	<b>438.1</b>	<b>373.9</b>	<b>4,141.7</b>	<b>60.8</b>	<b>—</b>	<b>4,202.5</b>
Insurance claims	(1,364.8)	(560.7)	(218.1)	(278.2)	(401.9)	(2,823.7)	(51.6)	—	(2,875.3)
Insurance claims recoverable from reinsurers	148.3	6.0	23.2	24.1	133.9	335.5	115.5	—	451.0
<b>Net insurance claims</b>	<b>(1,216.5)</b>	<b>(554.7)</b>	<b>(194.9)</b>	<b>(254.1)</b>	<b>(268.0)</b>	<b>(2,488.2)</b>	<b>63.9</b>	<b>—</b>	<b>(2,424.3)</b>
Commission expenses	(31.9)	(154.2)	(22.9)	(87.0)	(41.5)	(337.5)	(115.4)	—	(452.9)
Operating expenses	(407.1)	(209.2)	(98.8)	(94.8)	(44.9)	(854.8)	(3.2)	(189.5)	(1,047.5)
<b>Total expenses</b>	<b>(439.0)</b>	<b>(363.4)</b>	<b>(121.7)</b>	<b>(181.8)</b>	<b>(86.4)</b>	<b>(1,192.3)</b>	<b>(118.6)</b>	<b>(189.5)</b>	<b>(1,500.4)</b>
<b>Operating profit / (loss)</b>	<b>261.8</b>	<b>93.3</b>	<b>84.4</b>	<b>2.2</b>	<b>19.5</b>	<b>461.2</b>	<b>6.1</b>	<b>(189.5)</b>	<b>277.8</b>
Finance costs									(28.7)
<b>Profit before tax</b>									<b>249.1</b>
Loss ratio	74.6%	58.4%	50.9%	63.1%	78.1%	67.1%			
Commission ratio	2.0%	16.2%	6.0%	21.6%	12.1%	9.1%			
Expense ratio	25.0%	22.0%	25.8%	23.5%	13.1%	23.0%			
Combined operating ratio	101.6%	96.6%	82.7%	108.2%	103.3%	99.2%			

## Notes to the consolidated financial statements (continued)

### 2. Segmental analysis (continued)

The following is an analysis of the Group's revenue and results by reportable segment for the year ended 31 December 2011:

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	International £m	Total ongoing £m	Run-off £m	Restructuring and other one- off costs £m	Total Group £m
Gross written premium	1,734.8	1,031.3	350.2	438.6	570.0	4,124.9	43.4	—	4,168.3
Gross earned premium	1,797.4	1,031.1	410.3	420.5	482.8	4,142.1	380.8	—	4,522.9
Reinsurance premium ceded	(25.8)	(57.0)	(19.5)	(27.8)	(121.1)	(251.2)	(18.7)	—	(269.9)
<b>Net earned premium</b>	1,771.6	974.1	390.8	392.7	361.7	3,890.9	362.1	—	4,253.0
Investment return	145.2	28.5	9.5	30.5	25.0	238.7	43.2	—	281.9
Instalment income and other operating income	208.2	35.1	—	5.0	7.2	255.5	(15.4)	—	240.1
<b>Total income</b>	2,125.0	1,037.7	400.3	428.2	393.9	4,385.1	389.9	—	4,775.0
Insurance claims	(1,501.6)	(579.2)	(195.7)	(268.6)	(391.4)	(2,936.5)	(224.1)	—	(3,160.6)
Insurance claims recoverable from reinsurers	54.8	19.9	22.1	11.9	96.8	205.5	(12.4)	—	193.1
<b>Net insurance claims</b>	(1,446.8)	(559.3)	(173.6)	(256.7)	(294.6)	(2,731.0)	(236.5)	—	(2,967.5)
Commission expenses	(25.9)	(170.0)	(87.8)	(82.3)	(28.6)	(394.6)	(124.3)	—	(518.9)
Operating expenses	(397.5)	(196.5)	(75.6)	(101.6)	(66.4)	(837.6)	(53.0)	(54.0)	(944.6)
<b>Total expenses</b>	(423.4)	(366.5)	(163.4)	(183.9)	(95.0)	(1,232.2)	(177.3)	(54.0)	(1,463.5)
<b>Operating profit / (loss)</b>	254.8	111.9	63.3	(12.4)	4.3	421.9	(23.9)	(54.0)	344.0
Finance costs									(2.7)
Gain on disposal of subsidiary									1.6
<b>Profit before tax</b>									342.9
Loss ratio	81.7%	57.4%	44.4%	65.4%	81.4%	70.2%			
Commission ratio	1.5%	17.5%	22.5%	21.0%	7.9%	10.1%			
Expense ratio	22.4%	20.2%	19.4%	25.9%	18.3%	21.5%			
Combined operating ratio	105.6%	95.1%	86.3%	112.3%	107.6%	101.8%			

## Notes to the consolidated financial statements (continued)

### 3. Investment return

	Year ended 31 December	
	2012 £m	2011 £m
Investment income:		
Interest income on debt securities	172.5	208.1
Other investment funds income	3.1	8.5
Cash and cash equivalent interest income	19.3	20.4
Rental income on investment property	4.4	6.6
<b>Total</b>	<b>199.3</b>	<b>243.6</b>
Net realised gains:		
Debt securities	66.3	54.3
Other investment funds	23.2	—
Derivatives	17.8	—
Impairments on available-for-sale debt securities	—	(2.0)
Net unrealised losses:		
Derivatives	(20.0)	—
Investment property	(4.8)	(14.0)
<b>Total</b>	<b>281.8</b>	<b>281.9</b>

### 4. Instalment and other operating income

	Year ended 31 December	
	2012 £m	2011 £m
Instalment income	125.4	145.0
Solicitors' referral fee income	21.2	27.9
Vehicle replacement referral income	17.5	21.9
Revenue from vehicle recovery and repair services	25.9	39.3
Fee income from insurance intermediary services	1.9	3.4
Other income	6.8	2.6
Other operating income	73.3	95.1
<b>Total</b>	<b>198.7</b>	<b>240.1</b>

## Notes to the consolidated financial statements (continued)

### 5. Insurance claims

	Year ended 31 December 2012		
	Gross £m	Reinsurance £m	Net £m
Current accident year claims paid	1,360.0	(71.3)	1,288.7
Prior accident years claims paid	1,612.1	(55.6)	1,556.5
Movement in claims provision	(96.8)	(324.1)	(420.9)
<b>Total</b>	<b>2,875.3</b>	<b>(451.0)</b>	<b>2,424.3</b>

	Year ended 31 December 2011		
	Gross £m	Reinsurance £m	Net £m
Current accident year claims paid	1,646.5	(113.2)	1,533.3
Prior accident years claims paid	1,976.4	(37.4)	1,939.0
Movement in claims provision	(462.3)	(42.5)	(504.8)
<b>Total</b>	<b>3,160.6</b>	<b>(193.1)</b>	<b>2,967.5</b>

Loss adjustment expenses for the year ended 31 December 2012 of £290.3 million (2011: £296.4 million) have been included in the claims figures above.

An increase in the liability adequacy provision for the year ended 31 December 2012 of £0.7 million (2011: £21.8 million reduction) has been included in the movement in claims provision.

### 6. Earnings and net assets per share, return on equity

Earnings per share is calculated by earnings attributable to the owners of the Company and the weighted average of ordinary shares in issue during the period.

#### Basic earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to the owners of the Company and the weighted average of ordinary shares in issue during the period, excluding ordinary shares held as employee trust shares.

	Year ended 31 December	
	2012 £m	2011 £m
Earnings attributable to owners of the Company	<b>184.3</b>	249.0
Weighted average number of ordinary shares in issue (millions)	<b>1,499.4</b>	1,500.0
Basic earnings per share (pence)	<b>12.3</b>	16.6



## Notes to the consolidated financial statements (continued)

### 6. Earnings and net assets per share, return on equity (continued)

#### Diluted earnings per share

Diluted earnings per share is calculated by dividing the earnings attributable to the owners of the Company and the weighted average of ordinary shares in issue during the period adjusted for the dilutive potential ordinary shares. The Company has share options and contingently issuable shares as categories of dilutive potential ordinary shares.

	Year ended 31 December	
	2012	2011
	£m	£m
Earnings attributable to owners of the Company	<u>184.3</u>	<u>249.0</u>
	<b>As at 31 December</b>	
	2012	2011
	£m	£m
Weighted average number of ordinary shares in issue (millions)	<u>1,499.4</u>	1,500.0
Adjustments for share options and contingently issuable shares (millions)	<u>0.6</u>	—
Weighted average number of ordinary shares for diluted earnings per share (millions)	<u>1,500.0</u>	1,500.0
Diluted earnings per share (pence)	<u>12.3</u>	<u>16.6</u>

#### Net asset value and tangible net asset value per share

Net asset value per share is calculated as total shareholders' equity (excluding non-controlling interest) divided by the number of ordinary shares in issue at the end of the period. Ordinary shares in issue exclude shares held by employee share trusts at 31 December 2012 of 2,848,991 (2011: nil).

Tangible net asset value per share is calculated as total shareholders' equity (excluding non-controlling interest) less goodwill and other intangible assets divided by the number of ordinary shares in issue at the end of the period.

Net asset and tangible net asset value per share are as follows:

	At 31 December	
	2012	2011
	£m	£m
Net assets	2,831.6	3,612.8
Goodwill and other intangible assets	<u>(421.5)</u>	<u>(365.8)</u>
<b>Tangible net assets</b>	<u><b>2,410.1</b></u>	<u><b>3,247.0</b></u>
Number of ordinary shares in issue (millions)	1,500.0	1,500.0
Less shares held by employee share trusts (millions)	<u>(2.8)</u>	—
<b>Closing number of shares in issue (millions)</b>	<u><b>1,497.2</b></u>	<u><b>1,500.0</b></u>
<b>Net asset value per share (pence)</b>	<b>189.1</b>	<b>240.9</b>
<b>Tangible net asset value per share (pence)</b>	<b>161.0</b>	<b>216.5</b>

## Notes to the consolidated financial statements (continued)

### 6. Earnings and net assets per share, return on equity (continued)

#### Return on equity

Return on equity is calculated by dividing the profit attributable to the owners of the Company by average shareholders' equity for the period.

Return on equity is calculated as follows:

	2012 £m	2011 £m
<b>Profit for the year ending 31 December</b>	<b>184.3</b>	249.0
Opening shareholders' equity at 1 January	3,612.8	3,223.6
Closing shareholders' equity at 31 December	2,831.6	3,612.8
<b>Average shareholders' equity</b>	<b>3,222.2</b>	<b>3,418.2</b>
<b>Return on equity</b>	<b>5.7%</b>	<b>7.3%</b>

### 7. Financial investments

	At 31 December	
	2012 £m	2011 £m
<b>Available-for-sale debt securities</b>		
Sovereign, supranational and local government debt securities	2,635.7	3,481.2
Corporate debt securities	4,475.6	3,843.2
Mortgage backed securities	45.2	283.5
<b>Total</b>	<b>7,156.5</b>	<b>7,607.9</b>

	£m	£m
<b>Available-for-sale debt securities</b>		
Listed - fixed interest rate	6,854.2	6,747.8
Listed - floating interest rate	302.3	860.1
	7,156.5	7,607.9
Other investment funds <sup>1</sup>	—	382.8
<b>Total</b>	<b>7,156.5</b>	<b>7,990.7</b>

#### Loans and receivables

	£m	£m
Deposits with credit institutions with maturities in excess of three months		
- third parties	595.0	1,342.6
- related parties	50.0	147.0
<b>Total</b>	<b>645.0</b>	<b>1,489.6</b>
<b>Total</b>	<b>7,801.5</b>	<b>9,480.3</b>

<sup>1</sup> Other investment funds comprised a single fund which included Euro and US Dollar denominated bonds, hedged back to Sterling.

## Notes to the consolidated financial statements (continued)

### 7. Financial investments (continued)

Included within the debt securities balance at 31 December 2012 is £75.0 million (2011: £304.6 million) relating to securities issued by members of RBS Group.

The following table shows an analysis of financial instruments recorded at fair value, which equates to its carrying value, by level of the fair value hierarchy:

#### At 31 December 2012

	Level 1 (note i) £m	Level 2 (note ii) £m	Total £m
<b>Available-for-sale financial assets</b>			
Debt securities	<b>1,839.9</b>	<b>5,316.6</b>	<b>7,156.5</b>
<b>Total</b>	<b>1,839.9</b>	<b>5,316.6</b>	<b>7,156.5</b>

#### At 31 December 2011

	Level 1 (note i) £m	Level 2 (note ii) £m	Total £m
<b>Available-for-sale financial assets</b>			
Debt securities	2,862.6	4,745.3	7,607.9
Other investment funds	—	382.8	382.8
<b>Total</b>	<b>2,862.6</b>	<b>5,128.1</b>	<b>7,990.7</b>

#### Note:

(i) Level 1 financial assets are measured in whole or in part by reference to published quotes in an active market. In an active market quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

(ii) Included in the Level 2 category are financial assets measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. These are assets for which pricing is obtained via pricing services, but where prices have not been determined in an active market, financial assets with fair values based on broker quotes, investments in private equity funds with fair values obtained via fund managers and assets that are valued using the Group's own models whereby the majority of assumptions are market observable.

(iii) The Group held no Level 3 securities at 31 December 2012 and 2011.

## Notes to the consolidated financial statements (continued)

### 8. Cash and cash equivalents

	At 31 December	
	2012	2011
	£m	£m
Cash at bank and in hand:		
— third parties	132.6	153.5
— related parties	69.1	48.4
	<u>201.7</u>	<u>201.9</u>
Short-term deposits with credit institutions:		
— third parties <sup>1</sup>	1,277.9	1,029.5
— related parties	28.8	148.4
	<u>1,306.7</u>	<u>1,177.9</u>
<b>Total</b>	<u><b>1,508.4</b></u>	<u><b>1,379.8</b></u>

<sup>1</sup> Included in the above are investments of £492.5 million (2011: £612.0 million) held by the Group in Global Treasury Funds PLC (an open ended umbrella investment company with variable capital incorporated with limited liability in Ireland). RBS Asset Management (Dublin) Limited is the appointed manager to the fund.

The effective interest rate on short-term deposits with credit institutions for the year ended 31 December 2012 was 0.35% (2011: 0.78%) and has an average maturity of 11 days (2011: 85 days).

For the purposes of the cash flow statement, cash and bank overdrafts are as follows:

	At 31 December	
	2012	2011
	£m	£m
Cash and cash equivalents	1,508.4	1,379.8
Bank overdrafts	(90.9)	(70.2)
<b>Total</b>	<u><b>1,417.5</b></u>	<u><b>1,309.6</b></u>

## Notes to the consolidated financial statements (continued)

### 9. Insurance liabilities, unearned premium reserve and reinsurance assets

	At 31 December	
	2012	2011
	£m	£m
<b>Insurance liabilities</b>		
Life insurance	107.2	97.8
General insurance	6,291.3	6,411.2
<b>Total</b>	<b>6,398.5</b>	<b>6,509.0</b>
<b>Gross general insurance</b>		
Claims reported	3,969.3	4,036.9
Claims incurred but not reported	2,153.9	2,217.5
Loss adjustment expenses	163.8	153.2
Liability adequacy provision	4.3	3.6
<b>Total</b>	<b>6,291.3</b>	<b>6,411.2</b>
Unearned premium reserve	1,872.9	1,931.6
<b>Total</b>	<b>8,164.2</b>	<b>8,342.8</b>
<b>Reinsurers' share of general insurance</b>		
Claims reported	(397.8)	(318.1)
Claims incurred but not reported	(511.6)	(281.8)
<b>Total</b>	<b>(909.4)</b>	<b>(599.9)</b>
Unearned premium reserve	(97.9)	(59.0)
<b>Total</b>	<b>(1,007.3)</b>	<b>(658.9)</b>
<b>Net general insurance</b>		
Claims reported	3,571.5	3,718.8
Claims incurred but not reported	1,642.3	1,935.7
Loss adjustment expenses	163.8	153.2
Liability adequacy provision	4.3	3.6
<b>Total</b>	<b>5,381.9</b>	<b>5,811.3</b>
Unearned premium reserve	1,775.0	1,872.6
<b>Total</b>	<b>7,156.9</b>	<b>7,683.9</b>

## Notes to the consolidated financial statements (continued)

### 9. Insurance liabilities, unearned premium reserve and reinsurance assets (continued)

#### General insurance claims - gross

Accident year	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	Total £m
<b>Estimate of ultimate claims costs:</b>											
<b>At end of accident year</b>	3,648.5	3,679.1	4,007.5	4,091.6	4,390.5	3,878.1	4,148.0	4,261.9	3,080.5	2,797.3	37,983.0
One year later	(135.6)	(187.2)	(175.8)	(266.1)	(62.0)	23.2	120.0	(98.1)	(80.3)	—	(861.9)
Two years later	(105.5)	(89.8)	(141.7)	(42.0)	(1.1)	43.9	(42.5)	(115.3)	—	—	(494.0)
Three years later	(62.1)	(61.3)	(57.9)	(17.6)	49.4	(38.3)	(24.2)	—	—	—	(212.0)
Four years later	(42.9)	(41.9)	(59.5)	10.1	(7.0)	(22.0)	—	—	—	—	(163.2)
Five years later	(19.7)	(15.2)	15.3	(21.6)	(17.8)	—	—	—	—	—	(59.0)
Six years later	(25.3)	70.5	7.8	(9.1)	—	—	—	—	—	—	43.9
Seven years later	19.5	12.8	5.4	—	—	—	—	—	—	—	37.7
Eight years later	7.7	22.0	—	—	—	—	—	—	—	—	29.7
Nine years later	(12.1)	—	—	—	—	—	—	—	—	—	(12.1)
<b>Current estimate of cumulative claims</b>	3,272.5	3,389.0	3,601.1	3,745.3	4,352.0	3,884.9	4,201.3	4,048.5	3,000.2	2,797.3	36,292.1
<b>Cumulative payments to date</b>	(3,156.2)	(3,175.3)	(3,432.2)	(3,489.5)	(3,956.7)	(3,424.8)	(3,396.4)	(3,139.1)	(2,009.7)	(1,194.9)	(30,374.8)
<b>Liability recognised in balance sheet</b>	<b>116.3</b>	<b>213.7</b>	<b>168.9</b>	<b>255.8</b>	<b>395.3</b>	<b>460.1</b>	<b>804.9</b>	<b>909.4</b>	<b>990.5</b>	<b>1,602.4</b>	<b>5,917.3</b>
2002 and prior Loss adjustment expenses											205.9
											163.8
<b>Total gross liability</b>											<b>6,287.0</b>

## Notes to the consolidated financial statements (continued)

### 9. Insurance liabilities, unearned premium reserve and reinsurance assets (continued)

#### General insurance claims - net of reinsurance

Accident year	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	Total £m
<b>Estimate of ultimate claims costs:</b>											
<b>At end of accident year</b>	3,207.4	3,486.1	3,869.6	4,030.8	4,341.3	3,816.0	4,113.0	4,219.3	2,946.1	2,570.1	36,599.7
One year later	(103.3)	(169.2)	(159.3)	(249.7)	(81.7)	24.1	70.0	(109.7)	(119.3)	—	(898.1)
Two years later	(101.8)	(94.1)	(159.4)	(52.7)	(23.3)	8.2	(23.0)	(136.4)	—	—	(582.5)
Three years later	(71.0)	(68.3)	(62.0)	(28.2)	17.7	(24.5)	(64.2)	—	—	—	(300.5)
Four years later	(42.4)	(53.3)	(61.6)	9.9	(10.4)	(51.2)	—	—	—	—	(209.0)
Five years later	(36.0)	(13.5)	7.2	(43.5)	(22.4)	—	—	—	—	—	(108.2)
Six years later	(20.5)	60.7	(0.4)	(21.0)	—	—	—	—	—	—	18.8
Seven years later	5.5	(4.1)	(12.2)	—	—	—	—	—	—	—	(10.8)
Eight years later	6.2	(5.4)	—	—	—	—	—	—	—	—	0.8
Nine years later	(3.4)	—	—	—	—	—	—	—	—	—	(3.4)
<b>Current estimate of cumulative claims</b>	2,840.7	3,138.9	3,421.9	3,645.6	4,221.2	3,772.6	4,095.8	3,973.2	2,826.8	2,570.1	34,506.8
<b>Cumulative payments to date</b>	(2,778.4)	(3,020.9)	(3,303.4)	(3,439.4)	(3,895.9)	(3,391.6)	(3,366.2)	(3,122.8)	(1,929.2)	(1,141.9)	(29,389.7)
<b>Liability recognised in balance sheet</b>	<b>62.3</b>	<b>118.0</b>	<b>118.5</b>	<b>206.2</b>	<b>325.3</b>	<b>381.0</b>	<b>729.6</b>	<b>850.4</b>	<b>897.6</b>	<b>1,428.2</b>	<b>5,117.1</b>
2002 and prior											96.7
Loss adjustment expenses											163.8
<b>Total net liability</b>											<b>5,377.6</b>

## Notes to the consolidated financial statements (continued)

### 9. Insurance liabilities, unearned premium reserve and reinsurance assets (continued)

#### i. Movements in general insurance liabilities and reinsurance assets

	Gross £m	Reinsurance £m	Net £m
Notified claims	4,327.6	(310.0)	4,017.6
Incurred but not reported	2,514.2	(220.8)	2,293.4
Liability adequacy provision	25.4	—	25.4
<b>At 1 January 2011</b>	<b>6,867.2</b>	<b>(530.8)</b>	<b>6,336.4</b>
Cash paid for claims settled in the year	(3,547.7)	81.7	(3,466.0)
Increase / (decrease) in liabilities			
—arising from current-year claims	3,345.3	(134.4)	3,210.9
—arising from prior-year claims	(209.9)	(17.2)	(227.1)
Net exchange differences	(21.9)	0.8	(21.1)
Decrease in liability adequacy provision	(21.8)	—	(21.8)
<b>At 31 December 2011</b>	<b>6,411.2</b>	<b>(599.9)</b>	<b>5,811.3</b>
Notified claims	4,190.1	(318.1)	3,872.0
Incurred but not reported	2,217.5	(281.8)	1,935.7
Liability adequacy provision	3.6	—	3.6
<b>At 31 December 2011</b>	<b>6,411.2</b>	<b>(599.9)</b>	<b>5,811.3</b>
Cash paid for claims settled in the year	(2,949.1)	108.6	(2,840.5)
Increase / (decrease) in liabilities			
—arising from current-year claims	3,038.2	(227.2)	2,811.0
—arising from prior-year claims	(196.5)	(193.0)	(389.5)
Net exchange differences	(13.2)	2.1	(11.1)
Increase in liability adequacy provision	0.7	—	0.7
<b>At 31 December 2012</b>	<b>6,291.3</b>	<b>(909.4)</b>	<b>5,381.9</b>
Notified claims	4,133.1	(397.8)	3,735.3
Incurred but not reported	2,153.9	(511.6)	1,642.3
Liability adequacy provision	4.3	—	4.3
<b>At 31 December 2012</b>	<b>6,291.3</b>	<b>(909.4)</b>	<b>5,381.9</b>

#### ii. Movement in prior-year net claims liabilities by operating segment

	2012 £m	2011 £m
Motor	(174.3)	(138.2)
Home	(37.4)	48.5
Rescue and other personal lines	(23.9)	(52.8)
Commercial	(56.2)	(38.4)
International	(30.2)	(7.9)
<b>Total ongoing</b>	<b>(322.0)</b>	<b>(188.8)</b>
Run-off	(67.5)	(38.3)
<b>Total Group</b>	<b>(389.5)</b>	<b>(227.1)</b>



## Notes to the consolidated financial statements (continued)

### 9. Insurance liabilities, unearned premium reserve and reinsurance assets (continued)

#### iii. Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
<b>At 1 January 2011</b>	<b>2,288.6</b>	<b>(71.8)</b>	<b>2,216.8</b>
Net (decrease) / increase in the year	(354.6)	12.8	(341.8)
Exchange movement	(2.4)	—	(2.4)
<b>At 31 December 2011</b>	<b>1,931.6</b>	<b>(59.0)</b>	<b>1,872.6</b>
Net decrease in the year	(47.1)	(38.9)	(86.0)
Exchange movement	(11.6)	—	(11.6)
<b>At 31 December 2012</b>	<b>1,872.9</b>	<b>(97.9)</b>	<b>1,775.0</b>

### 10. Related parties

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc and is therefore the ultimate controlling party of the Group. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. This gives rise to related party transactions and balances, specifically in respect of tax with HMRC and debt security investments with the UK Government.

The Group's immediate holding company is The Royal Bank of Scotland Group plc which is incorporated in the United Kingdom and registered in Scotland.

At 31 December 2012, The Royal Bank of Scotland Group plc heads the largest group in which the Group is consolidated. Copies of the consolidated accounts of The Royal Bank of Scotland Group plc may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

The following transactions were carried out with related parties, who are all members of RBS Group.

#### i. Sales of insurance contracts and other services

	Year ended 31 December	
	2012 £m	2011 £m
Parent	(0.1)	—
Fellow subsidiaries	7.0	17.6
<b>Total</b>	<b>6.9</b>	<b>17.6</b>

## Notes to the consolidated financial statements (continued)

### 10. Related parties (continued)

#### ii. Purchases of services

	Year ended 31 December	
	2012	2011
	£m	£m
Parent	223.8	287.9
Fellow subsidiaries	46.9	63.9
<b>Total</b>	<b>270.7</b>	<b>351.8</b>

Purchases of services are charged on an arm's length basis.

Employee costs recharged by RBS Group include the full costs of key managers and other staff in respect of share based payments. The attribution among members of the RBS Group has regard to the needs of RBS Group as a whole.

#### iii. Compensation of key management

The aggregate remuneration of directors and other members of key management during the year was as follows:

	Year ended 31 December	
	2012	2011
	£m	£m
Short-term employee benefits	5.6	4.2
Post-employment benefits	0.6	0.4
Other long-term benefits	1.5	2.1
Termination benefits	2.2	0.1
Share based payments	0.5	0.1
<b>Total</b>	<b>10.4</b>	<b>6.9</b>

#### iv. Year-end balances arising from cash and investment transactions with members of the RBS Group

	Year ended 31 December	
	2012	2011
	£m	£m
Cash at bank held with related parties	69.1	48.4
Short-term bank deposits held with related parties	28.8	148.4
Bank overdrafts held with related parties	(90.9)	(64.2)
Derivative financial assets and liabilities	23.0	0.1
Term deposits held with related parties	50.0	147.0
<b>Total</b>	<b>80.0</b>	<b>279.7</b>

Debt securities held with related parties

	2012	2011
	£m	£m
RBS Group issuers	75.0	304.6

## Notes to the consolidated financial statements (continued)

### 10. Related parties (continued)

#### v. Year-end balances arising from sales/purchases of products/services.

Receivables from related parties

<b>At 31 December</b>	<b>2012</b>	<b>2011</b>
	<b>£m</b>	<b>£m</b>
Parent	<u>0.3</u>	0.1
Fellow subsidiaries	<u>4.8</u>	7.6
<b>Total</b>	<b><u>5.1</u></b>	<b><u>7.7</u></b>

Movements in receivables from related parties were as follows:

	<b>2012</b>	<b>2011</b>
	<b>£m</b>	<b>£m</b>
At 1 January	<u>7.7</u>	7.6
Transactions in the year	<b>68.0</b>	7.3
Settled in the year	<u>(70.6)</u>	(7.2)
<b>At 31 December</b>	<b><u>5.1</u></b>	<b><u>7.7</u></b>

Included in the above is an amount of £69.5 million in the year ended 31 December 2012, invoiced to and paid by RBS Group for the purchase of investment properties.

Due to related parties

<b>At 31 December</b>	<b>2012</b>	<b>2011</b>
	<b>£m</b>	<b>£m</b>
Parent	<u>5.4</u>	75.1
Fellow subsidiaries	<u>29.3</u>	83.6
<b>Total</b>	<b><u>34.7</u></b>	<b><u>158.7</u></b>

Movements due to related parties were as follows:

	<b>2012</b>	<b>2011</b>
	<b>£m</b>	<b>£m</b>
At 1 January	<u>158.7</u>	44.7
Transactions in the year	<b>294.6</b>	261.0
Settled in the year	<u>(418.6)</u>	(147.0)
<b>At 31 December</b>	<b><u>34.7</u></b>	<b><u>158.7</u></b>

Included in the above is an amount of £39.3 million in the year ended 31 December 2012, invoiced by and paid to the RBS Group for the acquisition of furniture, fittings and IT hardware. Furthermore, also included is an amount of £31.3 million paid to the RBS Group pension scheme.

#### vi. Loans from related parties

<b>At 31 December</b>	<b>2012</b>	<b>2011</b>
	<b>£m</b>	<b>£m</b>
Parent	<u>—</u>	12.5
Fellow subsidiary	<u>—</u>	235.2
<b>Total</b>	<b><u>—</u></b>	<b><u>247.7</u></b>

## Notes to the consolidated financial statements (continued)

### 10. Related parties (continued)

Movements in loans to related parties were as follows:

	2012	2011
	£m	£m
At 1 January	247.7	249.2
Loans received during the year	—	205.0
Loan repayments made	(246.4)	(205.5)
Interest charged	2.7	2.3
Interest settled	(2.7)	(2.3)
Exchange movements	(1.3)	(1.0)
<b>At 31 December</b>	<b>—</b>	<b>247.7</b>

During the year ended 31 December 2012, the Group repaid its loans from RBS Group in preparation for operational separation.

### 11. Post balance sheet events

On 8 January 2013, the Group repaid undated subordinated loans of £258.5 million to TPF.

### 12. Statutory information

The financial information set out in this preliminary announcement does not constitute the statutory accounts for the year ended 31 December 2012. The financial information is derived from the statutory accounts for that year which were signed on 27 February 2013 and will be delivered to the Registrar of Companies following the Annual General Meeting to be held on 6 June 2013. The independent auditors' report on the Group accounts for the year ended 31 December 2012 is unqualified, does not draw attention to any matters by way of emphasis and does not include a statement under section 498(2) or (3) of the Companies Act 2006.

## Directors' responsibility statement

We confirm that to the best of our knowledge:

1. the financial statements within the full Annual Report & Accounts, from which the financial information within this preliminary announcement has been extracted, are prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the undertakings included in the consolidation taken as a whole; and
2. the management report within this preliminary announcement includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties faced by the Group.

Signed on behalf of the Board

Paul Geddes  
Chief Executive Officer  
27 February 2013

John Reizenstein  
Chief Financial Officer  
27 February 2013