Half Year Report 2017

1 August 2017

Strong H1 results, rebasing dividend and refreshing targets

Paul Geddes, CEO of Direct Line Group, commented

"The Group delivered another strong first half performance, as we continued to focus on giving customers what they want. In particular, we are pleased with the continued momentum in our Direct Line brand, which shows that customers value the great service and unique insurance propositions we are offering in both Personal Lines and Commercial Lines.

"Today the Board is rebasing the Group's regular dividend upwards to reflect its confidence in the Group's earnings and the progress the business has made since the IPO nearly 5 years ago when the Group's dividend policy was previously set. We aim to grow the regular dividend in line with business growth, which we expect to be in the region of 2% to 3% per annum over the medium term.

"The investments we have made and continue to make in our business have delivered value for our customers and shareholders. As a result, we reiterate our 93% to 95% combined operating ratio target for 2017 and also extend this ambition over the medium term."

Results summary

	H1 2017 £m	H1 2016 £m	Change
Gross written premium	1,694.2	1,613.1	+5.0%
Operating profit – Ongoing operations	354.2	323.6	+9.5%
Commission ratio[1]	8.9%	10.9%	(2.0pts)
Expense ratio[1]	24.6%	25.3%	(0.7pts)
Combined operating ratio[1]	88.9%	89.6%	(0.7pts)
Return on tangible equity annualised[2]	26.1%	23.1%	+3.0pts
Dividend per share – regular interim (pence)[3]	6.8p	4.9p	+38.8%
	30 Jun 2017	31 Dec 2016	Change
Solvency II capital coverage ratio post-dividend	173%	165%	+8pts

Highlights and outlook

- Motor continued to grow gross written premiums, up 10% with Direct Line driving the growth
- Commercial launched the first of its flexible and bespoke business insurance policies, a part of our digital transformation, leveraging our strong Direct Line brand and our goal of making insurance much easier and better value for our customers
- The Board is rebasing the regular dividend up 38.8%, increasing the interim dividend to 6.8p[3]. In addition, the Group expects to operate around the middle of its Solvency II capital coverage ratio range of 140% to180%, in the normal course of business
- Reiterate the current financial targets for 2017: combined operating ratio in the range of 93% to 95% and investment income yield at 2.4%
- In addition, management targets maintaining a 93% to 95% combined operating ratio over the medium term, reflecting its ambition to maintain strong annual financial performance

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Notes:

1. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents a deterioration. See glossary on page 37 for definition.
2. See glossary on page 37 for definitions and appendix A – Alternative performance measures on page 39 for reconciliation to financial statements line items.
3. The Group's dividend policy states its expectation that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend and two-thirds will be paid as a final dividend in the second quarter of the following year.

Forward-looking statements disclaimer

Certain information contained in this document, including any information as to the Group's strategy, plans or future financial or operating performance, constitutes "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "aims", "ambition", "anticipates", "aspire", "believes", "continue", "could", "estimates", "expects", "guidance", "intends", "may", "mission", "outlook", "over the medium term", "plans", "predicts", "projects", "propositions", "seeks", "should", "strategy", "targets" 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 document and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, among other things: the Group's results of operations, financial condition, prospects, growth, strategies and the industry in which the Group operates. Examples of forward-looking statements include financial targets, which are contained in this document specifically with respect to the return on tangible equity, Solvency II capital coverage ratio, the Group's combined operating ratio, prior-year reserve releases, cost reduction, investment income yield, net realised and unrealised gains, results from the run-off segment, restructuring costs, and risk appetite range. By their nature, all forward-looking statements involve risk and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future 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 document, for example directly or indirectly as a result of, but not limited to, UK domestic and global economic business conditions, the result of the referendum and the negotiations relating to the UK's withdrawal from the European Union, the result of the UK general election, 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 and deflation, the timing impact and other uncertainties of future acquisitions, disposals, joint ventures 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 document reflect knowledge and information available as of the date of preparation of this document. The Group and the Directors expressly disclaim any obligations or undertaking to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, unless required to do so by applicable law or regulation. Nothing in this document should be construed as a profit forecast.

Inside information

Prior to publication, this document contained inside information for the purposes of Article 7 of European Union Regulation 596/2014.

Financial summary

	H1 2017 £m	H1 2016 £m	Change
Ongoing operations:			
In-force policies (thousands)	15,811	15,736	0.5%
Gross written premium	1,694.2	1,613.1	5.0%
Net earned premium	1,547.5	1,479.9	4.6%
Underwriting profit	172.0	154.2	11.5%
Investment return	92.6	91.0	1.8%
Instalment and other operating income	89.6	78.4	14.3%
Operating profit – Ongoing operations	354.2	323.6	9.5%
Run-off	10.0	23.6	(57.6%)
Restructuring costs	(4.5)	(30.3)	85.1%
Operating profit	359.7	316.9	13.5%
Finance costs	(18.3)	(18.4)	0.5%
Profit before tax	341.4	298.5	14.4%
Tax	(65.9)	(62.6)	(5.3%)
Profit after tax	275.5	235.9	16.8%
Of which Ongoing operations	271.2	244.2	11.1%
Key metrics – Ongoing operations			
Current-year attritional loss ratio[1]	68.8%	68.5%	0.3pts
Loss ratio[1]	55.4%	53.4%	2.0pts
Commission ratio[1]	8.9%	10.9%	(2.0pts)
Expense ratio[1]	24.6%	25.3%	(0.7pts)
Combined operating ratio[1]	88.9%	89.6%	(0.7pts)
Adjusted diluted earnings per share[2] (pence)	19.7	17.6	11.9%
Return on tangible equity annualised[2]	26.1%	23.1%	3.0pts
Key metrics			
Investment income yield annualised[2]	2.5%	2.5%	–
Investment return annualised[2]	2.8%	2.8%	–
Basic earnings per share (pence)	20.2	17.2	17.4%
Return on equity annualised	21.3%	17.8%	3.5pts
Dividend per share – regular interim (pence)	6.8	4.9	38.8%
– special interim (pence)	–	10.0	–
– total (pence)	6.8	14.9	(54.4%)
	30 Jun 2017	**31 Dec 2016**	**Change**
Solvency II capital coverage ratio	173%	165%	8pts
Net asset value per share (pence)	194.4	184.7	5.3%
Tangible net asset value per share (pence)	156.5	147.4	6.2%

Notes:

1. A reduction in the ratio represents an improvement as a proportion of net earned premium, while an increase in the ratio represents deterioration
2. See glossary on page 37 for definition and appendix A – Alternative performance measures on page 40 and 41 for reconciliation to the financial statement line items

Business update

Overview

Direct Line Group (the "**Group**") delivered a strong performance in the first half of 2017, grew gross written premium 5.0%, reduced expense and commission ratios compared to the first half of 2016 and achieved a return on tangible equity of 26.1%. Solvency II capital coverage ratio remained strong at 173% as at 30 June 2017 after taking into account the interim regular dividend of 6.8 pence per share (H1 2016: 4.9 pence per share).

Throughout its transformation, the Group has remained focussed on developing its future capabilities, with investments in the Group's digital offering, customer experience and operational efficiency. H1 2017 saw one of these investments reach a significant milestone with the launch in April of Commercial's first trade segment, Hair and Beauty, on its new digital platform. The benefits of the Group's long-term investment approach were clear in H1 2017, with continued momentum in the Direct Line brand as it grew policy count and gross written premium again across Motor, Home and Commercial. Since 2013, the Group's own brands in-force policies have grown on average between 2% to 3% p.a.

Motor

The Group continued to benefit from its strong competitive position in Motor, growing gross written premium 9.9% and in-force policies 4.9% in the first half of 2017, principally driven by the strength of the Direct Line brand. In the first half of the year, the Direct Line proposition was further enhanced with the addition of onward travel by taxi if the customer's car is not driveable. The growth was achieved while also improving the current-year loss ratio from 84.6% in H1 2016 to 81.7% in H1 2017.

Bodily injury claims continued to trend more favourably than expected. In addition, detailed case reviews conducted in Q2 of the additional costs arising from the lowering of the Ogden discount rate indicated a lower than expected increase to claims costs. This has resulted in a reserve release of £49m, leading to a total prior-year reserve release of £174.6m in the first half of 2017 (H1 2016 £134.0m). The Group continued to reserve prudently and assumes a minus 0.75% Ogden discount rate.

Commercial

Direct Line for Business ("**DL4B**") launched its first product on its new digital platform, initially for Hair and Beauty professionals, with more professions planned to follow. This key strategic step aligns a new customer-centric digital approach with leveraging the Group's strong, proposition led, Direct Line brand. The Group sees the under-served and growing small and micro business segment as an important medium term prospect.

At the same time, DL4B's current portfolio of predominantly landlord, tradesman and van products continued to grow well, with gross written premium up 13.4% compared to the first half of 2016. DL4B also enhanced its proposition in the first half of 2017 with its rent guarantee cover offer for landlord insurance, and won What Mortgage? 'Best Landlord Insurance Provider' for the fifth year running.

In addition to the direct channel, NIG and other continues to support commercial insurance brokers by using technology to improve trading efficiency through more on-line products, improved eTrade quotability and a fully paperless offering for all products.

Home

Home's results were robust, helped by low weather losses, partially offsetting higher than expected claims inflation from the escape of water ("**EoW**") peril. The first half of 2016 benefitted from an unusually high reserve release resulting from 2015 weather events (14.8pts). These weather releases were not repeated in H1 2017. The impact of EoW on the 2017 loss ratio (on both prior and current year) was partially offset through lower profit share commission due to partners. The commission ratio also reduced due to changes to partner arrangements and business mix.

The Home business has taken a number of significant actions across pricing, underwriting and claims management to mitigate EoW inflation. These actions are intended to help return profitability to more normal levels in 2018. While these actions saw reduced new business sales in the first half, Home was still able to maintain its year on year retention levels. In own brands, this supported in-force policy growth of 1.5% and gross written premium growth of 0.8%. Partnership premiums declined 7.9% as in-force policies fell 7.6%.

Rescue

Rescue had a strong half, benefitting from lower than normal claims frequency while growing gross written premium 2.1%. Green Flag, the Group's direct rescue brand, continued its growth momentum, growing in-force policies 8.0% and gross written premium 10.8%. New management has been appointed to the Rescue division and Green Flag has launched a new advertising campaign to highlight its challenger status.

Dividends and capital management

The Board has resolved to pay a regular interim dividend of 6.8 pence per share, an increase on H1 2016 of 1.9 pence per share, 38.8%, reflecting the Group's confidence in its earnings and the progress the business has made since the Group's initial public offering ("**IPO**") nearly 5 years ago. After deducting this regular interim dividend, the Group's estimated Solvency II capital coverage ratio as at 30 June 2017 was 173%.

The Board previously set its dividend policy at the time of the IPO in 2012 and has now updated the policy as set out on page 13. The Board continues to expect that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend and two-thirds will be paid in the second quarter of the following year. The Board aims to grow the regular dividend in line with business growth.

Under normal circumstances, the Group expects to operate around the middle of its Solvency II capital coverage ratio risk appetite range of 140% to 180% of the Group's solvency capital requirement, and it will take this into account when considering the potential for any special distributions.

The revised dividend policy reiterates that in the normal course of events the Board will consider whether or not it is appropriate to pay a special dividend once a year, alongside the full-year results.

Outlook

For 2017, the Group targets a combined operating ratio of 93% to 95%, reductions in its expense and commission ratios, a 2.4% investment income yield and a RoTE of at least 15%.

Beyond 2017, the Group targets having a 93% to 95% combined operating ratio over the medium term supported by reductions in its expense and commission ratios and reiterates its ongoing target of achieving at least a 15% return on tangible equity ("**RoTE**").

Finance review

Performance

Operating profit – Ongoing operations

	H1 2017 £m	H1 2016 £m
Underwriting profit	172.0	154.2
Investment return	92.6	91.0
Instalment and other operating income	89.6	78.4
Total	354.2	323.6

Underwriting profit increased to £172.0m, an increase of 11.5% compared to H1 2016. This included the benefit of improved current year loss ratios in Motor, Rescue and other personal lines and Commercial as well as lower expense and commission ratios compared to H1 2016. In Home, weather costs were lower than expected, and in line with H1 2016; however higher than expected claims inflation from EoW led to higher claims costs. Prior-year reserve releases were £19.7m lower at £216.4m (H1 2016: £236.1m) and excluding these releases, current-year operating profits were significantly higher at £137.8m (H1 2016: £87.5m).

Investment return improved to £92.6m (H1 2016: £91.0m) primarily due to a £1.9m increase in net realised and unrealised gains.

Operating profit from Ongoing operations increased by 9.5% to £354.2m (H1 2016: £323.6m) mainly due to an improvement in the underwriting result and higher instalment and other operating income.

In-force policies and gross written premium

In-force policies – Ongoing operations (thousands)

At	30 Jun 2017	31 Mar 2017	31 Dec 2016	30 Sep 2016	30 Jun 2016
Own brands	3,761	3,691	3,642	3,607	3,541
Partnerships	205	220	231	233	238
Motor total	3,966	3,911	3,873	3,840	3,779
Own brands	1,770	1,764	1,759	1,751	1,743
Partnerships	1,534	1,593	1,619	1,638	1,660
Home total	3,304	3,357	3,378	3,389	3,403
Of which Nationwide and Sainsbury's	688	706	719	723	724
Rescue	3,663	3,676	3,646	3,621	3,670
Other personal lines	4,178	4,188	4,234	4,219	4,224
Rescue and other personal lines	7,841	7,864	7,880	7,840	7,894
Of which own brands	2,007	1,936	1,886	1,847	1,850
Direct Line for Business	452	441	433	428	424
NIG and other	248	245	242	239	236
Commercial	700	686	675	667	660
Total	15,811	15,818	15,806	15,736	15,736

Gross written premium – Ongoing operations

	Q2 2017 £m	Q2 2016 £m	H1 2017 £m	H1 2016 £m
Own brands	412.7	362.9	781.2	694.3
Partnerships	19.0	26.7	43.2	56.0
Motor total	431.7	389.6	824.4	750.3
Own brands	97.6	96.3	193.2	191.6
Partnerships	95.7	104.1	194.9	211.6
Home total	193.3	200.4	388.1	403.2
Of which Nationwide and Sainsbury's	46.2	50.1	97.6	105.0
Rescue	42.9	42.5	83.6	81.9
Other personal lines	66.2	58.4	129.7	115.8
Rescue and other personal lines	109.1	100.9	213.3	197.7
Of which own brands	54.3	48.1	106.8	98.8
Direct Line for Business	31.5	27.1	60.1	53.0
NIG and other	118.3	117.3	208.3	208.9
Commercial	149.8	144.4	268.4	261.9
Total	883.9	835.3	1,694.2	1,613.1

Total in-force policies for Ongoing operations during the first half of 2017 remained stable at 15.8 million (31 December 2016 15.8 million). This was due primarily to continued in-force policy growth in Motor and Home's own brands, Green Flag direct and Commercial offset by lower partner volumes in Home and Rescue and other personal lines.

Gross written premium of £1,694.2m increased 5.0% compared with first half of 2016, reflecting continued growth as above.

Motor

In-force policies increased 4.9%, adding 187,000 policies, compared with the first half of 2016. Motor's own brands grew by 6.2% over the same period underpinned by higher levels of new business growth combined with strong customer retention. Investment in brand differentiation through a succession of new Direct Line propositions and competitive pricing continued to drive the improved performance. Motor gross written premium increased by 9.9% in comparison to the first half of 2016 which also reflects the Group's pricing response to ongoing claims inflation including the response to the Ogden discount rate change.

Motor average written premium[1] increased by 6.6% in H1 2017, and risk-adjusted prices increased 11.1%. The Group overall sought to price for changes to the Ogden discount rate (gross of reinsurance) and general claims inflation, partially offset by underlying improvements in bodily injury cost trends. Claims inflation remained around the top of the Group's long-term expectations, although bodily injury costs for prior years continued to improve over initial expectations.

Home

In-force policies for Home's own brands increased by 1.5% compared with the first half of 2016, while partnership volumes reduced by 7.6% due to the cessation of new business in Sainsbury's and a slow-down in other partnership arrangements. The Group's partnership with Nationwide is now expected to continue to the end of 2017. Gross written premium was 3.7% lower than the first half of 2016, due to partners which were 7.9% lower, while own brands experienced a small increase of 0.8%.

Home own brands' average written premium[2] decreased by 0.9% compared with the first half of 2016 driven by lower risk mix partially offset by low single-digit price increases in a highly competitive market. Claims inflation continued to rise in the quarter ahead of price increases. In addition to price increases, the Group is also taking action in underwriting and claims management to mitigate higher claims inflation. Retention in Home own brands continued to be strong.

Notes:

1. Average incepted written premiums excluding IPT for total Motor for year to date 30 June 2017.
2. Average incepted written premiums excluding IPT for Home own brands for year to date 30 June 2017.

Rescue and other personal lines

Rescue and other personal lines experienced a small reduction in in-force policies of 0.7% in the first half of 2017 compared with the first half of 2016, primarily resulting from lower partner volumes. Gross written premium for Rescue and other personal lines increased by 7.9% compared with the first half of 2016, mainly due to price increases in Travel and strong growth in Green Flag.

Commercial

Commercial in-force policies were 6.1% higher than for the first half of 2016, reflecting growth in both Direct Line for Business and NIG and other. The increase in gross written premium of 2.5%, compared to the first half of 2016, reflected continuing strong growth in Direct Line for Business, with NIG and other premiums slightly lower primarily due to product mix.

Underwriting profit – Ongoing operations

	H1 2017	H1 2016
Underwriting profit (£m)	172.0	154.2
Loss ratio	55.4%	53.4%
Commission ratio	8.9%	10.9%
Expense ratio	24.6%	25.3%
Combined operating ratio	88.9%	89.6%

The combined operating ratio for Ongoing operations of 88.9% (H1 2016: 89.6%) improved by 0.7 percentage points primarily due to improvements in the commission and expense ratios offset by a higher loss ratio. The increase in the loss ratio to 55.4% (H1 2016: 53.4%) reflected lower prior-year reserve releases, and an increase in Home's current-year loss ratio partially offset by an improvement in Motor's current-year loss ratio. The Group's expense ratio of 24.6% improved by 0.7pts as the Group kept its cost base stable and grew its earned premium. The reduction in the commission ratio of 2.0 percentage points primarily reflected lower profit share payments to Home partners, as a result of lower prior-year reserve releases, a higher attritional loss ratio, changes to partnership arrangements and business mix.

The Group achieved a combined operating ratio for Ongoing operations, normalised for weather of approximately 91% (H1 2016: approximately 91%). The Group maintains its target to achieve a combined operating ratio of 93%-95% for 2017, assuming normal weather for the year.

Beyond 2017, the Group targets maintaining a 93%-95% combined operating ratio over the medium term, assuming a normal annual level of weather claims.

Loss ratio analysis by division – Ongoing operations

	Notes[1]	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Ongoing £m
H1 2017						
Net insurance claims	4	403.5	190.7	135.7	127.1	857.0
Prior-year reserve release/(strengthening)	19	174.6	16.8	(2.1)	27.1	216.4
Major weather events		n/a	(9.0)	n/a	n/a	(9.0)
Attritional net insurance claims		578.1	198.5	133.6	154.2	1,064.4
Net earned premium	4	707.8	397.0	209.0	233.7	1,547.5
Loss ratio current-year attritional		81.7%	50.0%	63.9%	66.0%	68.8%
Loss ratio – prior-year reserve releases		(24.7%)	(4.3%)	1.0%	(11.6%)	(14.0%)
Loss ratio – major weather events		n/a	2.3%	n/a	n/a	0.6%
Loss ratio – reported	4	57.0%	48.0%	64.9%	54.4%	55.4%
Commission ratio	4	2.6%	17.0%	5.0%	17.9%	8.9%
Expense ratio	4	25.5%	23.8%	23.9%	23.8%	24.6%
Combined operating ratio	4	85.1%	88.8%	93.8%	96.1%	88.9%
H1 2016						
Net insurance claims	4	416.1	137.7	121.4	115.1	790.3
Prior-year reserve releases	19	134.0	60.6	7.5	34.0	236.1
Major weather events		n/a	(13.0)	n/a	n/a	(13.0)
Attritional net insurance claims		550.1	185.3	128.9	149.1	1,013.4
Net earned premium	4	650.3	411.7	194.8	223.1	1,479.9
Loss ratio current-year attritional		84.6%	45.0%	66.2%	66.8%	68.5%
Loss ratio – prior-year reserve releases		(20.6%)	(14.8%)	(3.9%)	(15.2%)	(16.0%)
Loss ratio – major weather events		n/a	3.2%	n/a	n/a	0.9%
Loss ratio – reported	4	64.0%	33.4%	62.3%	51.6%	53.4%
Commission ratio	4	2.6%	22.2%	4.9%	19.4%	10.9%
Expense ratio	4	25.7%	25.3%	25.5%	24.0%	25.3%
Combined operating ratio	4	92.3%	80.9%	92.7%	95.0%	89.6%

The movement in the current-year attritional loss ratio is a key indicator of underlying accident year performance as it excludes prior-year reserve movements and claims costs from major weather events in the Home division. The Group's current-year attritional loss ratio of 68.8% was broadly stable compared to the same period in 2016 with improvements in Motor, Rescue and other personal lines and Commercial, partially offset by a deterioration in Home as a result of rising claims inflation due to EoW.

Prior-year reserve releases from Ongoing operations continued to be significant at £216.4m (H1 2016: £236.1m) and were equivalent to 14.0% of net earned premium (H1 2016: 16.0% of net earned premium). Reserve releases were high in H1 2017 as bodily injury claims continued to trend more favourably than expected. Additionally, detailed case reviews in Q2 2017, for the additional costs arising from the lowering of the Ogden discount rate, indicated a £49m reduction in the impact of the rate change. Prior-year reserve releases are expected to reduce in future years, although they are expected to remain a significant contribution to profits.

Note:

1. See notes to the condensed consolidated financial statements.

Motor

The combined operating ratio for the Motor division was 85.1% (H1 2016: 92.3%), an improvement of 7.2 percentage points due to higher prior-year reserve releases, including reserve releases from the detailed case reviews, and the current-year improvement in the loss ratio. The current-year attritional loss ratio improved by 2.9 percentage points, to 81.7% due to a favourable trading environment and the recognition of benefits from our claims handling processes and initiatives. The Group expects to continue to re-invest in our customer propositions. Both the expense and commission ratios were stable compared to the first half of 2016.

Home

In Home, the combined operating ratio increased by 7.9 percentage points to 88.8% (H1 2016: 80.9%) with a higher loss ratio, in part offset by improving expense and commission ratios. The loss ratio was higher as a result of lower prior-year reserve releases compared with H1 2016, which benefitted from approximately 7 percentage points of one-off weather-related releases, and the impact of higher than expected claims inflation from EoW claims. The current-year attritional loss ratio, excluding major weather event claims, increased by 5.0 percentage points, also reflecting higher EoW claims inflation experience. The weather in H1 2017 was benign with £9.0m of claims costs from major weather events (H1 2016: £13.0m).

The commission ratio of 17.0% was 5.2 percentage points lower than the first half of 2016 reflective of lower profit commission payments to partners resulting from the impact of elevated claims experience and changes to partner arrangements.

Rescue and other personal lines

The combined operating ratio for Rescue and other personal lines increased by 1.1 percentage points to 93.8% (H1 2016: 92.7%) due principally to an increase in the loss ratio with lower prior-year reserve releases on Travel, partly offset by a 2.3 percentage points improvement in the current-year attritional loss ratio. The expense ratio improved primarily due to lower marketing expenditure on Rescue, while the commission ratio remained stable.

Commercial

The combined operating ratio for Commercial increased by 1.1 percentage points to 96.1% (H1 2016: 95.0%) primarily due to an increase in the loss ratio as a result of a 3.6 percentage points lower contribution from prior-year reserve releases. The current-year attritional loss ratio improved by 0.8 percentage points to 66.0% (H1 2016: 66.8%). The higher loss ratio was partly offset by lower expense and commission ratios. Normalising for claims from weather and large claims, the combined operating ratio was approximately 99% (H1 2016: approximately 98%).

Total costs – Ongoing operations

	Notes	H1 2017 £m	H1 2016 £m
Staff costs		202.2	209.1
Other operating expenses		165.0	144.9
Marketing		59.0	62.6
Amortisation and impairment of other intangible assets		26.7	30.0
Depreciation		14.1	15.0
Total costs		467.0	461.6
Operating expenses	4	380.4	374.6
Claims handling expenses	8	86.6	87.0
Total costs		467.0	461.6

Total costs for Ongoing operations increased by £5.4m to £467.0m. Other operating expenses increased due to higher IT costs, offshoring fees and levies. The Group continues to invest in its significant IT programme and operational efficiency improvements while supporting business growth and investment in future capability.

Instalment and other operating income – Ongoing operations

	H1 2017 £m	H1 2016 £m
Instalment income	55.8	51.4
Other operating income:		
Vehicle replacement referral income	8.3	6.8
Revenue from vehicle recovery and repair services[1]	9.8	9.4
Other income	15.7	10.8
Total other operating income	33.8	27.0
Total	89.6	78.4

Instalment and other operating income from Ongoing operations increased by £11.2m, with increased instalment payments of £4.4m due to higher Motor gross written premium.

Investment return – Ongoing operations

	H1 2017 £m	H1 2016 £m
Investment income	82.4	82.7
Net realised and unrealised gains	10.2	8.3
Total investment return	92.6	91.0

Investment income remained broadly stable compared to H1 2016, despite a reduction of 25 basis points by the Bank of England in the UK base rate in August 2016 and lower assets under management.

Net realised and unrealised gains were higher at £10.2m (H1 2016: £8.3m) primarily due to higher unrealised property gains.

Investment yields

	H1 2017	H1 2016
Investment income yield	2.5%	2.5%
Investment return yield	2.8%	2.8%

The investment income yield for H1 2017 was 2.5%, which is slightly above the full year expectation of 2.4%.

Investment holdings – total Group

At	30 Jun 2017 £m	31 Dec 2016 £m
Investment-grade credit[2]	3,923.6	3,888.3
High yield	392.3	409.9
Investment-grade private placements	88.3	85.1
Credit	4,404.2	4,383.3
Sovereign	363.0	341.2
Total debt securities	4,767.2	4,724.5
Infrastructure debt	328.0	337.0
Commercial real estate loans	90.9	79.7
Cash[3]	1,047.2	1,110.8
Investment property	314.9	329.0
Total Group	6,548.2	6,581.0

Notes:

1. Vehicle recovery includes post-accident and pay-on-use recovery. Repair services constitute the provision of non-insurance related services.
2. Asset allocation at 30 June 2017 includes investment portfolio derivatives, which have been netted and have a mark-to-market asset of £30.6m included in investment-grade credit (31 December 2016: mark-to-market liability of £5.8m included in investment grade credit). This excludes derivatives that have been used to hedge interest on subordinated debt and operational cash flows.
3. Net of bank overdrafts, includes cash at bank and in hand and money market funds with no notice period for withdrawal.

At 30 June 2017, total investment holdings of £6,548.2m were 0.5% lower than at the start of the year. Total debt securities were £4,767.2m (31 December 2016: £4,724.5m), of which 6.1% were rated as 'AAA' and a further 63.1% were rated as 'AA' or 'A'. The average duration at 30 June 2017 of total debt securities was 2.3 years (31 December 2016: 2.3 years).

At 30 June 2017, total unrealised gains, net of tax, on available-for-sale investments were £86.5m (31 December 2016: £92.1m).

Operating profit – Ongoing operations

	H1 2017 £m	H1 2016 £m
Motor	233.9	168.8
Home	67.5	101.5
Rescue and other personal lines	22.6	23.4
Commercial	30.2	29.9
Total	354.2	323.6

All divisions were profitable in H1 2017 with a significant increase in Motor offset by reduced operating profits in Home and Rescue and other personal lines.

Reconciliation of operating profit

	H1 2017 £m	H1 2016 £m
Operating profit – Ongoing operations	354.2	323.6
Run-off	10.0	23.6
Restructuring costs	(4.5)	(30.3)
Operating profit	359.7	316.9
Finance costs	(18.3)	(18.4)
Profit before tax	341.4	298.5
Tax	(65.9)	(62.6)
Profit after tax	275.5	235.9

Run-off
The Run-off segment generated a profit of £10.0m in H1 2017 compared with £23.6m in H1 2016. The reduction in the result followed lower prior-year reserve releases from large bodily injury claims. It is expected that the Run-off segment will continue to contribute positively to operating profit in future years, albeit at a lower level.

Restructuring costs
Restructuring costs for H1 2017 of £4.5m (H1 2016: £30.3m) were significantly lower than in H1 2016.

Over the four year period 2015 to 2018, the Group expects cumulative restructuring costs to be broadly offset by operating profit from the Run-off segment.

Finance costs
Finance costs remained stable at £18.3m (H1 2016: £18.4m).

Taxation
The effective tax rate in H1 2017 was 19.3% (H1 2016: 21.0%), which was higher than the standard UK corporation tax rate of 19.25% (H1 2016: 20.0%) driven primarily by disallowable expenses offset by a prior year tax credit.

Profit for the period and return on tangible equity
Profit for the period of £275.5m (H1 2016: £235.9m) reflected an increase on H1 2016 predominantly due to an improvement in the underwriting result, an increase in instalment and other operating income and a reduction in restructuring costs.

Return on tangible equity increased to 26.1% (H1 2016: 23.1%) due to an annualised profit after tax from Ongoing operations of £542.4m (H1 2016: £488.4m) and a reduction in the average shareholders' tangible equity.

Earnings per share

Basic earnings per share increased by 17.4% to 20.2 pence (H1 2016: 17.2 pence).

Adjusted diluted earnings per share increased by 11.9% to 19.7 pence reflecting an increase in profit after tax from Ongoing operations and a reduction in the weighted average number of Ordinary Shares.

Dividends

The Board has resolved to pay an interim dividend for the Company for 2017 of £93.5m in aggregate, representing 6.8 pence per share, an increase of 38.8% on the regular interim dividend for 2016 of 4.9 pence.

The regular interim dividend will be paid on 8 September 2017 to shareholders on the register on 11 August 2017. The ex-dividend date will be 10 August 2017.

Net assets and tangible net assets

At	30 Jun 2017 £m	31 Dec 2016 £m
Net assets	2,654.5	2,521.5
Goodwill and other intangible assets	(517.4)	(508.9)
Tangible net assets	**2,137.1**	2,012.6
Net assets per share (pence)	194.4	184.7
Tangible net assets per share (pence)	156.5	147.4

The net assets at 30 June 2017 increased to £2,654.5m (31 December 2016: £2,521.5m) and tangible net assets increased to £2,137.1m (31 December 2016: £2,012.6m). These increases mainly reflect the profit in H1 2017 partially offset by the payment of the 2016 final dividend.

Financial management

Capital management

Dividend policy

The Group aims to manage its capital efficiently and generate long-term sustainable value for shareholders, while balancing operational, regulatory, rating agency and policyholder requirements.

The Group aims to grow its regular dividend in line with business growth.

Where the Board believes that the Group has capital which is expected to be surplus to the Group's requirements for a prolonged period, it would intend to return any surplus to shareholders. In normal circumstances, the Board expects that a capital coverage ratio around the middle of its risk appetite range of 140% to 180% of the Group's solvency capital requirement ("**SCR**") would be appropriate and it will therefore take this into account when considering the potential for special distributions.

In the normal course of events the Board will consider whether or not it is appropriate to distribute any surplus capital to shareholders once a year, alongside the full year results.

The Group expects that one-third of the annual dividend will generally be paid in the third quarter as an interim dividend, and two-thirds will be paid as a final dividend in the second quarter of the following year. The Board may revise the dividend policy from time to time. The Company may consider a special dividend and/or a repurchase of its own shares to distribute surplus capital to shareholders.

Solvency II

The Group is regulated, under Solvency II requirements, by the Prudential Regulation Authority ("**PRA**") on both a Group basis and, for the Group's principal underwriter, U K Insurance Limited ("**UKI**"), on a solo basis.

UKI calculates its capital requirement using its PRA approved internal model, which forms part of a Group-wide partial internal model.

The Board has considered the risk appetite range of the Group under its Solvency II partial internal model and considers that the appropriate range, which should enable it to meet its operational, regulatory and rating agency requirements, is 140% to 180% of its solvency capital requirement. Under normal circumstances, the group expects to operate around the middle of the risk appetite range.

Sensitivity analysis

The following table shows estimated sensitivities based on assessed impact of scenarios at 30 June 2017

Scenario	Impact on solvency ratio
Motor premium rate reduction of 10%	(17pts)
Motor bodily injury deterioration equivalent to accident years 2008 and 2009	(8pts)
Increase in periodic payment order propensity by 10pts	(5pts)
One-off catastrophe loss equivalent to 1990 storm	(9pts)
One-off catastrophe loss equivalent based on extensive flooding of the Thames	(9pts)
Change in the reserving basis for PPOs to use a real discount rate of minus 1% instead of 0%	(10pts)
100bps increase in credit spreads	(11pts)
100bps decrease* in interest rates	(10pts)

*This has been changed from the version issued on 1 August 2017.

Capital position

At 30 June 2017, the Group held a capital surplus of approximately £1.04bn after foreseeable dividends and above its estimated Solvency II regulatory capital requirements on the Group's partial internal model basis. This was equivalent to an estimated capital coverage ratio of 173%.

At	30 Jun 2017 £bn	31 Dec 2016[1] £bn
Solvency capital requirement	1.42	1.40
Capital surplus above solvency capital requirement	1.04	0.91
Capital coverage ratio post-dividend	173%	165%

The following table splits the Group's own funds by tier on a Solvency II basis.

At	30 Jun 2017 £bn	31 Dec 2016[1] £bn
Tier 1 capital before foreseeable dividends	1.97	1.87
Foreseeable dividends	(0.09)	(0.13)
Tier 1 capital	1.88	1.74
Tier 2 capital	0.53	0.54
Tier 3 capital	0.05	0.03
Own funds	2.46	2.31

Tier 1 capital after foreseeable dividends represents 76% of own funds and 132% of the estimated solvency capital requirement. Tier 2 capital relates solely to the Group's £0.53bn subordinated debt. The amount of Tier 2 and 3 capital permitted under the Solvency II Regulations is 50% of the Group's solvency capital requirement, and of Tier 3 is 15%. Therefore, the Group has no ineligible capital.

Reconciliation of IFRS shareholders' equity to Solvency II own funds

At	30 Jun 2017 £bn	31 Dec 2016[1] £bn
Shareholders' equity	2.65	2.52
Goodwill and intangible assets	(0.52)	(0.51)
Change in valuation of technical provisions	(0.08)	(0.05)
Other asset and liability adjustments	(0.08)	(0.09)
Foreseeable dividends	(0.09)	(0.13)
Tier 1 capital	1.88	1.74
Tier 2 capital: subordinated debt	0.53	0.54
Tier 3 capital: deferred tax	0.05	0.03
Total own funds	2.46	2.31

Note:

1. The comparatives have been updated to reflect the amounts in the Solvency Financial Condition Report for the year ended 31 December 2016, published on the 15 May 2017.

Movement in capital surplus

	2017 £bn
Capital surplus at 1 January 2017	0.91
Underlying movement in capital generation	0.28
Market movements	–
Capital generation	0.28
Increase in solvency capital requirement	(0.02)
Surplus generation	0.26
Capital expenditure	(0.04)
Capital distribution – regular dividend	(0.09)
Net surplus movement	0.13
Capital surplus at 30 June 2017	1.04

Leverage

At	30 Jun 2017 £m	31 Dec 2016 £m
Shareholders' equity	2,654.5	2,521.5
Financial debt – subordinated guaranteed dated notes	533.0	539.6
Total capital employed	3,187.5	3,061.1
Financial-leverage ratio[1]	16.7%	17.6%

During H1 2017, leverage reduced 0.9 percentage points to 16.7%, due primarily to an increase in profit for the period, partially offset by the payment of the final dividend for 2016.

Credit ratings

Standard & Poor's and Moody's Investors Service provide insurance financial-strength ratings for UKI. UKI is currently rated 'A' (strong) with a stable outlook by Standard & Poor's and 'A2' (good) with a stable outlook by Moody's.

Regulatory update

The Group has continued to operate within a highly dynamic and evolving regulatory landscape, particularly in the UK motor insurance market where a number of reviews and initiatives have been announced by the UK Government, the Ministry of Justice ("**MoJ**"), the Financial Conduct Authority ("**FCA**") and the PRA. On 23 February 2017, the government announced measures to reduce the volume and cost of soft tissue damage 'whiplash' claims and stated its expectation that this will see a reduction in motor insurance premiums by £40 on average. On 27 February 2017 the Lord Chancellor announced a reduction in the Ogden discount rate to minus 0.75% with effect from 20 March 2017. The Group has also been engaged in the consultation to consider options for reform concerning the discount rate.

During the first half of 2017, the FCA's focus has been on value measures and pricing practices as well as the publication of its business plan. The PRA focus has been on the pillars of its financial risk framework, namely reserving, pricing, reinsurance and investments.

The Group will continue to support proportionate reforms which result in a level playing field across the industry.

Note:

1. Total financial debt as a percentage of total capital employed.

Principal risks and uncertainties

The Group carries out a robust assessment of the principal risks facing it in the current and future financial years. Principal risks are defined as having a residual risk impact of £40m or more on profit before tax or net asset value on a one-in-200 years basis, accounting for customer, financial and reputational impacts. The Group considers that the risk profile remains broadly unchanged over the last six months, since the profile disclosed in the Annual Report & Accounts 2016, pages 27 to 29.

Principal risks
Insurance risk The risk of loss due to fluctuations in the timings, amount, frequency and severity of an insured event relative to the expectations at the time of underwriting. Insurance risk includes underwriting, reserve, distribution, pricing and reinsurance risks. The Group faces the risk that future claims on business written could be materially different from expectations resulting in losses. The risk of misstatement of reserves arises from the uncertain nature of claims, data issues and operational failures. Distribution risk is that a material change in the volume of business written may result in losses or reduced profitability. Incorrect pricing could result in the potential loss of market share or profitability. Furthermore, the inappropriate selection or placement of reinsurance arrangements could render the transfer of risk inappropriate or ineffective.
Market risk The risk of loss resulting from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments. Market risk includes spread, interest rate and property risks. The Group is exposed to fluctuations in the value of assets or the income from its investment portfolio. The value of assets and investments are sensitive to changes in credit spreads above the risk-free interest rate. Asset values are sensitive to changes in interest rates. Property risk arises as a result of sensitivity of assets to market prices of property.
Credit risk The risk of loss resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors to which the Group is exposed. Credit risk includes concentration and counterparty default risks. Concentration risk arises from inadequately diversified portfolios of assets or obligations. The Group has many suppliers, in particular reinsurers as well as a number of investment and broker counterparties. The failure of any of these parties could result in a financial loss. Counterparty risk arises from unexpected default by, or deterioration in the credit standing of, counterparties and debtors.
Operational risk The risk of loss due to inadequate or failed internal processes, people, systems or from external events. Operational risk includes information security, IT and business continuity, outsourcing, financial reporting, model, partnership contractual obligations, change, and technology and infrastructure risks. Information security risk includes the potential loss or corruption of data or intellectual property. IT and business continuity risk relates to the failure to recover from major external or internal events, resulting in a delay or inability to deliver services to customers. Outsourcing risk is that an outsourcing arrangement may fail to deliver services to expected levels. The financial reporting misstatement risk derives from the potential misstatement, misrepresentation or untimely delivery of financial information or regulatory returns. Model risk includes the inadequate, incorrect, ineffective or misused model outputs, or a lack of models, for decision-making, product design or for customer offerings. Partnership contractual obligations risk arises where contractual obligations are not delivered for business partners. The Group has a substantial portfolio of change underway which could result in conflicting priorities, failure to deliver strategic outcomes and impairment of intangible assets. Technology and infrastructure risk is the risk that the IT infrastructure is inadequate to deliver the Group's strategy.
Regulatory compliance and conduct risk Regulatory compliance risk is the potential loss and reputational damage from regulatory or legal censure, fines or prosecutions arising from non-compliance with law and regulations. Conduct risk is the failure to put the customer at the heart of the business and failure to ensure that fairness is a natural outcome of the Group's activities.
Strategic risk The risk of direct or indirect impact on the earnings, capital, or value of the business as a result of strategies not being optimally chosen, implemented or adapted to changing conditions. Strategic risk includes strategy formulation and implementation risks. These are the risks of failing to formulate and implement an appropriate strategy to deliver strategic objectives.

Emerging risks

The Group's definition of emerging risks are newly developing risks which are often difficult to quantify; they are also highly uncertain and are external to the Group. The Group records emerging risks within an Emerging Risk Register. Emerging risks are reported to the Risk Management Committee and Board Risk Committee for review and challenge. The Group's emerging risks processes aim to:

- achieve 'first mover advantage' by recognising risks and associated opportunities early;
- reduce the uncertainty and volatility of the Group's results; and
- manage emerging risks proactively.

The Group considers its main emerging risks to be:

Emerging risks
Technological changes in driving habits reduce consumer need for motor insurance New car technologies, such as crash-prevention technologies and driverless cars, could significantly affect the size and nature of the insurance market and the role of insurers. In addition to the Group's partnership with the Government on automated Driving systems (MOVE_UK), the Group continues to consider new motor technologies as part of its pricing and underwriting approach.
Changes to traditional insurance business models New market entrants and changes in consumer expectations could result in significant changes to the structure of the general insurance market and require the Group to update its business model. The Group's strategy, aligned to its mission to make insurance much easier and better value for its customers, is positioned to take advantage of changes in technology and customer behaviours.
UK economy The UK could enter a prolonged period of reduced growth following its referendum vote on EU membership, potentially reducing insurance sales and the value of the Group's investment portfolio. Whilst the Group's operations are based mainly in the UK, the uncertainty surrounding Brexit negotiations could have various implications which the Group will continue to monitor. The UK Government also continues to work through the results of the UK General Election and the impact this may have on the economy and Brexit negotiations.
Climate change Climate change could increase the frequency of severe weather events in the UK and, in particular, flooding claims costs. The Group continues to monitor changes in claims experience and considers weather trends as part of its pricing and underwriting approach.

Condensed consolidated income statement

For the six months ended 30 June 2017

	Notes	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Gross earned premium	5	1,645.0	1,579.5	3,202.8
Reinsurance premium	5	(97.5)	(99.6)	(202.2)
Net earned premium	5	1,547.5	1,479.9	3,000.6
Investment return	6	93.0	92.7	171.5
Instalment income		55.8	51.4	107.1
Other operating income	7	33.8	27.0	58.2
Total income		1,730.1	1,651.0	3,337.4
Insurance claims	8	(768.2)	(738.9)	(2,179.0)
Insurance claims recoverable from reinsurers	8	(79.2)	(29.4)	375.2
Net insurance claims	8	(847.4)	(768.3)	(1,803.8)
Commission expenses	9	(138.1)	(160.8)	(344.0)
Operating expenses	10	(384.9)	(405.0)	(799.4)
Total expenses		(523.0)	(565.8)	(1,143.4)
Operating profit		359.7	316.9	390.2
Finance costs	11	(18.3)	(18.4)	(37.2)
Profit before tax		341.4	298.5	353.0
Tax charge	12	(65.9)	(62.6)	(74.2)
Profit for the period attributable to owners of the Company		275.5	235.9	278.8
Earnings per share:				
Basic (pence)	14	20.2	17.2	20.4
Diluted (pence)	14	20.0	17.0	20.2

Condensed consolidated statement of comprehensive income

For the six months ended 30 June 2017

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Profit for the period	275.5	235.9	278.8
Other comprehensive (loss) / income			
Items that will not be reclassified subsequently to the income statement:			
Actuarial loss on defined benefit pension scheme	–	–	(4.4)
Tax relating to items that will not be reclassified	–	–	0.7
	–	–	(3.7)
Items that may be reclassified subsequently to the income statement:			
Exchange differences on translation of foreign operations	–	–	0.1
Cash flow hedges	(0.4)	0.9	1.4
Fair value gains on available-for-sale investments	8.0	76.7	119.6
Less: realised net gains on available-for-sale investments included in the income statement	(14.8)	(8.2)	(15.3)
Tax relating to items that may be reclassified	1.2	(12.2)	(17.6)
	(6.0)	57.2	88.2
Other comprehensive (loss) / income for the period net of tax	(6.0)	57.2	84.5
Total comprehensive income for the period attributable to owners of the Company	269.5	293.1	363.3

Condensed consolidated balance sheet

As at 30 June 2017

	Notes	30 Jun 2017 £m	31 Dec 2016 £m (audited)
Assets			
Goodwill and other intangible assets		517.4	508.9
Property, plant and equipment		170.4	180.9
Investment property		314.9	329.0
Reinsurance assets	16	1,270.9	1,371.8
Current tax assets		0.1	0.1
Deferred acquisition costs		189.9	203.1
Insurance and other receivables		1,009.9	988.3
Prepayments, accrued income and other assets		124.3	131.0
Derivative financial instruments		77.7	79.7
Retirement benefit asset		12.0	12.0
Financial investments	17	5,155.5	5,147.0
Cash and cash equivalents	18	1,106.6	1,166.1
Assets held for sale		3.8	3.8
Total assets		9,953.4	10,121.7
Equity		2,654.5	2,521.5
Liabilities			
Subordinated liabilities		533.0	539.6
Insurance liabilities	19	4,409.0	4,666.6
Unearned premium reserve		1,597.1	1,547.9
Borrowings	18	59.4	55.3
Derivative financial instruments		13.3	45.1
Trade and other payables including insurance payables		613.9	699.2
Deferred tax liabilities		35.6	46.0
Current tax liabilities		37.6	0.5
Total liabilities		7,298.9	7,600.2
Total equity and liabilities		9,953.4	10,121.7

Condensed consolidated statement of changes in equity

For the six months ended 30 June 2017

	Note	Share capital £m	Employee trust shares £m	Capital reserves £m	AFS revaluation reserve £m	Non-distributable reserve £m	Foreign exchange translation reserve £m	Retained earnings £m	Total shareholders' equity £m
Balance at 1 January 2016		150.0	(20.4)	1,450.0	5.4	152.9	(0.1)	892.2	2,630.0
Profit for the period		–	–	–	–	–	–	278.8	278.8
Other comprehensive income		–	–	–	86.7	–	1.5	(3.7)	84.5
Dividends	13	–	–	–	–	–	–	(450.6)	(450.6)
Transfer to non-distributable reserve		–	–	–	–	(152.9)	–	152.9	–
Shares acquired by employee trusts		–	(39.5)	–	–	–	–	–	(39.5)
Credit to equity for equity-settled share-based payments		–	–	–	–	–	–	16.8	16.8
Shares distributed by employee trusts		–	25.6	–	–	–	–	(25.6)	–
Tax on share-based payments		–	–	–	–	–	–	1.5	1.5
Balance at 31 December 2016 (audited)		150.0	(34.3)	1,450.0	92.1	–	1.4	862.3	2,521.5
Profit for the period		–	–	–	–	–	–	275.5	275.5
Other comprehensive loss		–	–	–	(5.6)	–	(0.4)	–	(6.0)
Dividends	13	–	–	–	–	–	–	(132.4)	(132.4)
Shares acquired by employee trusts		–	(10.5)	–	–	–	–	–	(10.5)
Credit to equity for equity-settled share-based payments		–	–	–	–	–	–	6.3	6.3
Shares distributed by employee trusts		–	12.9	–	–	–	–	(12.9)	–
Tax on share-based payments		–	–	–	–	–	–	0.1	0.1
Balance at 30 June 2017		150.0	(31.9)	1,450.0	86.5	–	1.0	998.9	2,654.5

	Note	Share capital £m	Employee trust shares £m	Capital reserves £m	AFS revaluation reserve £m	Non-distributable reserve £m	Foreign exchange translation reserve £m	Retained earnings £m	Total shareholders' equity £m
Balance at 1 January 2016		150.0	(20.4)	1,450.0	5.4	152.9	(0.1)	892.2	2,630.0
Profit for the period		–	–	–	–	–	–	235.9	235.9
Other comprehensive income		–	–	–	56.2	–	1.0	–	57.2
Dividends	13	–	–	–	–	–	–	(246.6)	(246.6)
Transfer to non-distributable reserve		–	–	–	–	(152.9)	–	152.9	–
Shares acquired by employee trusts		–	(17.5)	–	–	–	–	–	(17.5)
Credit to equity for equity-settled share-based payments		–	–	–	–	–	–	10.0	10.0
Shares distributed by employee trusts		–	15.4	–	–	–	–	(15.4)	–
Tax on share-based payments		–	–	–	–	–	–	(0.2)	(0.2)
Balance at 30 June 2016		150.0	(22.5)	1,450.0	61.6	–	0.9	1,028.8	2,668.8

Condensed consolidated cash flow statement

For the six months ended 30 June 2017

	Notes	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Net cash generated from / (used by) operating activities before investment of insurance assets		27.3	(63.6)	35.0
Cash generated from investment of insurance assets		109.6	518.1	827.4
Net cash generated from operating activities		136.9	454.5	862.4
Cash flows from investing activities				
Purchases of property, plant and equipment		(3.8)	(37.4)	(49.9)
Purchases of goodwill and other intangible assets		(35.2)	(46.5)	(80.8)
Proceeds from disposals of assets held for sale		–	–	5.1
Net cash used by investing activities		(39.0)	(83.9)	(125.6)
Cash flows from financing activities				
Dividends paid	13	(132.4)	(246.6)	(450.6)
Finance costs		(18.6)	(19.2)	(38.3)
Purchase of employee trust shares		(10.5)	(17.5)	(39.5)
Net cash used by financing activities		(161.5)	(283.3)	(528.4)
Net (decrease) / increase in cash and cash equivalents		(63.6)	87.3	208.4
Cash and cash equivalents at the beginning of the period		1,110.8	902.4	902.4
Cash and cash equivalents at the end of the period	18	1,047.2	989.7	1,110.8

Notes to the condensed consolidated financial statements

Corporate information
Direct Line Insurance Group plc is a public limited company registered in England and Wales (company number 02280426). The address of the registered office is Churchill Court, Westmoreland Road, Bromley BR1 1DP, England.

1. General information
The financial information for the year ended 31 December 2016 and included in the condensed consolidated financial statements does not constitute statutory accounts as defined in S434 of the Companies Act 2006, but has been abridged from the statutory accounts for that year which have been delivered to the Registrar of Companies. The independent auditor's report on the Group accounts for the year ended 31 December 2016 is unqualified, does not draw attention to any matters by way of emphasis and does not include a statement under S498(2) or (3) of the Companies Act 2006.

2. Accounting policies
Basis of preparation
The annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards as adopted by the European Union. The condensed consolidated financial statements included in this Interim Report have been prepared in accordance with International Accounting Standard 34 'Interim Financial Reporting' as adopted by the European Union.

The Group has not adopted any new standard, interpretation or amendment since 31 December 2016.

Going concern
The Directors, having assessed the principal risks of the Group over the full duration of the planning cycle, consider it appropriate to adopt the going concern basis of accounting in preparing the interim condensed consolidated financial statements.

Accounting policies and accounting developments
The same accounting policies, presentation and methods of computation are followed in the condensed consolidated financial statements as applied in the Group's latest annual audited financial statements.

3. Critical accounting estimates and judgements
Pages 134 to 136 of the Annual Report & Accounts 2016 provide full details of critical accounting estimates and judgements used in applying the Group's accounting policies. There have been no significant changes to the principles or assumptions of these critical accounting estimates and judgements during the period.

Notes to the condensed consolidated financial statements

4. Segmental analysis

There have been no significant changes to the Group's reportable segments as set out on page 150 of the Annual Report & Accounts 2016.

The table below is an analysis of the Group's revenue and results by reportable segment for the six months ended 30 June 2017:

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Ongoing £m	Run-off £m	Total £m
Gross written premium	824.4	388.1	213.3	268.4	1,694.2	–	1,694.2
Gross earned premium	773.5	409.1	209.8	252.6	1,645.0	–	1,645.0
Reinsurance premium	(65.7)	(12.1)	(0.8)	(18.9)	(97.5)	–	(97.5)
Net earned premium	707.8	397.0	209.0	233.7	1,547.5	–	1,547.5
Investment return	62.2	11.2	2.4	16.8	92.6	0.4	93.0
Instalment income	40.5	11.4	1.0	2.9	55.8	–	55.8
Other operating income	25.7	0.4	6.3	1.4	33.8	–	33.8
Total income	836.2	420.0	218.7	254.8	1,729.7	0.4	1,730.1
Insurance claims	(348.9)	(191.1)	(136.2)	(133.2)	(809.4)	41.2	(768.2)
Insurance claims recoverable from reinsurers	(54.6)	0.4	0.5	6.1	(47.6)	(31.6)	(79.2)
Net insurance claims	(403.5)	(190.7)	(135.7)	(127.1)	(857.0)	9.6	(847.4)
Commission expenses	(18.3)	(67.4)	(10.5)	(41.9)	(138.1)	–	(138.1)
Operating expenses	(180.5)	(94.4)	(49.9)	(55.6)	(380.4)	–	(380.4)
Total expenses	(198.8)	(161.8)	(60.4)	(97.5)	(518.5)	–	(518.5)
Operating profit before restructuring costs	233.9	67.5	22.6	30.2	354.2	10.0	364.2
Restructuring costs							(4.5)
Operating profit							359.7
Finance costs							(18.3)
Profit before tax							341.4

	Motor	Home	Rescue and other personal lines	Commercial	Total Ongoing
Underwriting profit	105.5	44.5	12.9	9.1	172.0
Loss ratio	57.0%	48.0%	64.9%	54.4%	55.4%
Commission ratio	2.6%	17.0%	5.0%	17.9%	8.9%
Expense ratio	25.5%	23.8%	23.9%	23.8%	24.6%
COR	85.1%	88.8%	93.8%	96.1%	88.9%

Notes to the condensed consolidated financial statements

4. Segmental analysis continued

The table below is an analysis of the Group's revenue and results by reportable segment for the six months ended 30 June 2016:

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Ongoing £m	Run-off £m	Total £m
Gross written premium	750.3	403.2	197.7	261.9	1,613.1	–	1,613.1
Gross earned premium	710.7	427.4	195.6	245.8	1,579.5	–	1,579.5
Reinsurance premium	(60.4)	(15.7)	(0.8)	(22.7)	(99.6)	–	(99.6)
Net earned premium	650.3	411.7	194.8	223.1	1,479.9	–	1,479.9
Investment return	63.0	11.0	2.1	14.9	91.0	1.7	92.7
Instalment income	36.2	11.6	0.9	2.7	51.4	–	51.4
Other operating income	19.6	0.1	6.2	1.1	27.0	–	27.0
Total income	769.1	434.4	204.0	241.8	1,649.3	1.7	1,651.0
Insurance claims	(397.4)	(137.9)	(121.4)	(117.3)	(774.0)	35.1	(738.9)
Insurance claims recoverable from reinsurers	(18.7)	0.2	–	2.2	(16.3)	(13.1)	(29.4)
Net insurance claims	(416.1)	(137.7)	(121.4)	(115.1)	(790.3)	22.0	(768.3)
Commission expenses	(16.7)	(91.2)	(9.6)	(43.3)	(160.8)	–	(160.8)
Operating expenses	(167.5)	(104.0)	(49.6)	(53.5)	(374.6)	(0.1)	(374.7)
Total expenses	(184.2)	(195.2)	(59.2)	(96.8)	(535.4)	(0.1)	(535.5)
Operating profit before restructuring costs	168.8	101.5	23.4	29.9	323.6	23.6	347.2
Restructuring costs							(30.3)
Operating profit							316.9
Finance costs							(18.4)
Profit before tax							298.5

	Motor	Home	Rescue and other personal lines	Commercial	Total Ongoing
Underwriting profit	50.0	78.8	14.2	11.2	154.2
Loss ratio	64.0%	33.4%	62.3%	51.6%	53.4%
Commission ratio	2.6%	22.2%	4.9%	19.4%	10.9%
Expense ratio	25.7%	25.3%	25.5%	24.0%	25.3%
COR	92.3%	80.9%	92.7%	95.0%	89.6%

4. Segmental analysis continued

The table below shows the Group's revenue and results by reportable segment for the year ended 31 December 2016 (audited):

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Ongoing £m	Run-off £m	Total £m
Gross written premium	1,539.1	834.4	400.8	499.8	3,274.1	–	3,274.1
Gross earned premium	1,461.3	851.0	396.1	494.4	3,202.8	–	3,202.8
Reinsurance premium	(124.2)	(34.7)	(1.7)	(41.6)	(202.2)	–	(202.2)
Net earned premium	1,337.1	816.3	394.4	452.8	3,000.6	–	3,000.6
Investment return	116.9	19.9	3.9	27.4	168.1	3.4	171.5
Instalment income	76.1	23.5	1.9	5.6	107.1	–	107.1
Other operating income	40.9	0.8	13.5	3.0	58.2	–	58.2
Total income	1,571.0	860.5	413.7	488.8	3,334.0	3.4	3,337.4
Insurance claims	(1,297.3)	(332.1)	(243.0)	(297.7)	(2,170.1)	(8.9)	(2,179.0)
Insurance claims recoverable from reinsurers	295.6	0.1	–	47.2	342.9	32.3	375.2
Net insurance claims	(1,001.7)	(332.0)	(243.0)	(250.5)	(1,827.2)	23.4	(1,803.8)
Commission expenses	(42.9)	(184.4)	(28.4)	(88.3)	(344.0)	–	(344.0)
Operating expenses	(377.3)	(177.4)	(96.4)	(108.2)	(759.3)	(0.2)	(759.5)
Total expenses	(420.2)	(361.8)	(124.8)	(196.5)	(1,103.3)	(0.2)	(1,103.5)
Operating profit before restructuring costs	149.1	166.7	45.9	41.8	403.5	26.6	430.1
Restructuring costs							(39.9)
Operating profit							390.2
Finance costs							(37.2)
Profit before tax							353.0

	Motor	Home	Rescue and other personal lines	Commercial	Total Ongoing
Underwriting (loss) / profit	(84.8)	122.5	26.6	5.8	70.1
Loss ratio	74.9%	40.7%	61.6%	55.3%	60.9%
Commission ratio	3.2%	22.6%	7.2%	19.5%	11.5%
Expense ratio	28.2%	21.7%	24.5%	23.9%	25.3%
COR	106.3%	85.0%	93.3%	98.7%	97.7%

Notes to the condensed consolidated financial statements

5. Net earned premium

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Gross earned premium:			
Gross written premium	1,694.2	1,613.1	3,274.1
Movement in unearned premium reserve	(49.2)	(33.6)	(71.3)
	1,645.0	1,579.5	3,202.8
Reinsurance premium:			
Premium payable	(81.6)	(83.1)	(206.2)
Movement in reinsurance unearned premium reserve	(15.9)	(16.5)	4.0
	(97.5)	(99.6)	(202.2)
Total	1,547.5	1,479.9	3,000.6

6. Investment return

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Investment income:			
Interest income from debt securities	68.0	69.2	136.5
Cash and cash equivalent interest income	1.7	2.3	4.2
Interest income from infrastructure debt	3.6	4.0	7.8
Interest income from commercial real estate loans	1.1	–	1.0
Interest income	74.4	75.5	149.5
Rental income from investment property	8.4	8.9	18.4
	82.8	84.4	167.9
Net realised gains / (losses):			
Available-for-sale debt securities	14.8	8.2	15.3
Derivatives	109.3	(15.9)	(282.3)
Investment property	(0.3)	–	1.3
	123.8	(7.7)	(265.7)
Net unrealised (losses) / gains:			
Impairment of loans and receivables	(3.4)	–	–
Derivatives	(120.1)	15.5	265.2
Investment property	9.9	0.5	4.1
	(113.6)	16.0	269.3
Total	93.0	92.7	171.5

Notes to the condensed consolidated financial statements

6. Investment return continued

The table below analyses the realised and unrealised gains / (losses) on derivative instruments included in investment return.

	Realised 6 months 2017 £m	Unrealised 6 months 2017 £m	Realised 6 months 2016 £m	Unrealised 6 months 2016 £m
Derivative gains / (losses):				
Foreign exchange forward contracts[1]	41.8	54.6	(68.7)	(149.3)
Associated foreign exchange risk	61.5	(166.6)	42.8	177.5
Net gains / (losses) on foreign exchange forward contracts	103.3	(112.0)	(25.9)	28.2
Interest rate swaps[1]	9.4	(18.4)	5.0	(62.4)
Associated interest rate risk	(3.4)	10.3	5.0	49.7
Net gains / (losses) on interest rate derivatives	6.0	(8.1)	10.0	(12.7)
Total	109.3	(120.1)	(15.9)	15.5

	Realised Full year 2016 (audited) £m	Unrealised Full year 2016 (audited) £m
Derivative (losses) / gains:		
Foreign exchange forward contracts[1]	(425.7)	19.1
Associated foreign exchange risk	151.0	253.0
Net (losses) / gains on foreign exchange forward contracts	(274.7)	272.1
Interest rate swaps[1]	(16.9)	20.7
Associated interest rate risk	9.3	(27.6)
Net losses on interest rate derivatives	(7.6)	(6.9)
Total	(282.3)	265.2

Note:

1. Foreign exchange forward contracts are at fair value through the income statement and interest rate swaps are designated as hedging instruments.

7. Other operating income

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Vehicle replacement referral income	8.3	6.8	14.1
Revenue from vehicle recovery and repair services	9.8	9.4	19.3
Other income[1]	15.7	10.8	24.8
Total	33.8	27.0	58.2

Note:

1. Other income includes legal services revenue, salvage income and fee income from insurance intermediary services.

8. Net insurance claims

	Gross 6 months 2017 £m	Reinsurance 6 months 2017 £m	Net 6 months 2017 £m	Gross 6 months 2016 £m	Reinsurance 6 months 2016 £m	Net 6 months 2016 £m
Current accident year claims paid	452.4	(0.1)	452.3	436.4	–	436.4
Prior accident year claims paid	573.4	(5.7)	567.7	577.3	(7.2)	570.1
Movement in insurance liabilities	(257.6)	85.0	(172.6)	(274.8)	36.6	(238.2)
Total	768.2	79.2	847.4	738.9	29.4	768.3

8. Net insurance claims continued

	Gross Full year 2016 £m (audited)	Reinsurance Full year 2016 £m (audited)	Net Full year 2016 £m (audited)
Current accident year claims paid	1,131.7	–	1,131.7
Prior accident year claims paid	905.2	(18.8)	886.4
Movement in insurance liabilities	142.1	(356.4)	(214.3)
Total	2,179.0	(375.2)	1,803.8

The table below analyses the claims handling expenses included in the net insurance claims.

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Ongoing operations	86.6	87.0	164.4
Run-off	–	1.0	1.2
Total	86.6	88.0	165.6

9. Commission expenses

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Commission expenses	117.1	123.1	246.8
Expenses incurred under profit participations	21.0	37.7	97.2
Total	138.1	160.8	344.0

10. Operating expenses

	Total Ongoing 6 months 2017 £m	Restructuring costs 6 months 2017 £m	Run-off 6 months 2017 £m	Total Group 6 months 2017 £m
Staff costs[1]	131.6	4.5	–	136.1
Other operating expenses[1,2]	149.0	–	–	149.0
Marketing	59.0	–	–	59.0
Amortisation and impairment of other intangible assets	26.7	–	–	26.7
Depreciation	14.1	–	–	14.1
Total	380.4	4.5	–	384.9

	Total Ongoing 6 months 2016 £m	Restructuring costs 6 months 2016 £m	Run-off 6 months 2016 £m	Total Group 6 months 2016 £m
Staff costs[1]	137.2	8.7	–	145.9
Other operating expenses[1,2,3]	129.8	21.6	0.1	151.5
Marketing	62.6	–	–	62.6
Amortisation and impairment of other intangible assets	30.0	–	–	30.0
Depreciation	15.0	–	–	15.0
Total	374.6	30.3	0.1	405.0

Notes:

1. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
2. Other operating expenses include IT costs, insurance levies, professional fees and property costs.
3. A property site in Bristol comprising of freehold property and fixtures and fittings was transferred from freehold property to assets held for sale in 2016. The property with a carrying value of £23.5 million was re-measured on transfer to its fair value of £3.8 million resulting in a charge to other operating expense in Restructuring costs of £19.7 million.

Notes to the condensed consolidated financial statements

10. Operating expenses continued

	Total Ongoing	Restructuring costs	Run-off	Total Group
	Full year (audited) 2016 £m	Full year (audited) 2016 £m	Full year (audited) 2016 £m	Full year (audited) 2016 £m
Staff costs[1]	269.0	16.0	–	285.0
Other operating expenses[1,2,3]	250.9	23.9	0.2	275.0
Marketing	112.6	–	–	112.6
Amortisation and impairment of other intangible assets	96.7	–	–	96.7
Depreciation	30.1	–	–	30.1
Total	759.3	39.9	0.2	799.4

Notes:

1. Staff costs and other operating expenses attributable to claims handling activities are allocated to the cost of insurance claims.
2. Other operating expenses include IT costs, insurance levies, professional fees and property costs.
3. A property site in Bristol comprising of freehold property and fixtures and fittings was transferred from freehold property to assets held for sale in 2016. The property with a carrying value of £23.5 million was re-measured on transfer to its fair value of £3.8 million resulting in a charge to other operating expense in Restructuring costs of £19.7 million.

11. Finance costs

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Interest expense on subordinated liabilities	**23.1**	23.0	46.3
Net interest received on designated hedging instrument[1]	**(4.5)**	(3.9)	(8.0)
Unrealised loss / (gain) on designated hedging instrument[1]	**6.3**	(30.9)	(19.6)
Unrealised (gain) / loss on associated interest rate risk on hedged item[1]	**(6.9)**	29.9	17.8
Amortisation of arrangement costs and discount on issue of subordinated liabilities	**0.3**	0.3	0.7
Total	**18.3**	18.4	37.2

Note:

1. On 27 April 2012 the Group issued subordinated guaranteed dated notes with a nominal value of £500 million at a fixed rate of 9.25%. On the same date, the Group also entered into a 10-year designated hedging instrument to exchange the fixed rate of interest on the notes for a rate of three-month LIBOR plus a spread of 706 basis points, which increased to 707 basis points with effect from 29 July 2013.

12. Tax charge

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Current taxation:			
Charge for the period	**69.9**	65.0	84.4
Under / (over) provision in respect of the prior period	**6.4**	–	(7.7)
	76.3	65.0	76.7
Deferred taxation:			
Credit for the period	**(2.2)**	(2.4)	(5.1)
(Over) / under provision in respect of the prior period	**(8.2)**	–	2.6
	(10.4)	(2.4)	(2.5)
Current taxation	**76.3**	65.0	76.7
Deferred taxation	**(10.4)**	(2.4)	(2.5)
Tax charge for the period	**65.9**	62.6	74.2

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13. Dividends

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Amounts recognised as distributions to equity holders in the period:			
2016 final dividend of 9.7p per share paid on 18 May 2017	132.4	–	–
2015 final dividend of 9.2p per share paid on 19 May 2016	–	126.0	126.0
2016 first interim dividend of 4.9p per share paid on 9 September 2016	–	–	67.1
2016 first special interim dividend of 10.0p per share paid on 9 September 2016	–	–	136.9
2015 second special interim dividend of 8.8p per share paid on 19 May 2016	–	120.6	120.6
Total	132.4	246.6	450.6

The trustees of the employee share trusts waived their entitlement to dividends on shares held to meet obligations arising on certain share awards, which reduced the total dividend paid for the six months ended 30 June 2017 by £1.0 million (six months ended 30 June 2016: £0.9 million and year ended 31 December 2016: £1.8 million).

14. Earnings per share

Earnings per share is calculated by dividing the earnings attributable to the owners of the Company by the weighted average number of Ordinary Shares during the period.

Basic

Basic earnings per share is calculated by dividing the earnings attributable to the owners of the Company by the weighted average number of Ordinary Shares for the purposes of basic earnings per share during the period, excluding Ordinary Shares held as employee trust shares.

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Earnings attributable to owners of the Company	275.5	235.9	278.8
Weighted average number of Ordinary Shares (millions)	1,365.5	1,370.2	1,368.7
Basic earnings per share (pence)	**20.2**	17.2	20.4

Diluted

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

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Earnings attributable to owners of the Company	275.5	235.9	278.8
Weighted average number of Ordinary Shares (millions)	1,365.5	1,370.2	1,368.7
Effect of dilutive potential of share options and contingently issuable shares (millions)	12.7	15.5	13.1
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	1,378.2	1,385.7	1,381.8
Diluted earnings per share (pence)	**20.0**	17.0	20.2

Notes to the condensed consolidated financial statements

15. Net assets per share and return on equity

Net asset value per share is calculated as total shareholders' equity divided by the number of Ordinary Shares at the end of the period excluding shares held by employee share trusts.

Tangible net asset value per share is calculated as total shareholders' equity less goodwill and other intangible assets divided by the number of Ordinary Shares at the end of the period excluding shares held by employee share trusts.

The table below analyses net asset and tangible net asset value per share.

At	30 Jun 2017 £m	31 Dec 2016 £m (audited)
Net assets	2,654.5	2,521.5
Goodwill and other intangible assets	(517.4)	(508.9)
Tangible net assets	2,137.1	2,012.6
Number of Ordinary Shares (millions)	1,375.0	1,375.0
Shares held by employee share trusts (millions)	(9.3)	(9.9)
Closing number of Ordinary Shares (millions)	1,365.7	1,365.1
Net asset value per share (pence)	194.4	184.7
Tangible net asset value per share (pence)	156.5	147.4

Return on equity

The table below details the calculation of return on equity and annualised return on equity.

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Earnings attributable to owners of the Company	275.5	235.9	278.8
Annualised[1]	551.0	471.8	278.8
Opening shareholders' equity	2,521.5	2,630.0	2,630.0
Closing shareholders' equity	2,654.5	2,668.8	2,521.5
Average shareholders' equity	2,588.0	2,649.4	2,575.8
Return on equity for period	10.6%	8.9%	10.8%
Return on equity annualised[1]	21.3%	17.8%	10.8%

Note:

1. Earnings have been annualised using profits for the 6 months ended 30 June 2017 (2016: 6 months ended 30 June 2016).

16. Reinsurance assets

At	30 Jun 2017 £m	31 Dec 2016 £m (audited)
Reinsurers' share of general insurance liabilities	1,250.6	1,329.0
Impairment provision	(57.3)	(50.7)
	1,193.3	1,278.3
Reinsurers' unearned premium reserve	77.6	93.5
Total	1,270.9	1,371.8

Notes to the condensed consolidated financial statements

17. Financial investments

At	30 Jun 2017 £m	31 Dec 2016 £m (audited)
Available-for-sale debt securities		
Corporate	4,174.9	4,183.7
Supranational	98.1	98.6
Local government	12.3	21.7
Sovereign	363.0	341.2
Total	4,648.3	4,645.2
Held-to-maturity debt securities		
Corporate	88.3	85.1
Total debt securities	4,736.6	4,730.3
Total debt securities		
Fixed interest rate[1]	4,720.2	4,709.6
Floating interest rate	16.4	20.7
Total	4,736.6	4,730.3
Loans and receivables		
Infrastructure debt	328.0	337.0
Commercial real estate loans	90.9	79.7
Total	5,155.5	5,147.0

Note:

1. The Group swaps a fixed interest rate for a floating rate of interest on its US Dollar, Euro and a small amount of its Sterling corporate debt securities by entering into interest rate derivatives. The hedged amount at 30 June 2017 was £1,543.1 million (31 December 2016: £1,593.6 million).

18. Cash and cash equivalents and borrowings

At	30 Jun 2017 £m	31 Dec 2016 £m (audited)
Cash at bank and in hand	215.8	166.6
Short-term deposits with credit institutions[1]	890.8	999.5
Cash and cash equivalents	1,106.6	1,166.1
Bank overdrafts[2]	(59.4)	(55.3)
Cash and bank overdrafts[3]	1,047.2	1,110.8

Notes:

1. This represents money market funds with no notice period for withdrawal.
2. Bank overdrafts represent short-term timing differences between transactions posted in the records of the Group transactions flowing through the accounts at the bank.
3. Cash and bank overdrafts are included for the purposes of the condensed consolidated cash flow statement.

The effective interest rate on short-term deposits with credit institutions for the six months ended 30 June 2017 was 0.39% (year ended 31 December 2016: 0.45%) and average maturity at 30 June 2017 was 10 days (31 December 2016: 10 days).

19. Insurance liabilities

Movements in gross and net insurance liabilities

	Gross £m	Reinsurance £m	Net £m
Claims reported	2,732.2	(375.0)	2,357.2
Incurred but not reported	1,697.9	(546.9)	1,151.0
Claims handling provision	94.4	–	94.4
At 1 January 2016 (audited)	4,524.5	(921.9)	3,602.6
Cash paid for claims settled in the year	(2,036.9)	18.8	(2,018.1)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,329.3	(235.4)	2,093.9
Arising from prior-year claims	(150.3)	(139.8)	(290.1)
At 31 December 2016 (audited)	4,666.6	(1,278.3)	3,388.3
Claims reported	2,584.5	(388.3)	2,196.2
Incurred but not reported	2,002.8	(890.0)	1,112.8
Claims handling provision	79.3	–	79.3
At 31 December 2016 (audited)	4,666.6	(1,278.3)	3,388.3
Cash paid for claims settled in the period	(1,025.8)	5.8	(1,020.0)
Increase / (decrease) in liabilities:			
Arising from current-year claims	1,204.0	(130.6)	1,073.4
Arising from prior-year claims	(435.8)	209.8	(226.0)
At 30 June 2017	4,409.0	(1,193.3)	3,215.7
Claims reported	2,956.6	(694.2)	2,262.4
Incurred but not reported	1,373.1	(499.1)	874.0
Claims handling provision	79.3	–	79.3
At 30 June 2017	4,409.0	(1,193.3)	3,215.7

Movement in prior-year net claims liabilities by operating segment

	6 months 2017 £m	6 months 2016 £m	Full year 2016 £m (audited)
Motor	(174.6)	(134.0)	(123.5)
Home	(16.8)	(60.6)	(75.9)
Rescue and other personal lines	2.1	(7.5)	(17.5)
Commercial	(27.1)	(34.0)	(49.8)
Total Ongoing	(216.4)	(236.1)	(266.7)
Run-off	(9.6)	(22.0)	(23.4)
Total	(226.0)	(258.1)	(290.1)

Notes to the condensed consolidated financial statements

20. Fair value

The following table compares the carrying value and the fair value of financial instruments and other assets where the Group discloses fair value.

At 30 June 2017	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
Assets held at fair value:					
Investment property	314.9	–	–	314.9	314.9
Derivative assets	77.7	–	77.7	–	77.7
Available-for-sale debt securities (note 17)	4,648.3	363.0	4,285.3	–	4,648.3
Other financial assets:					
Held-to-maturity debt securities (note 17)	88.3	–	14.5	76.9	91.4
Infrastructure debt (note 17)	328.0	–	–	336.3	336.3
Commercial real estate loans (note 17)	90.9	–	–	90.9	90.9
Total assets	5,548.1	363.0	4,377.5	819.0	5,559.5
Liabilities held at fair value:					
Derivative liabilities	13.3	–	13.3	–	13.3
Other financial liabilities:					
Subordinated liabilities	533.0	–	653.1	–	653.1
Total liabilities	546.3	–	666.4	–	666.4

At 31 December 2016	Carrying value £m	Level 1 £m	Level 2 £m	Level 3 £m	Fair value £m
Assets held at fair value:					
Investment property	329.0	–	–	329.0	329.0
Derivative assets	79.7	–	79.7	–	79.7
Available-for-sale debt securities (note 17)	4,645.2	341.2	4,304.0	–	4,645.2
Other financial assets:					
Held-to-maturity debt securities (note 17)	85.1	–	13.6	74.6	88.2
Infrastructure debt (note 17)	337.0	–	–	339.2	339.2
Commercial real estate loans (note 17)	79.7	–	–	79.8	79.8
Total assets	5,555.7	341.2	4,397.3	822.6	5,561.1
Liabilities held at fair value:					
Derivative liabilities	45.1	–	45.1	–	45.1
Other financial liabilities:					
Subordinated liabilities	539.6	–	625.0	–	625.0
Total liabilities	584.7	–	670.1	–	670.1

Differences arise between carrying value and fair value where the measurement basis of the assets or liabilities is not fair value (e.g. assets and liabilities carried at amortised cost). Fair values of the following assets and liabilities approximate their carrying values:

- Insurance and other receivables;
- Cash and cash equivalents;
- Borrowings; and
- Trade and other payables including insurance payables (excluding provisions).

The movements in assets held at fair value and classified as level 3 in the fair value hierarchy are all within Investment property. There were no changes in the categorisation of assets between levels 1, 2 and 3 during the current period for assets and liabilities held at 31 December 2016.

20. Fair value continued

The table below analyses the movement in assets classified as Level 3 in the fair value hierarchy.

	Investment property £m
At 1 January 2016 (audited)	347.4
Additions	1.4
Increase in fair value in the year (note 6)	5.4
Disposals	(25.2)
At 31 December 2016 (audited)	329.0
Increase in fair value in the period (note 6)	9.6
Disposals	(23.7)
At 30 June 2017	314.9

Glossary

Term	Definition and explanation
Adjusted diluted earnings per share	Adjusted diluted earnings per share is calculated by dividing the adjusted profit after tax of Ongoing operations by the weighted average number of Ordinary Shares during the period adjusted for dilutive potential Ordinary Shares (see page 40 alternative performance measures).
Adjusted profit after tax	Profit after tax is adjusted to exclude the Run-off segment and restructuring costs, and is stated after charging tax using the UK standard tax rate of 19.25%; (2016: 20.00%). See page 40 alternative performance measure.
Available-for-sale ("AFS") investment	Financial assets that are classified as available-for-sale. Please refer to the accounting policy note 1.12 on page 130 of the Annual Report and Accounts 2016.
Capital	The funds invested in the Group, including funds invested by shareholders and retained profits.
Capital coverage ratio	The ratio of Solvency II own funds to the solvency capital requirement.
Claims frequency	The number of claims divided by the number of policies per year.
Claims handling provision (provision for losses and loss-adjustment expense)	Funds the Group sets aside to meet the estimated cost of paying claims and related expenses that the Group considers it will ultimately need to pay.
Combined operating ratio ("COR")	The sum of the loss, commission and expense ratios. The ratio measures the amount of claims costs, commission and expenses, compared to net earned premium generated. A ratio of less than 100% indicates profitable underwriting.
Commission	Payments to brokers, partners and PCWs for generating business.
Commission ratio	The ratio of commission expense divided by net earned premium.
Current-year attritional loss ratio	The loss ratio for the current accident year, excluding the movement of claims reserves relating to previous accident years, and claims relating to major weather events in the Home division.
Earnings per share	The amount of the Group's profit allocated to each Ordinary Share of the Company.
Expense ratio	The ratio of operating expenses divided by net earned premium.
Finance costs	The cost of servicing the Group's external borrowings.
Gross written premium	The total premiums from contracts that began during the period.
International Accounting Standards Board ("IASB")	A not-for-profit public interest organisation that is overseen by a monitoring board of public authorities. It develops IFRS: standards that aim to make worldwide markets transparent, accountable and efficient.
Incurred but not reported ("IBNR")	Funds set aside to meet the cost of claims for accidents that have occurred, but have not yet been reported to the Group. This includes an element of uplift on the value of claims reported. Where the Group has determined that the value currently held in reserves is not sufficient to meet the estimated ultimate costs of the claim is referred to as incurred but not enough reported (**"IBNER"**).
In-force policies	The number of policies on a given date that are active and against which the Group will pay, following a valid insurance claim.
Insurance liabilities	This comprises insurance claims reserves and claims handling provision, which the Group maintains to meet current and future claims.
Investment income yield	The income earned from the investment portfolio, recognised through the income statement during the period, and divided by the average assets under management (**"AUM"**). This excludes unrealised and realised gains and losses, impairments, and fair-value adjustments. The average AUM derives from the period's opening and closing balances for the total Group; see page 40 alternative performance measures.
Investment return	The income earned from the investment portfolio, including unrealised and realised gains and losses, impairments, and fair value adjustments.
Investment return yield	The return earned from the investment portfolio, recognised through the income statement during the period divided by the average AUM. This includes unrealised and realised gains and losses, impairments, and fair-value adjustments. The average AUM derives from the period's opening and closing balances; see page 40 alternative performance measures.
Loss ratio	Net insurance claims divided by net earned premium.
Net asset value	The net asset value of the Group is calculated by subtracting total liabilities from total assets.
Net claims	The cost of claims incurred in the period less any claims costs recovered under reinsurance contracts. It includes claims payments and movements in claims reserves.

Glossary continued

Term	Definition and explanation
Net earned premium	The element of gross earned premium less reinsurance premium ceded for the period where insurance cover has already been provided.
Ongoing operations	Ongoing operations comprise Direct Line Group's Ongoing divisions: Motor, Home, Rescue and other personal lines, and Commercial. It excludes discontinued operations, the Run-off segment, and restructuring costs.
Operating profit	The pre-tax profit that the Group's activities generate, including insurance and investment activity, but excluding finance costs.
Prudential Regulation Authority ("PRA")	The PRA is a part of the Bank of England. It is responsible for regulating and supervising insurers and financial institutions in the UK.
Reinsurance	Contractual arrangements where the Group transfers part or all of the accepted insurance risk to another insurer.
Return on equity	Return on equity is calculated by dividing the profit attributable to the owners of the Company by average Ordinary Shareholders' equity for the period.
Return on tangible equity ("RoTE")	Return on tangible equity is adjusted profit after tax from Ongoing operations, divided by the Group's average shareholders' equity, less goodwill and other intangible assets. Profit after tax is adjusted to exclude the Run-off segment and restructuring costs. It is stated after charging tax using the UK standard tax rate of 19.25% (2016: 20.0%). See page 39 alternative performance measures.
Risk and business mix	Risk and business mix measures the premium impact of channel, tenure and underlying risk mix. It reflects the risk models used in the period, the outputs of which are revised when models are updated.
Run-off	Where the Group no longer underwrites new business, but continues to meet its claims liabilities under existing contracts.
Solvency II	The capital adequacy regime for the European insurance industry, which became effective on 1 January 2016. It establishes capital requirements and risk management standards. It comprises three pillars: Pillar I, which sets out capital requirements for an insurer; Pillar II, which focuses on systems of governance; and Pillar III, which deals with disclosure requirements.
Total costs	Total costs comprise operating expenses and claims handling expenses for Ongoing operations.
Underwriting result (profit or loss)	The profit or loss from operational activities, excluding investment return and other operating income. It is calculated as net earned premium less net insurance claims and total expenses.

Appendix A – Alternative performance measures

The Group has identified Alternative Performance Measures **("APMs")** in accordance with the European Securities and Markets Authority's published Guidelines. The Group uses APMs to improve comparability of information between reporting periods and reporting segments, by adjusting for either uncontrollable or one-off costs which impact on IFRS measures, to aid the user of the Half Year Report in understanding the activity taking place across the Group. These APMs are contained within the main narrative sections of this document, outside of the condensed consolidated financial statements and notes, and may not necessarily have standardised meanings for ease of comparability across peer organisations.

Further information is presented below, defined in the glossary on pages 37 and 38 and reconciled to the most directly reconcilable line items in the financial statements and notes. Note 4 on page 24 of the condensed consolidated financial statements presents a reconciliation of the Group's business activities on a segmental basis to the condensed consolidated income statement including Ongoing operations of the Group.

Group APM	Equivalent IFRS measure	Adjustment to reconcile primary statements and where calculated	Rationale for adjustments
Adjusted diluted earnings per share	Diluted earnings per share	Adjusted diluted earnings per share is defined in the glossary on page 37 and is reconciled on page 40.	This is a representation of the underlying earnings over the number of shares in issue adjusted for potential dilutions from the exercise of options.
Current-year attritional loss ratio	Loss ratio	Current-year attritional loss ratio is defined in the glossary on page 37 and is reconciled to loss ratio on page 9.	Expresses claims performance in the current accident year in relation to net earned premium.
COR	Operating profit	COR is defined in the glossary on page 37. The constituent parts: operating profit – Ongoing operations is discussed below; and net earned premium (note 5).	This is a measure of underwriting profitability whereby a ratio of less than 100% represents an underwriting profit and a ratio of more than 100% represents an underwriting loss and excludes non-insurance income.
Investment income yield	Investment income	Investment income yield is defined in the glossary on page 37 and is reconciled on page 41.	Expresses a relationship between the investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Investment return yield	Investment return	Investment return yield is defined in the glossary on page 37 and is reconciled on page 41.	Expresses a relationship between the investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Loss ratio	Net insurance claims	Loss ratio is defined in the glossary on page 37 and is reconciled in note 4.	Expresses claims performance in relation to net earned premium.
Operating profit from Ongoing operations	Operating profit	Operating profit from Ongoing operations is defined as operating profit (see glossary on page 38) less operating profit from run-off segment plus restructuring costs (see note 4) and is reconciled on page 40.	This measure shows the underlying performance (before tax and finance costs) of the business activities without the impact of business that is in run-off and non-repeating restructuring costs.
Profit after tax from Ongoing operations	Profit after tax	Operating profit from Ongoing operations (as above) less finance costs and tax at standard rate and is reconciled on page 40.	This measure shows the underlying performance (after tax and finance costs) of the business activities without the impact of business that is in run-off and non-repeating restructuring costs.
RoTE	Return on Equity	RoTE is defined in the glossary on page 38 and is reconciled on page 40.	This shows underlying performance against a measure of equity that is more able to be compared with other companies.
Tangible equity	Equity	Tangible equity is defined as equity less intangible assets and is reconciled on page 40.	This shows the equity excluding intangible assets for comparability with companies who have not acquired businesses or capitalised intangible assets.
Tangible net asset per share	Net assets per share	Tangible net asset per share is defined as tangible equity (as above) expressed as a value per share and is reconciled in note 15 on page 32.	This shows the equity excluding intangible assets per share for comparability with companies who have not acquired businesses or capitalised intangible assets.
Total costs from Ongoing operations	Operating expenses	Total costs from Ongoing operations is defined as operating expenses adjusted to remove restructuring costs and operating expenses charged to the run-off segment (reconciled in note 10) plus claims handling expenses incurred in net insurance claims on Ongoing operations (note 8). This is reconciled on page 10.	This represents the total value of operating expenses including those allocated to the insurance claims line as claims handling expenses.

Additionally, the current-year attritional loss ratio within the analysis by division section and total costs have also been identified as alternative performance measures, similarly reconciled to the financial statements and notes, on page 9 and 10, and defined in the glossary.

Appendix A – Alternative performance measures continued

Return on tangible equity[1]

	Note[2]	H1 2017 £m	H1 2016 £m
Operating profit	4	359.7	316.9
Add back: restructuring costs	4	4.5	30.3
Exclude: operating profit from run-off	4	(10.0)	(23.6)
Operating profit from Ongoing operations	4	354.2	323.6
Finance costs	11	(18.3)	(18.4)
Adjusted profit before tax from Ongoing operations		335.9	305.2
Tax charge (using the UK standard tax rate of 19.25% and 20.0% respectively)		(64.7)	(61.0)
Adjusted profit after tax from Ongoing operations		271.2	244.2
Annualised adjusted profit after tax		542.4	488.4
Opening shareholders' equity		2,521.5	2,630.0
Opening goodwill and other intangible assets		(508.9)	(524.8)
Opening shareholders' tangible equity		2,012.6	2,105.2
Closing shareholders' equity		2,654.5	2,668.8
Closing goodwill and other intangible assets		(517.4)	(541.4)
Closing shareholders' tangible equity		2,137.1	2,127.4
Average shareholders' tangible equity[3]		2,074.8	2,116.3
Return on tangible equity annualised		26.1%	23.1%

Adjusted diluted earnings per share[1]

	Note[2]	H1 2017 £m	H1 2016 £m
Adjusted profit after tax from Ongoing operations		271.2	244.2
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	14	1,378.2	1,385.7
Adjusted diluted earnings per share (pence)		19.7	17.6

Notes:

1. See glossary on page 37 and 38 for definitions
2. See notes to the condensed consolidated financial statements
3. Mean average of opening and closing balances

Appendix A – Alternative performance measures continued

Investment income and return yields[1]

	Note[2]	H1 2017 £m	H1 2016 £m
Investment income	6	82.8	84.4
Investment return	6	93.0	92.7
Investment income annualised		165.6	168.8
Investment return annualised		186.0	185.4
Opening investment property		329.0	347.4
Opening financial investments		5,147.0	5,614.6
Opening cash and cash equivalents		1,166.1	963.7
Opening borrowings		(55.3)	(61.3)
Opening derivatives[3]		(5.8)	(45.7)
Opening investment holdings		6,581.0	6,818.7
Closing investment property		314.9	348.6
Closing financial investments		5,155.5	5,515.7
Closing cash and cash equivalents		1,106.6	1,055.1
Closing borrowings		(59.4)	(65.4)
Closing derivatives[3]		30.6	(257.5)
Closing investment holdings		6,548.2	6,596.5
Average investment holdings		6,564.6	6,707.6
Investment income yield annualised		2.5%	2.5%
Investment return yield annualised		2.8%	2.8%

Notes:

1. See glossary on page 37 for definitions
2. See notes to the consolidated financial statements
3. See note 2 on page 11

Directors' responsibility statement

We confirm that to the best of our knowledge:

1. the condensed consolidated financial statements, which have been prepared in accordance with International Accounting Standard 34 'Interim Financial Reporting' as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of Direct Line Insurance Group plc and the undertakings included in the consolidation taken as a whole as required by Disclosure and Transparency Rule 4.2.4R;
2. the interim management report includes a fair review of the information required by:
   - Disclosure and Transparency Rule 4.2.7R being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
   - Disclosure and Transparency Rule 4.2.8R being related parties transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or the performance of the entity during that period; and any changes in the related parties transactions described in the last Annual Report & Accounts that could do so.

Signed on behalf of the Board

Paul Geddes	John Reizenstein
Chief Executive Officer	Chief Financial Officer
31 July 2017	31 July 2017

Independent review report to Direct Line Insurance Group plc

We have been engaged by Direct Line Insurance Group plc (the "**Company**") to review the condensed set of financial statements ~~i~~n the half-yearly financial report for the six months ended 30 June 2017 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated balance sheet, the condensed consolidated statement of changes in equity, the condensed consolidated cash flow statement and related notes 1 to 20. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 2, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Deloitte LLP
Statutory Auditor
London, UK
31 July 2017