5 March 2019

DIRECT LINE INSURANCE GROUP PLC
PRELIMINARY RESULTS FOR THE YEAR ENDED 31 DECEMBER 2018
STRONG RESULTS AND DIVIDENDS DRIVEN BY A RESILIENT BUSINESS MODEL

PAUL GEDDES, CEO OF DIRECT LINE GROUP, COMMENTED

"I am pleased to announce a strong set of results driven by our resilient business model which performed well in a highly competitive market. We have added a million direct own brand policies since 2014 showing that our customers value our brands, propositions and service.

"Together, our diversified product and channel portfolio and disciplined approach to underwriting have produced operating profits of £601.7 million, a combined operating ratio of 91.7% and a 21.5% return on tangible equity. As a result, the Board is able to announce a final dividend of 14.0p, an increase of 2.9% on last year, and a special dividend of 8.3p.

"We enter a pivotal year of operational delivery in 2019. This includes starting the roll-out of the latest generation IT systems for personal lines, following the successful launch of our new systems for small businesses in 2018, which we believe will deliver benefits for customers, colleagues and shareholders over the coming years. This aims to provide the springboard from which to deliver a step change in both capability and efficiency to help to grow the contribution from current-year profitability.

"This gives us the confidence to continue to target a combined operating ratio of 93% to 95% in 2019 and over the medium term.

"It gives me great pleasure to be handing over to Penny James as our next Chief Executive Officer with effect from the AGM in May. Penny's expertise as our Chief Financial Officer and the breadth of experience she brings from previous roles will be invaluable as she leads the business. I've worked closely with Penny for over twelve months and have been impressed by her drive, energy and ambition for the Group. I am pleased to be leaving the Group in such experienced and capable hands."

Results summary

	FY 2018 £m	FY 2017[1] £m	Change
Gross written premium	**3,211.9**	3,392.1	(5.3%)
Of which: direct own brands	**2,223.0**	2,184.1	1.8%
Operating profit	**601.7**	642.8	(6.4%)
Combined operating ratio[2]	**91.7%**	90.8%	(0.9pts)
Profit before tax	**582.6**	539.0	8.1%
Return on tangible equity[3]	**21.5%**	23.0%	(1.5pts)
Dividend per share – interim (pence)[4]	**7.0**	6.8	2.9%
– final (pence)[4]	**14.0**	13.6	2.9%
– special (pence)	**8.3**	15.0	(44.7%)
	31 Dec 2018	31 Dec 2017	Change
Solvency capital ratio post-dividends[5]	**170%**	165%	5pts

Financial highlights

- Direct own brands premium up 1.8% compared to 2017, driven by growth across all segments. Total Group premium reduced by 5.3% year on year, as a result of the exit from Nationwide and Sainsbury's[6] Home partnerships.
- Operating profit decreased by £41.1 million compared to 2017, primarily due to reductions in prior-year reserve releases and investment return as expected. Operating profit included a £55 million benefit from moving to an assumed 0% Ogden discount rate (2017: £49 million benefit relating to Ogden).
- Demonstrating the value in the Group's diversified product base, current-year underwriting profitability was stable despite a reversal of the benign motor conditions in 2017. The expense ratio reduced to 23.4%.
- Profit before tax increased by 8.1% to £582.6 million (2017: £539.0 million) as the decrease in operating profit was more than offset by the non-repeat of finance costs in relation to the debt repurchased in 2017.
- Final ordinary dividend of 14.0 pence per share, an increase of 2.9% on 2017. Special dividend of 8.3 pence per share. Total dividends of 29.3 pence per share. (2017 total dividends of 35.4 pence per share including a special dividend of 15.0 pence per share).
- Strong capital position with solvency capital ratio of 170% (after proposed dividends) reflecting prudence given current political and economic uncertainties.
- Reiteration of financial targets for 2019 and over the medium term of achieving a combined operating ratio in the range of 93% to 95% normalised for weather. In 2019, targeting operating expenses below £700 million. Reiteration of ongoing target of achieving at least a 15% return on tangible equity.

Strategic and operational highlights

- Successful build and test of core personal lines systems; on track for first launch in Q2 2019.
- Good progress on alternative pricing project, with innovative pricing capability; aiming to launch in Q2 2019 under new brand.
- NIG successfully launched a new Motor Trade product using a new policy system and pricing engine.
- Direct Line launched two further unique customer propositions, in Motor and Home.
- Direct Line for Business launched cover for over 500 new trades in 2018 on its new digital platform alongside a national marketing campaign.
- Green Flag's five-year transformation plan kicked off with a Centre of Excellence to drive benefits through greater focus; Rescue Me app rebuilt in-house and re-launched – Apple App store score of 4.8 and used in over 35,000 claims.
- Increased use of data in Motor to improve fraud prevention helping to drive 18% growth in price comparison website new business volumes.
- Third in the Sunday Times list of 25 Best Big Companies[7] to work for in 2019.

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Notes:

1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.
2. 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 pages 45 and 46 for definitions.
3. See glossary on pages 45 and 46 for definitions and appendix A – Alternative performance measures on pages 47 to 48 for reconciliation to financial statement line items.
4. 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.
5. Estimates based on the Group's solvency II partial internal model.
6. Exit from Sainsbury's in respect of new business.
7. https://www.b.co.uk/the-lists/big-companies/

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 and guidance which are contained in this document specifically with respect to the return on tangible equity, solvency capital ratio, the Group's combined operating ratio, prior-year reserve releases, cost reduction, reductions in expense and commission ratios, investment income yield, net realised and unrealised gains 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, United Kingdom ("**UK**") domestic and global economic business conditions, the outcome of discussions within the UK parliament and discussions between the UK and the European Union ("**EU**") regarding the manner and terms on which, if any, the UK leaves the EU (usually called "**Brexit**") and the terms in due course of any future trading relationship between the UK and the EU, 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.

Neither the content of Direct Line Group's website nor the content of any other website accessible from hyperlinks on the Group's website is incorporated into, or forms part of, this document.

Financial summary

	FY 2018 £m	FY 2017[1] £m	Change
In-force policies (thousands)	15,032	15,714	(4.3%)
Of which: direct own brands (thousands)	7,132	6,909	3.2%
Gross written premium	3,211.9	3,392.1	(5.3%)
Of which: direct own brands	2,223.0	2,184.1	1.8%
Net earned premium	3,089.5	3,135.0	(1.5%)
Underwriting profit	255.1	288.1	(11.5%)
Instalment and other operating income	192.0	179.3	7.1%
Investment return	154.6	175.4	(11.9%)
Operating profit	601.7	642.8	(6.4%)
Finance costs	(19.1)	(103.8)	81.6%
Profit before tax	582.6	539.0	8.1%
Tax	(108.9)	(105.0)	(3.7%)
Profit after tax	473.7	434.0	9.1%
Key metrics			
Current-year attritional loss ratio[2]	72.5%	69.4%	(3.1pts)
Loss ratio[2]	61.8%	56.0%	(5.8pts)
Commission ratio[2]	6.5%	9.1%	2.6pts
Expense ratio[2]	23.4%	25.7%	2.3pts
Combined operating ratio[2]	91.7%	90.8%	(0.9pts)
Return on tangible equity[3]	21.5%	23.0%	(1.5pts)
Investment income yield[3]	2.5%	2.5%	–
Net investment income yield[3]	2.0%	2.1%	(0.1pts)
Investment return yield[3]	2.4%	2.6%	(0.2pts)
Basic earnings per share (pence)	33.5	31.8	5.3%
Diluted earnings per share (pence)	33.1	31.5	5.1%
Return on equity	17.3%	16.6%	0.7pts
Dividend per share – interim (pence)	7.0	6.8	2.9%
– final (pence)	14.0	13.6	2.9%
– total ordinary (pence)	21.0	20.4	2.9%
– special (pence)	8.3	15.0	(44.7%)
– total (pence)	29.3	35.4	(17.2%)

	31 Dec 2018	31 Dec 2017	Change
Net asset value per share (pence)	188.6	198.9	(5.2%)
Tangible net asset value per share (pence)	147.0	164.4	(10.6%)
Solvency capital ratio post-dividends[4]	170%	165%	5pts

Notes:

1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.
2. 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 pages 45 and 46 for definitions.
3. See glossary on pages 45 and 46 for definitions and appendix A – Alternative performance measures on pages 47 to 48 for reconciliation to financial statement line items.
4. See note 5 on page 2, reported after proposed dividends.

CEO REVIEW

I am pleased to report another strong set of results in a highly competitive market driven by the Group's resilient and customer-centric business model. We continued to make significant operational progress in 2018 and we head into a pivotal year of delivery in 2019, with the aim of delivering a springboard from which to grow the contribution from current-year profitability. We maintained good cost discipline in 2018 and are determined to leverage our investment in the business to step change our efficiency. The new technology and greater efficiency are, in turn, designed to support our ambition to innovate more rapidly and find new ways to serve our customers as their demands evolve. Financially, we continued to see the benefits of improving the efficiency of our balance sheet, which has contributed to another attractive dividend, while continuing to invest in the business and maintaining a prudent solvency margin.

Business performance

We ended 2018 having delivered a sixth successive year of strong financial performance and a return on tangible equity of 21.5% (2017: 23.0%), well ahead of our target of at least a 15% return on tangible equity.

Our direct own brands gross written premium increased by 1.8%, whereas total gross written premium was lower as expected due to the exits from Nationwide and Sainsbury's Home partnerships. We achieved an operating profit of £601.7 million (2017: £642.8 million). The reduction in operating profit was primarily due to lower prior-year reserve releases and investment return. Both years benefited from reserve releases relating to the Ogden discount rate. In respect of 2018, we have now assumed a higher Ogden discount rate of 0%, following Royal Assent of the Civil Liability Act 2018, which contributed £55 million to operating profit (2017: £49 million), of which £51 million related to the prior years.

Weather returned to normal levels in 2018 after a benign 2017 and this offset the non-repeat in 2018 of the £57 million non-cash impairment charge incurred in 2017 in relation to IT projects. Normalised for weather and adjusted for the assumed Ogden discount rate change, the combined operating ratio was approximately 93.5%, towards the lower end of our medium-term target range of 93% to 95%.

Overall, our current-year combined operating ratio was stable, demonstrating the value in the Group's diversified product base and channel portfolio as well as lower operating expenses.

Good Motor performance in competitive markets

In 2018 the Motor division traded well, maintaining target loss ratios, in a generally deflationary market which has been increasingly competitive. Whilst the current-year attritional loss ratio was up by 1.8 percentage points, the underlying current-year combined operating ratio was stable and operating profit was up 4.7%.

We grew in-force policies by 1.9% to 4.1 million and gross written premium was broadly stable at £1,671 million. The growth in in-force policies was across both direct and price comparison website channels, driven by growth in Direct Line and particularly Churchill through the price comparison website channel, which showed the value of our multi-channel strategy. While new business volumes fell slightly, retention remained strong year on year across all channels.

Motor risk-adjusted prices increased by 0.6% in 2018 while risk mix reduced average premiums by 1.5%. The change in risk mix primarily reflected the attractiveness of our promotion of free Motor legal protection cover to Churchill aggregator customers, who typically have lower average premiums.

Home normalised combined operating ratio improved

As expected, overall Home gross written premium was 24.1% lower in 2018 as we exited from the Nationwide and Sainsbury's partnership arrangements. Despite this, profitability remained strong with an improved normalised combined operating ratio of approximately 92% (2017: approximately 94%) and operating profit exceeded £80 million after £65 million of weather-related claims.

In-force policies for Home's own brands were broadly stable compared with 2017 at 1.8 million policies, while own brands gross written premium rose by 0.7% with increases across all brands. New business volumes were lower during the second half of 2018 as shopping levels slowed following the anniversary of the introduction of the new rules requiring the previous year's premium to be included on renewal documents. Retention in Home own brands continued to be strong.

Home own brands average written premium increased slightly by 0.4% compared with 2017 with a 3.5% price increase more than offsetting a reduced risk mix.

Rescue and other personal lines reshaping for future growth

This division includes our challenger Rescue brand, Green Flag, as well as other personal lines products – Pet, Travel and Motor and Home products for mid- to high-net-worth customers. We were successful in growing our higher margin Green Flag direct business in 2018 which we believe gives us a strong position heading into 2019. Overall operating profit in 2018 was in line with 2017.

Gross written premium for Rescue and other personal lines increased by 0.4% compared with 2017 while in-force policies fell by 2.7% to 7.5 million.

Green Flag direct continued to grow throughout 2018, increasing in-force policies by 11.5% to over 894,000. Gross written premium grew by 14.3% to £69.6 million, which was driven by higher volumes and a shift towards higher levels of cover which attracted higher average premiums.

Commercial investing for growth and margin improvement

Within our Commercial division we have two main businesses which are executing their respective strategies. Direct Line for Business once again delivered on its growth strategy with gross written premium up by 7.7% in 2018 as it grew in its traditionally strong areas of Van and Landlord, supplemented by growth in the small and micro business products on its new platform. Meanwhile, NIG focused on improving margins whilst progressing with its strategic aim of being effortless to trade with.

Operating profit of £60.0 million was down on 2017 primarily as a result of higher weather-related claims in 2018, compared to a benign 2017, and lower prior-year reserve releases. The current-year attritional loss ratio improved by 2.0 percentage points in 2018.

Strategic update

Trusted brands and direct growth

Once again, the growth we achieved across Direct Line, Direct Line for Business and Green Flag demonstrated that by giving customers a reason to come to us direct, they will. Since 2014, our own brand in-force policies have grown by over one million, to over seven million policies.

In Direct Line we launched another two new unique propositions – in Home and Motor. Our new Motor proposition removed one of our customers' greatest frustrations and protected their no claim discount on no-fault claims. We now offer a combination of nine Direct Line propositions that our customers cannot get anywhere else in the market.

Direct Line for Business achieved its 11th consecutive year of premium growth. This time last year, we launched a more personalised approach for our business customers, from start-ups to growing businesses. Starting with Hair and Beauty and followed by Bed & Breakfast in 2017, this year we ramped up our delivery by releasing cover for over 500 new trades, taking us to 75% of our target trades on the new platform. A national marketing campaign was launched in the year and the early campaign metrics have been positive. This has driven higher volumes to the website and there has been a 100% increase in brand searches. Work is underway to re-launch two of our biggest products on our new system, Van and Tradesman in 2019. This continues to demonstrate our increased ability to work in an agile way and to launch new, innovative products quickly to meet the ever-changing needs of our customers.

And finally Green Flag, our challenger brand in the Rescue market, continued to display great growth potential and demonstrated this again by achieving another period of double digit percentage growth in policy count and premiums. Our Rescue network dealt with over 640,000 breakdowns in 2018, which is one every 49 seconds. There has been great progress in Rescue in 2018, launching a five-year transformational plan and the team have relocated to a Centre of Excellence, bringing together multi-skilled teams to recognise efficiencies and offer greater flexibility. The Rescue Me app, which is rated 4.8 in the Apple App store, was rebuilt using in-house digital capabilities and was used in over 35,000 claims.

Moving towards best in class in the price comparison website market

We see a real opportunity in strengthening our capabilities on price comparison websites. We increased our focus in 2018 and created a new trading hub in Motor and Home to support this. We made some tactical pricing changes driven by improved anti-fraud capabilities and this helped increase Churchill and Privilege Motor new business volumes by 18%. We believe there is an opportunity to strengthen margins in this channel.

Investing in technology

Whilst we have already made significant progress in delivering our Direct Line for Business systems, most of our transformational work has been going on behind the scenes on our core personal lines technology, as we continued our ambitious programme to build our latest generation IT capabilities.

These systems, which started to go into testing at the end of 2018, are designed to make insurance much easier for our customers by introducing more self-service and customer-focused innovations. In addition they are designed also to enable a step change in our ability to use internal and external data more effectively to improve our pricing accuracy and improve our competitiveness. Our new pricing engine is designed to make it much easier and quicker to develop, test and deploy new models. This is intended to allow us to tailor our models better to the price comparison website channel and improve our speed to market. We are also in the process of testing our new digital Travel platform. 2019 is an important year in starting to deliver these systems which we see as a key enabler in transforming our business.

We continue to make good progress on our alternative pricing project which we expect to give us new capability by applying new data science methods and machine learning. We believe this approach will enable us to deepen our competitive footprint with more granular and flexible pricing capabilities. Testing is progressing well and we are aiming to launch in Q2 2019 under a new brand.

Improving our efficiency

In order to be able to give our customers the best value for money, we recognise it is imperative to operate efficiently. Over the past five years we've made significant strides in reducing our costs, such as through improved marketing efficiency, where we reduced marketing spend by over 30% whilst returning our direct own brands to growth and reducing our number of sites by nearly a half and annual rental costs by around 40%.

Over the past two years we have been expanding our robotic process automation capability and are now managing concurrently 28 processes and approximately 500,000 automated transactions each quarter. But we don't intend to stop there and have already identified a strong pipeline of processes to add to our existing portfolio and which has the potential to increase our transaction volume capability by a further 500,000 in 2019.

The actions we've taken supported the reduction in the operating expense ratio and we aim to continue to transform our business and improve our efficiency and long-term competitiveness.

Leveraging our scale via partnerships

In Home, we leveraged our capabilities in digital and data to streamline the customer experience. Our improved capabilities in digital are helping us have conversations with potential new partners.

In Travel, we are building a new system that is designed to enable customers to self-serve and interact with us day or night, offering greater support and helping us renew our partnerships with RBS Group and Nationwide.

In Motor, our new partnership with Volkswagen Insurance Service (Great Britain) Limited is going well. We provide both annual insurance cover and complimentary '5 day driveaway' cover for customers buying new and used cars from Volkswagen, Volkswagen Commercial Vehicles, SEAT, Audi and ŠKODA dealers.

Investing in our talented people

The success of the business is due to the commitment and dedication of our people who use their expertise to serve our customers. We rightly celebrate our diversity and are united in our customer focus. This focus is reflected in our unique propositions and the fact that on average we manage one claim every single minute of every single hour, every day of the year. The freezing weather earlier in the year hit many drivers, households and businesses hard, and the way our people helped our customers get their lives back on track during this difficult period demonstrated the value of our insurance cover and gives customers a reason to keep coming back to us.

Nearly 10,000 of our people now own shares in our company which gives them a real sense of ownership and investment in our future success. Our engagement scores increased again in 2018 and I'm proud that this year we came third in the Sunday Times list of the 25 Best Big Companies to work for in 2019. This is a huge achievement and is testament to the value we place in our people.

Regulation

The Group has continued to operate within a highly dynamic and evolving regulatory landscape, where there are a number of reviews and initiatives, including those that have been announced by the UK Government, the FCA and the PRA.

In 2018 both the FCA and PRA have been focused on Brexit preparations and the implementation of the Senior Managers and Certification Regime. The PRA's focus continues to be on the pillars of its financial risk framework, namely reserving, pricing, reinsurance and investments. The FCA has also been focused on pricing practices, including the launch of its market study. The Group is supportive of the FCA's market study. At this early stage however, the outcomes are not yet known.

The insurance market is very competitive with high levels of switching and lots of introductory discounts which leads to most people shopping around for the best deal. For those customers who don't shop around it is crucial that insurers have active pricing processes for all their long-term customers. We have had these measures in place for several years and increasing numbers of long-standing customers have seen their renewal premium either frozen or reduced as a result. We worked closely with the Association of British Insurers on their pricing principles and actions on premiums which we hope will embed best practice across the whole industry.

Brexit

Brexit, when the UK is due to leave the EU, is scheduled to take place on 29 March 2019. Although the Group is predominantly a UK business, it does, for example, have exposure to financial markets and it imports goods and services in order to fulfil insurance claims, including from the EU. The Group has been monitoring events carefully and proactively taken steps to mitigate the likely impact on the Group to the extent we consider it to be appropriate and proportionate to do so, given the considerable uncertainties; however, in the event of a disruptive Brexit the Group will not be immune. We have more information on this in the Risk section, on pages 25 and 26.

Dividend and capital management

The Group's solvency capital ratio prior to all proposed dividends was 194%, resulting from good capital generation from the business and lower capital requirements due in part to increasing the level of reinsurance purchased by the Group in recent years. This was partially offset by higher unrealised mark to market losses due to credit spread widening and continued capital expenditure as the Group invests with the aim of improving its capabilities and efficiency.

The Board has recommended a final dividend of 14.0 pence per share (2017: 13.6 pence), an increase of 0.4 pence per share (2.9%), in line with business growth. This reflects the Board's continued confidence in the Group's earnings and the progress the business continued to make.

The Board has also declared a special dividend of 8.3 pence per share. After both dividends the solvency capital ratio will be 170% as at 31 December 2018.

The Board has taken into account the high level of political and economic uncertainty, including in relation to Brexit, and considers it appropriate for the time being to maintain a prudent solvency capital ratio towards the upper end of the solvency capital ratio risk appetite range of 140% to 180%. The Board will keep this position under review as it monitors developments in the political and economic environment. In normal circumstances, the Board expects the Group to operate around the middle of its solvency capital ratio risk appetite range.

Outlook

The Group targets a combined operating ratio of 93% to 95% for 2019 and over the medium term, normalised for weather. Over time, the Group expects to increase the contribution from current-year underwriting as the contribution from prior-year reserve releases reduces. The latter is predominantly as a result of increasing the level of reinsurance purchased by the Group in recent years, which has reduced the risk profile of the Group.

The targeted improvement in current-year underwriting profitability is supported by the significant investment the Group is making in building future capability. This aims to improve the current-year loss ratio by delivering additional pricing sophistication and supporting multiple initiatives to combat fraud. In addition, the Group is targeting to improve efficiency through self-service and digitalisation. These improvements are targeted to emerge over a number of years. In 2019, the Group expects to make further progress in reducing operating costs and is targeting operating expenses below £700 million. We reiterate our ongoing target of achieving at least a 15% return on tangible equity.

As I prepare to hand over the reins to Penny, not only do I look back over the last ten years with great pride, I also look to the future with great excitement for our customers, people and shareholders. Over the next 12 months, as we begin the roll-out of our new core personal lines IT applications, we plan to increase our flexibility to deal with changing business requirements, offer more self-service and deliver more straight-through processing. This combined with our leading brands and great people will help Direct Line Group with its mission to make insurance much easier and better value for its customers.

PAUL GEDDES
CHIEF EXECUTIVE OFFICER

FINANCE REVIEW

Performance

Operating profit

	FY 2018 £m	FY 2017 £m
Underwriting profit	255.1	288.1
Instalment and other operating income	192.0	179.3
Investment return	154.6	175.4
Total operating profit	**601.7**	**642.8**
Of which:		
Current-year operating profit	197.3	207.4
Prior-year reserve releases	404.4	435.4

Operating profit decreased by £41.1 million to £601.7 million (2017: £642.8 million) mainly due to a reduction in the underwriting profit and investment return, partly offset by an increase in instalment and other operating income. Overall, current-year operating profit was lower, with a stable current-year combined operating ratio offset by a lower investment return.

Underwriting profit decreased to £255.1 million (2017: £288.1 million) predominantly due to lower prior-year reserve releases of £31.0 million. Increased weather-related claims of £75 million, mainly associated with the major freeze event in Q1 2018 (2017: £13 million weather-related claims), were mostly offset by the non-repeat in 2018 of the £56.9 million impairment charge in 2017 in relation to IT projects.

The current-year attritional loss ratio increased by 3.1 percentage points to 72.5% (2017: 69.4%) as the Group experienced a reversal of the benign motor conditions in 2017 and a reduction in partnership business in Home. This was offset by a 2.6 percentage points reduction in the commission ratio as a result of both lower commissions and profit share payments to Home partners, as a result of the exit of the Nationwide and Sainsbury's partnerships and changes to other partnership commissions arrangements. The current-year combined operating ratio was stable.

Effect of Ogden discount rate changes

	Motor £m	Commercial £m	FY 2018 Total £m	Motor £m	FY 2017 Total £m
Prior year	47.9	3.5	51.4	49.0	49.0
Current year	2.7	0.7	3.4	–	–
Total Ogden reserve releases	**50.6**	**4.2**	**54.8**	49.0	49.0

Following Royal Assent of the Civil Liability Act 2018, which introduced a new framework for setting the personal injury discount rate, the Group reviewed the Ogden discount rate for reserves for large bodily injury claims and selected an assumed rate of 0% for reserving purposes. This has resulted in a release of £54.8 million in 2018 and this release was split across the Motor and Commercial segments. Given the Group's lower reinsurance retention in recent years, the majority of the reserve release related to prior years. In 2017, the Motor segment benefited from a reserve release of £49.0 million resulting from a lower than expected increase in claims costs following the change in Ogden discount rate to minus 0.75%.

Instalment and other operating income increased to £192.0 million (2017: £179.3 million) and included a £9.6 million gain on sale of a property in Bristol.

Investment return decreased to £154.6 million (2017: £175.4 million) primarily due to a £7.9 million reduction year on year in investment income as a result of lower assets under management and a £12.9 million reduction year on year in realised and unrealised gains.

In-force policies and gross written premium

In-force policies (thousands)

At	31 Dec 2018	30 Sep 2018	30 Jun 2018	31 Mar 2018	31 Dec 2017
Own brands	3,950	3,920	3,894	3,874	3,845
Partnerships	144	149	155	160	174
Motor	**4,094**	4,069	4,049	4,034	4,019
Own brands	1,789	1,789	1,793	1,795	1,794
Partnerships (excluding Nationwide and Sainsbury's)	803	810	815	822	823
Partnerships (Nationwide and Sainsbury's)	59	188	335	472	631
Home	**2,651**	2,787	2,943	3,089	3,248
Rescue	3,491	3,530	3,537	3,544	3,591
Travel	3,759	3,771	3,783	3,796	3,853
Pet	156	156	157	159	162
Other personal lines	126	126	127	128	133
Rescue and other personal lines	**7,532**	7,583	7,604	7,627	7,739
Of which: Green Flag direct	894	875	846	820	802
Direct Line for Business	499	494	485	477	468
NIG and other	256	250	245	242	240
Commercial	**755**	744	730	719	708
Total in-force policies	**15,032**	15,183	15,326	15,469	15,714
Of which: direct own brands	7,132	7,078	7,018	6,966	6,909

Total in-force policies reduced to 15.0 million (31 December 2017: 15.7 million), primarily due to lower partner volumes in Home, following the exit from the Nationwide and Sainsbury's partnerships, and reductions in Rescue and other personal lines as a result of lower packaged bank account volumes. Own brands in-force policies grew to 7.1 million (31 December 2017: 6.9 million) with growth in Motor, Green Flag and Direct Line for Business, which partly offset the overall reduction.

Gross written premium

	H2 2018 £m	H2 2017 £m	FY 2018 £m	FY 2017 £m
Own brands	801.5	809.7	1,608.8	1,590.9
Partnerships	29.9	36.3	62.4	79.5
Motor	831.4	846.0	1,671.2	1,670.4
Own brands	218.2	216.5	412.6	409.7
Partnerships (excluding Nationwide and Sainsbury's)	91.1	98.3	181.7	195.6
Partnerships (Nationwide and Sainsbury's)	6.9	96.2	12.6	193.8
Home	316.2	411.0	606.9	799.1
Rescue	83.3	77.7	163.4	161.3
Travel	70.7	71.6	143.9	143.4
Pet	36.5	37.0	72.4	74.8
Other personal lines	22.4	21.5	43.1	41.6
Rescue and other personal lines	212.9	207.8	422.8	421.1
Of which: Green Flag direct	36.3	31.5	69.6	60.9
Direct Line for Business	68.0	62.5	132.0	122.6
NIG and other	173.1	170.6	379.0	378.9
Commercial	241.1	233.1	511.0	501.5
Total gross written premium	1,601.6	1,697.9	3,211.9	3,392.1
Of which: direct own brands	1,124.0	1,120.2	2,223.0	2,184.1

Gross written premium of £3,211.9 million (2017: £3,392.1 million) decreased by 5.3% primarily due to the exit from the Nationwide and Sainsbury's partnerships in Home. Direct own brands gross written premium of £2,223.0 million (2017: £2,184.1 million) grew by 1.8%.

Motor

The Motor division grew in-force policies by 1.9% to 4.1 million and gross written premium was broadly stable at £1,671.2 million. The growth in in-force policies was across both direct and price comparison website channels, driven by growth in Direct Line and Churchill which demonstrated the value of the Group's multi-brand strategy. While new business volumes fell slightly, retention remained strong year on year across all channels.

Motor average premium[1] fell by 1.0% in 2018. Motor risk-adjusted prices increased by 0.6% in 2018 while risk mix reduced average premiums by 1.5%. The change in risk mix primarily reflected the attractiveness of the Group's free Motor legal protection cover to lower average premium Churchill aggregator customers.

Home

In-force policies for Home's own brands were broadly stable compared with 2017 at 1.8 million policies, while partnerships volumes reduced by 40.7% predominantly due to the exit from the Nationwide and Sainsbury's partnerships. Excluding Nationwide and Sainsbury's, partnership volumes reduced by 2.4% in 2018.

Gross written premium was 24.1% lower than 2017, predominantly due to the reduction in partnerships. Own brands gross written premium rose by 0.7% with increases across all brands. New business volumes were lower during the second half of 2018 as shopping levels slowed following the anniversary of the introduction of the new rules requiring the previous year's premium to be included on renewal documents. Retention in Home own brands continued to be strong.

Home own brands average written premium[2] increased slightly by 0.4% compared with 2017 with a 3.5% price increase offset by a reduced risk mix.

Rescue and other personal lines

Rescue and other personal lines in-force policies fell by 2.7% to 7.5 million. Gross written premium for Rescue and other personal lines increased by 0.4% compared with 2017.

Green Flag continued to grow its higher margin direct business during 2018, increasing in-force policies by 11.5% to over 894,000 as 2018's extreme weather events reminded potential customers of the benefits of having breakdown cover. Gross written premiums grew by14.3% to £69.6 million, which was driven by higher volumes and a shift towards higher levels of cover which attracted higher average premiums.

Notes:

1. Average incepted written premium excluding IPT for total Motor for year to date 31 December 2018.
2. Average incepted written premium excluding IPT for Home own brands for year to date 31 December 2018.

In-force policies for the Group's linked rescue channel reduced to 1.9 million, driven by the end of the Churchill "Free Rescue" campaign in July, where Churchill Motor customers received a year's Rescue cover when they purchased their policy. Rescue partnerships in-force policies and gross written premiums, where margins tend to be lower than for direct, reduced, driven by a partnership exit and a reduction in packaged bank account volumes.

Other personal lines in-force policies reduced by 2.6% to 4.0 million primarily due to lower packaged bank account volumes. The rate of reduction of pet in-force policies slowed considerably in 2018 and insurance packages tailored for mid- and high-net-worth Home and Motor customers saw strong growth. Gross written premium remained broadly stable as a slight growth in Travel offset a reduction in Pet.

Commercial

Commercial in-force policies increased by 6.6% compared with 2017 to 755,000. This reflected strong growth in both Direct Line for Business and NIG and other. Gross written premium increased by 1.9% to £511.0 million.

Direct Line for Business grew in-force policies by 6.6% as it grew in its traditionally strong areas of Van and Landlord, supplemented by growth in the small and micro business products on its new platform. Gross written premium increased by 7.7% to £132.0 million with increases across all product lines.

NIG and other in-force policies grew by 6.7%. Gross written premium remained steady at £379.0 million as the business continued to focus on improving margins and delivering on its strategy of being 'Effortless to Trade With'.

Underwriting profit and combined operating ratio

	FY 2018	FY[1] 2017
Underwriting profit (£ million)	255.1	288.1
Loss ratio	61.8%	56.0%
Commission ratio	6.5%	9.1%
Expense ratio	23.4%	25.7%
COR	91.7%	90.8%

Note:

1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.

The Group's combined operating ratio of 91.7% (2017: 90.8%) increased by 0.9 percentage points primarily due to a higher loss ratio which was partly offset by improvements in commission and expense ratios. Weather returned to close to normal levels in 2018 after a benign 2017 and this offset the non-repeat in 2018 of the £56.9 million non-cash impairment charge incurred in 2017. Normalised for weather and adjusted for the Ogden discount rate change, the combined operating ratio was approximately 93.5%, towards the lower end of the Group's medium-term target of 93% to 95%.

The loss ratio was 5.8 percentage points higher at 61.8% (2017: 56.0%) and reflected lower prior-year reserve releases, increases in Home and Commercial loss ratios due to the major freeze event in Q1 2018 and a reversal of benign motor conditions in 2017.

The expense ratio improved by 2.3 percentage points to 23.4% (2017: 25.7%), as the Group continued to reduce its operating expenses (0.5 percentage points excluding the impact of impairments in 2017). The reduction in the commission ratio of 2.6 percentage points primarily reflected both lower commissions and profit share payments to Home partners, as a result of the exit of the Nationwide and Sainsbury's partnerships and changes to other partnership commissions arrangements. The remaining premium from these partnerships was substantially earned in 2018 and consequently the commission ratio is expected to reduce again in 2019 albeit at a significantly slower rate. In subsequent years the direction of the commission ratio will be dependent on the Group's partnership activities.

Ratio analysis by division

	Notes	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
For the year ended 31 December 2018						
Net earned premium	3	1,541.8	667.8	414.7	465.2	3,089.5
Net insurance claims	3	980.0	413.3	277.2	241.3	1,911.8
Prior-year reserve releases	20	276.3	32.6	16.1	79.4	404.4
Major weather events		n/a	(65.0)	n/a	(10.0)	(75.0)
Attritional net insurance claims		1,256.3	380.9	293.3	310.7	2,241.2
Loss ratio – current-year attritional		81.5%	57.0%	70.7%	66.8%	72.5%
Loss ratio – prior-year reserve releases		(17.9%)	(4.9%)	(3.9%)	(17.1%)	(13.1%)
Loss ratio – major weather events[1]		n/a	9.7%	n/a	2.1%	2.4%
Loss ratio – reported	3	63.6%	61.8%	66.8%	51.8%	61.8%
Commission ratio	3	2.0%	9.4%	4.6%	18.9%	6.5%
Expense ratio	3	23.3%	22.4%	23.8%	24.8%	23.4%
COR	3	88.9%	93.6%	95.2%	95.5%	91.7%
Current-year COR		106.8%	98.5%	99.1%	112.6%	104.8%
For the year ended 31 December 2017[2]						
Net earned premium	3	1,470.6	790.5	417.6	456.3	3,135.0
Net insurance claims	3	852.9	400.5	273.3	227.5	1,754.2
Prior-year reserve releases	20	318.6	23.7	6.8	86.3	435.4
Major weather events		n/a	(13.0)	n/a	n/a	(13.0)
Attritional net insurance claims		1,171.5	411.2	280.1	313.8	2,176.6
Loss ratio – current-year attritional		79.7%	52.0%	67.1%	68.8%	69.4%
Loss ratio – prior-year reserve releases		(21.7%)	(3.0%)	(1.7%)	(18.9%)	(13.9%)
Loss ratio – major weather events[1]		n/a	1.6%	n/a	n/a	0.4%
Loss ratio – reported	3	58.0%	50.6%	65.4%	49.9%	56.0%
Commission ratio	3	2.5%	17.7%	5.5%	19.1%	9.1%
Expense ratio	3	29.3%	21.1%	23.4%	24.4%	25.7%
COR	3	89.8%	89.4%	94.3%	93.4%	90.8%
Current-year COR		111.5%	92.4%	96.0%	112.3%	104.7%

Notes:

1. Home and Commercial claims for major weather events, including inland and coastal flooding and storms.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.

The movement in the current-year attritional loss ratio is an indicator of underlying accident year performance as it excludes prior-year reserve releases and claims costs from major weather events. The Group's current-year attritional loss ratio of 72.5% increased by 3.1 percentage points compared to 2017, primarily due to a change in business mix and a reversal of benign conditions experienced in 2017 in Motor.

Prior-year reserve releases continued to be significant at £404.4 million (2017: £435.4 million), were equivalent to 13.1% of net earned premium (2017: 13.9%) and were concentrated towards more recent accident years. Reserve releases in 2018 included a £51.4 million Ogden rate-related prior-year reserve release (2017: £49.0 million release). Assuming current claims trends continue, prior-year reserve releases are expected to reduce further in future years, although they are expected to remain a significant contribution to profits.

The Group's current-year combined operating ratio remained broadly steady at 104.8% (2017: 104.7%) as increases in attritional loss ratios were offset by reductions in commission and expense ratios.

Motor

The current-year attritional loss ratio in Motor increased by 1.8 percentage points to 81.5% (2017: 79.7%) following a reversal of benign conditions experienced in 2017. The Group observed higher claims frequency in 2018 following an unusually low frequency year in 2017. The Group's long-term view of claims inflation remains within the range of 3% to 5%.

In total, prior-year reserve releases were £42.3 million lower year on year at £276.3 million and included £47.9 million relating to the change in the assumed Ogden discount rate (2017: £49.0 million release). Bodily injury claims reserves continued to develop favourably.

Motor's reported combined operating ratio improved by 0.9 percentage points to 88.9% (2017: 89.8%). This was primarily as a result of the improvement in the expense ratio, following the non-repeat in 2018 of 2017's impairment of intangible assets.

Home

The current-year attritional loss ratio, excluding major weather event claims, increased by 5.0 percentage points to 57.0%, reflecting changes in business mix, and was more than offset by lower commissions from partnerships. Claims inflation, excluding the impact of major weather events, remained within the Group's long-term expectation of 3% to 5%. Subsidence claims, including those associated with the dry summer weather in the UK, were not materially above normal annual expectations.

The commission ratio of 9.4% was 8.3 percentage points lower than for 2017, reflecting lower commission and profit share payments to partners resulting from the exit from the Nationwide and Sainsbury's partnerships and changes to other partnership commission arrangements.

Home's combined operating ratio increased by 4.2 percentage points to 93.6% (2017: 89.4%) with higher loss and expense ratios in part offset by an improved commission ratio. The loss ratio was 11.2 percentage points higher at 61.8% compared to 2017 primarily as a result of the major weather events in Q1 2018. The impact of weather in Q1 was approximately £65 million (2017: £13 million) and no additional major weather events were experienced for the remainder of the year. Normalised for weather, the combined operating ratio was approximately 2.0 percentage points better than last year at 92% (2017: approximately 94%).

Rescue and other personal lines

The combined operating ratio for Rescue and other personal lines increased by 0.9 percentage points to 95.2% (2017: 94.3%) primarily due to an increase in the loss ratio partially offset by a lower commission ratio. During the year, Rescue experienced a higher average claims cost due to a mix of recoveries, weather conditions and a restructuring of the Group's third-party recovery network. As a result, Rescue's combined operating ratio increased to 85.0% (2017: 82.8%). Other personal lines combined operating ratio was stable as improved performance in Pet and Travel was offset by weather-related and large claims in Home products for mid- to high-net-worth customers.

Commercial

The current-year attritional loss ratio in Commercial improved by 2.0 percentage points to 66.8% as risk selection over volume remained the priority. Prior-year reserve releases were £6.9 million lower at £79.4 million.

The combined operating ratio for Commercial increased by 2.1 percentage points to 95.5% (2017: 93.4%), primarily due to a 1.9 percentage points increase in the loss ratio as a result of the major weather events in Q1 2018 and the reduction in prior-year reserve releases, partially offset by an improvement in the current-year attritional claims ratio. The impact of weather events in 2018 was approximately £10 million.

Commission and expense ratios remained broadly stable compared to 2017 despite increased pressure on commissions due to broker consolidation.

Operating expenses

	Note	2018 £m	2017 £m
Staff costs[1]	9	269.9	280.1
Other operating expenses[1,2]	9	253.3	273.6
Marketing	9	121.2	113.7
Amortisation and impairment of other intangible assets[3]	9	46.7	111.0
Depreciation	9	31.1	27.9
Total operating expenses		722.2	806.3

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. Amortisation and impairment of other intangible assets includes a £1.5 million impairment charge for year ended 31 December 2018 (2017: £56.9 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.

Operating expenses reduced by £84.1 million to £722.2 million (2017: £806.3 million) resulting in an expense ratio of 23.4% (2017: 25.7%). Excluding an impairment of intangible assets of £56.9 million in 2017, operating expenses reduced by 3.6% as reductions in staff costs and other operating expenses were partially offset by an increase in marketing spend in Motor and Commercial to drive brand awareness. The Group continued to invest in its significant IT programme and operational efficiency improvements while supporting business growth and investment in future capability.

The Group will apply IFRS 16 'Leases' from 1 January 2019. If the Group had applied this standard in 2018, the impact would have been a reduction in operating expenses of approximately £5 million and an increase in finance costs of approximately £7 million.

In 2019, the Group expects to make further progress in reducing operating costs and is targeting operating expenses below £700 million.

Instalment and other operating income

	Note	FY 2018 £m	FY 2017 £m
Instalment income		**119.9**	116.4
Other operating income:			
Vehicle replacement referral income	6	**17.2**	16.9
Revenue from vehicle recovery and repair services	6	**11.7**	11.3
Legal services income	6	**11.2**	11.0
Other income	6	**32.0**	23.7
Other operating income	6	**72.1**	62.9
Total instalment and other operating income		**192.0**	179.3

Instalment and other operating income increased by £12.7 million, with increased instalment income of £3.5 million due to higher Motor gross written premium partly offset by a reduction in Home due to the exit from Nationwide and Sainsbury's partnerships. Other operating income increased by £9.2 million, primarily relating to a one-off gain on disposal of the Bristol property of £9.6 million.

Investment return

	Note	FY 2018 £m	FY 2017 £m
Investment income		**159.2**	167.1
Hedging to a sterling floating rate basis		**(30.8)**	(27.0)
Net investment income		**128.4**	140.1
Net realised and unrealised gains excluding hedging		**26.2**	35.3
Total investment return	5	**154.6**	175.4

Investment yields

	FY 2018	FY 2017
Investment income yield[1]	**2.5%**	2.5%
Net investment income yield[1]	**2.0%**	2.1%
Investment return yield[1]	**2.4%**	2.6%

Note:

1. See glossary on pages 45 and 46 for definitions and appendix A – Alternative performance measures on pages 47 to 48 for reconciliation to financial statement line items.

Total investment return decreased by £20.8 million to £154.6 million (2017: £175.4 million). This was due to a reduction in investment income, primarily as a result of lower assets under management, and a reduction in realised and unrealised gains excluding hedging which was predominantly driven by a reduction in investment property valuations (2018: £12.7 million, 2017: £21.6 million) and debt security disposals.

The investment income yield for 2018 remained stable at 2.5% (2017: 2.5%). The net investment income yield was lower at 2.0% (2017: 2.1%) as a result of increased hedging costs.

The Group's investment strategy aims to deliver several objectives, which are summarised below:

- to ensure there is sufficient liquidity available within the investment portfolio to meet stressed liquidity scenarios;
- to match periodic payment orders ("**PPO**") and non-PPO liabilities in an optimal manner; and
- to deliver a suitable risk-adjusted investment return commensurate with the Group's risk appetite.

Investment holdings

At 31 December	2018 £m	2017 £m
Investment-grade credit[1]	3,606.6	3,893.1
High yield	393.9	388.6
Investment-grade private placements	101.0	103.6
Credit	4,101.5	4,385.3
Sovereign	156.9	224.8
Total debt securities	4,258.4	4,610.1
Infrastructure debt	289.6	316.4
Commercial real estate loans	201.6	169.0
Cash and cash equivalents[2]	1,092.4	1,304.5
Investment property	322.1	309.3
Total investment holdings	6,164.1	6,709.3

Notes:

1. Asset allocation at 31 December 2018 includes investment portfolio derivatives, which have been included and have a mark-to-market asset value of £11.8 million included in investment grade credit (31 December 2017 mark-to-market asset value of £55.1 million). This excludes non-investment derivatives that have been used to hedge interest on subordinated debt and operational cash flows.
2. Net of bank overdrafts: includes cash at bank and in hand and money market funds with no notice period for withdrawal.

At 31 December 2018, total investment holdings of £6,164.1 million were 8.1% lower than at the start of the year primarily reflecting the cash paid in 2018 for dividends and a decline in fair value of debt securities. Total debt securities were £4,258.4 million (31 December 2017: £4,610.1 million), of which 4.6% were rated as 'AAA' and a further 59.3% were rated as 'AA' or 'A'. The average duration at 31 December 2018 of total debt securities was 2.5 years (31 December 2017: 2.3 years).

At 31 December 2018, total unrealised losses, net of tax, on AFS investments were £36.8 million (31 December 2017: £80.2 million unrealised gains). In 2019, the Group expects a net investment income yield of 2.0% and gains significantly lower than in 2018.

Reconciliation of operating profit

	Note	FY 2018 £m	FY[1] 2017 £m
Motor	3	415.2	396.4
Home	3	83.1	128.8
Rescue and other personal lines	3	43.4	43.6
Commercial	3	60.0	74.0
Operating profit	3	601.7	642.8
Finance costs	3	(19.1)	(103.8)
Profit before tax	3	582.6	539.0
Tax		(108.9)	(105.0)
Profit after tax		473.7	434.0

Note:

1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits within the Motor segment.

Operating profit by segment

All divisions were profitable in 2018 with Motor increasing profits by £18.8 million compared to 2017. Home reported reduced operating profits primarily due to the major freeze event in Q1 2018. Commercial also experienced higher weather costs in 2018 although attritional claim performance improved. Rescue and other personal lines reported slightly lower profits. Rescue operating profit of £40.2 million (2017: £43.5 million) is included in the Rescue and other personal lines result.

Finance costs

Finance costs reduced to £19.1 million (2017: £103.8 million), with 2017 including costs and interest associated with the repurchase of £250 million nominal value of the subordinated debt in December 2017.

Effective corporation tax rate

The effective tax rate for 2018 was 18.7% (2017: 19.5%), which was lower than the standard UK corporation tax rate of 19.0% (2017: 19.25%) driven primarily by tax relief for the Tier 1 coupon payments offset by disallowable expenses.

Profit for the year and return on tangible equity[1]

Profit for the year was £473.7 million (2017: £434.0 million) as the decrease in operating profit was more than offset by the non-repeat of finance costs in relation to the debt repurchase in 2017.

Return on tangible equity decreased to 21.5% (2017: 23.0%) due primarily to a £31.5 million decrease in adjusted profit after tax to £457.1 million (2017: £488.6 million). Profit after tax in 2018 was adjusted for coupon payments in respect of Tier 1 notes, while profit after tax in 2017 was adjusted to add back finance costs for the one-off subordinated debt buy-back.

Note:

1. See glossary on pages 45 and 46 for definitions and appendix A – Alternative performance measures on pages 47 to 48 for reconciliation to financial statement line items.

Earnings per share

Basic earnings per share increased by 5.3% to 33.5 pence (2017: 31.8 pence). Diluted earnings per share increased by 5.1% to 33.1 pence (2017: 31.5 pence*) mainly reflecting an increase in profit after tax.

*(*The comparative has been changed to 31.5 pence from the version issued on 5 March 2019 (33.6 pence) to reflect the re-presentation of restructuring costs and Run-off segment profits in the Motor segment. This is consistent with the comparative for diluted earnings per share in the Financial summary on page 4 and in note 12 to the consolidated notes to the financial statements, which are presented correctly.)*

Net asset value

At 31 December	Note	2018 £m	2017 £m
Net assets[1]	13	2,573.1	2,715.1
Goodwill and other intangible assets	13	(566.8)	(471.1)
Tangible net assets	13	2,006.3	2,244.0
Closing number of Ordinary Shares (millions)	13	1,364.6	1,365.1
Net asset value per share (pence)	13	188.6	198.9
Tangible net asset value per share (pence)	13	147.0	164.4

Note:

1. See glossary on pages 45 and 46 for definitions and appendix A – Alternative performance measures on pages 47 to 48 for reconciliation to financial statement line items.

The net assets at 31 December 2018 decreased to £2,573.1 million (31 December 2017: £2,715.1 million) and tangible net assets decreased to £2,006.3 million (31 December 2017: £2,244.0 million). These decreases mainly reflected the payment of the 2017 final and special dividends, a reduction in the available-for-sale reserves due to rising market yields and an increase in expenditure on intangible assets as the Group continued to invest in the business, partially offset by the 2018 retained profit.

Balance sheet management

Capital management and 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 solvency capital 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.

The Board has recommended a final dividend of 14.0 pence per share (2017: 13.6 pence), an increase of 0.4 pence per share (2.9%), in line with business growth. This reflects the Board's continued confidence in the Group's earnings and the progress the business continued to make.

The Board has also declared a special dividend of 8.3 pence per share. After both dividends the solvency capital ratio will be 170% as at 31 December 2018.

The Board has taken into account the high level of political and economic uncertainty, including in relation to Brexit, and considers it appropriate for the time being to maintain a prudent solvency capital ratio towards the upper end of the solvency capital ratio risk appetite range of 140% to 180%. The Board will keep this position under review as it monitors developments in the political and economic environment. In normal circumstances, the Board expects the Group to operate around the middle of its solvency capital ratio risk appetite range.

The final dividend and special dividend will be paid on 16 May 2019 to shareholders on the register on 5 April 2019. The ex-dividend date will be 4 April 2019.

Capital analysis

The Group is regulated under solvency II requirements by the PRA on both a Group basis and for the Group's principal underwriter, U K Insurance Limited. In its results, the Group has estimated its solvency II own funds, SCR and solvency capital ratio as at 31 December 2018.

Capital position

At 31 December 2018, the Group held a solvency II capital surplus of approximately £0.89 billion above its regulatory capital requirements which was equivalent to an estimated solvency capital ratio of 170%, post the proposed final and special dividends.

The Group's SCR and solvency capital ratio are as follows:

At 31 December	2018	2017[1]
Solvency capital requirement (£ billion)	1.26	1.39
Capital surplus above solvency capital requirement (£ billion)	0.89	0.91
Solvency capital ratio post-dividend	170%	165%

Movement in capital surplus

	2018 £bn	2017[1] £bn
Capital surplus at 1 January	0.91	0.91
Capital generation excluding market movements	0.47	0.54
Market movements	(0.06)	–
Capital generation	0.41	0.54
Change in solvency capital requirement	0.13	0.01
Surplus generation	0.54	0.55
Capital expenditure	(0.15)	(0.10)
Management capital action	–	0.03
Capital distribution – ordinary dividends[2]	(0.30)	(0.28)
Capital distribution – special dividends[2]	(0.11)	(0.20)
Net surplus movement	(0.02)	–
Capital surplus at 31 December	0.89	0.91

Notes:

1. The 2017 comparative period has been updated to reflect the amounts in the Solvency and Financial Condition Report for the year ended 31 December 2017, published on 2 May 2018.
2. Foreseeable dividends included above are adjusted to exclude the expected dividend waivers in relation to shares held by the employee share trusts, which are held to meet obligations arising on the various share option awards.

During 2018, the Group's own funds decreased from £2.30 billion to £2.15 billion. The Group generated £0.41 billion of solvency II capital offset by £0.15 billion of capital expenditure and capital distribution of £0.41 billion for the 2018 dividend. The increased capital expenditure reflects the significant investment the Group is making in building future capability including the development of the latest generation core personal lines IT systems. In 2019, the level of expenditure is expected to be approximately £175 million, reducing to less than £150 million in 2020. Thereafter, expenditure levels are expected to reduce further.

Change in solvency capital requirement

	2018 £bn
Solvency capital requirement at 1 January	1.39
Model and parameter changes	(0.07)
Exposure changes	(0.06)
Solvency capital requirement at 31 December	1.26

The Group's SCR has reduced by £0.13 billion in the year. Model and parameter changes reduced the SCR by £0.07 billion. Exposure changes, as a result of the exited Home partnerships, a reduction in solvency II technical provisions including an assumed change in the Ogden discount rate to 0%, and lower assets under management, led to a reduction in the SCR of £0.06 billion.

Scenario and sensitivity analysis

The following table shows the impact on the Group's estimated solvency capital ratio in the event of the following scenarios as at 31 December 2018. The impact on the Group's solvency capital ratio arises from movements in both the Group's solvency capital requirement and own funds.

Scenario	Impact on solvency capital ratio 31 Dec 2018	31 Dec 2017
Motor small bodily injury deterioration equivalent to accident years 2008 and 2009	(7pts)	(7pts)
One-off catastrophe loss equivalent to the 1990 storm	(8pts)	(9pts)
One-off catastrophe loss based on extensive flooding of the River Thames	(8pts)	(9pts)
Change in reserving basis for PPOs to use a real discount rate of minus 1%[1]	(10pts)	(13pts)
100bps increase in credit spreads[2]	(11pts)	(11pts)
100bps decrease in interest rates with no change in the PPO real discount rate	(1pt)	(3pts)

Notes:

1. The PPO real discount rate used is an actuarial judgement which is reviewed annually based on the economic outlook for wage inflation relative to the EIOPA discount rate curve.
2. These sensitivities only include the assessed impact of the above scenarios in relation to AFS investments.

Own funds

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

At 31 December	2018 £bn	2017[1] £bn
Tier 1 capital before foreseeable dividends	1.76	2.04
Foreseeable dividends	(0.31)	(0.39)
Tier 1 capital – unrestricted	1.45	1.65
Tier 1 capital – restricted	0.35	0.35
Tier 1 capital	1.80	2.00
Tier 2 capital – subordinated debt	0.26	0.26
Tier 3 capital – deferred tax	0.09	0.04
Total own funds	2.15	2.30

Tier 1 capital after foreseeable dividends represents 84% of own funds and 143% of the estimated SCR. Tier 2 capital relates solely to the Group's £0.26 billion subordinated debt. The amount of Tier 2 and Tier 3 capital permitted under the solvency II regulations is 50% of the Group's SCR and of Tier 3 alone it is less than 15%. Therefore, the Group currently has no ineligible capital. The requirement that Tier 1 restricted capital should not exceed 20% of total Tier 1 capital, when satisfying the requirement that eligible Tier 1 items should be at least 50% of SCR, is not applicable to the Group.

The special dividend will be payable from surplus capital generated from continuing operations of the Group.

Reconciliation of IFRS shareholders' equity to solvency II own funds

At 31 December	2018 £bn	2017[1] £bn
Total shareholders' equity	2.57	2.72
Goodwill and intangible assets	(0.57)	(0.47)
Change in valuation of technical provisions	(0.15)	(0.13)
Other asset and liability adjustments	(0.09)	(0.08)
Foreseeable dividends	(0.31)	(0.39)
Tier 1 capital – unrestricted	1.45	1.65
Tier 1 capital – restricted	0.35	0.35
Tier 1 capital	1.80	2.00
Tier 2 capital – subordinated debt	0.26	0.26
Tier 3 capital – deferred tax	0.09	0.04
Total own funds	2.15	2.30

Note

1. The 2017 comparative period has been updated to reflect the amounts in the Solvency and Financial Condition Report for the year ended 31 December 2017, published on 2 May 2018.

Leverage

The Group's financial leverage increased by 0.7 percentage points, but remained conservative at 19.1% (2017: 18.4%). The increase was primarily due to the reduction in shareholders' equity. While the Tier 1 notes issued during 2017 are presented as equity in the balance sheet, the Group considers this to be part of its total leverage.

At 31 December	2018 £m	2017 £m
Shareholders' equity	2,573.1	2,715.1
Tier 1 notes	346.5	346.5
Financial debt – subordinated debt	259.5	264.7
Total capital employed	3,179.1	3,326.3
Financial-leverage ratio[1]	19.1%	18.4%

Note:

1. Total IFRS financial debt and Tier 1 notes as a percentage of total IFRS capital employed.

Credit ratings

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

Reserving

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling costs. The Group considers the class of business, the length of time to notify a claim, the validity of the claim against a policy, and the claim value. Claims reserves could settle across a range of outcomes, and settlement certainty increases over time. However, for bodily injury claims the uncertainty is greater due to the length of time taken to settle these claims. The possibility of annuity payments for injured parties also increases this uncertainty.

The Group seeks to adopt a conservative approach to assessing liabilities, as evidenced by the favourable development of historical claims reserves. Reserves are based on management's best estimate, which includes a prudence margin that exceeds the internal actuarial best estimate. This margin is set by reference to various actuarial scenario assessments and reserve distribution percentiles. It also considers other short and long-term risks not reflected in the actuarial inputs, as well as management's view on the uncertainties in relation to the actuarial best estimate.

The most common method of settling bodily injury claims is by a lump sum paid to the claimant and, in the cases where this includes an element of indemnity for recurring costs such as loss of earnings or ongoing medical care, settlement calculations have reference to a standardised annuity factor at a discount rate normally referred to as the Ogden discount rate. The Ogden discount rate was 2.5% from 2001 until 2017, when it was changed to minus 0.75% based on a 3-year average of yields on index-linked Government securities, in line with case law that claimants were entitled to invest their lump sum in a way which was very low or even zero risk. The Civil Liability Act 2018 changes this approach and instead requires the Government to reset the Ogden discount rate by reference to low risk rather than very low or zero risk investments. The process is due to conclude in 2019, but there is considerable uncertainty about its outcome and the date from which a new rate will apply.

The Group will continue to exercise judgement around the Ogden discount rate used in its reserves. Risks and uncertainties here are significant but the move to introduce additional asset classes into the assumed claimant portfolio points towards a higher rate than minus 0.75%. The Group has therefore made a judgement that it is likely that the Ogden discount rate will change and has selected an estimate of 0% to value its lump sum bodily injury reserves. An allowance for further movements in the Ogden rate is made within the Group's solvency II balance sheet and capital requirements. Details of the IFRS sensitivity analysis to the assumed Ogden discount rate are shown overleaf.

The Group's prior-year reserve releases were £404.4 million (2017: £435.4 million) with good experience in large bodily injury claims being a key contributor.

Looking forward, the Group expects to continue setting its initial management best estimate conservatively. Assuming current claims trends continue, the contribution from prior-year reserve releases will reduce over time, although it is expected to remain significant.

Claims reserves net of reinsurance

At 31 December	2018 £m	2017[1] £m
Motor	1,946.4	2,187.3
Home	323.8	293.3
Rescue and other personal lines	89.1	85.6
Commercial	541.4	578.3
Total	2,900.7	3,144.5

Note:

1. Results for the year ended 31 December 2018 are based on total Group operations including the Run-off segment. Comparative data has been re-presented accordingly to include Run-off segment profits within the Motor segment.

Sensitivity analysis – the discount rate used in relation to PPOs and changes in the assumed Ogden discount rate

The table below provides a sensitivity analysis of the potential net impact of a change in a single factor (the discount rate used for PPOs and separately the Ogden discount rate) with all other assumptions left unchanged. Other potential risks beyond the ones described could have an additional financial impact on the Group.

	Increase / (decrease) in profit before tax[1,2]	
At 31 December	2018 £m	2017 £m
PPOs[3]		
Impact of an increase in the discount rate used in the calculation of present values of 100 basis points	50.7	54.6
Impact of a decrease in the discount rate used in the calculation of present values of 100 basis points	(70.1)	(75.1)
Ogden discount rate[4]		
Impact of the Group reserving at a discount rate of 1% compared to 0% (2017: 0% compared to minus 0.75%)	56.2	68.4
Impact of the Group reserving at a discount rate of minus 1% compared to 0% (2017: minus 1.5% compared to minus 0.75%)	(76.3)	(102.9)

Notes:

1. These sensitivities are net of reinsurance and exclude the impact of taxation.
2. These sensitivities reflect one-off impacts at 31 December and should not be interpreted as predictions.
3. The sensitivities relating to an increase or decrease in the real discount rate used for PPOs illustrate a movement in the time value of money from the assumed level of 0% for reserving. The PPO sensitivity has been calculated as the direct impact of the change in the real discount rate with all other factors remaining unchanged.
4. Ogden discount rate sensitivity has been calculated as the direct impact of a permanent change in the discount rate with all other factors remaining unchanged. The Group will consider the statutory discount rate when setting its reserves but not necessarily provide on this basis, as is the case at the year ended 31 December 2018. This is intended to ensure that reserves are appropriate for current and potential future developments.

The sensitivity above is calculated on the basis of a permanent change in the rate used for the actuarial best estimate reserves as at 31 December 2018. It does not take into account a change in the Ogden discount rate setting regime, nor any second order impacts such as those on the Group's PPO assumptions or reinsurance bad debt assumptions.

The reduction in sensitivity to a change in the Ogden discount rate since 31 December 2017 primarily reflects the overall reduction in bodily injury exposures. The reduction in exposure is due to continued positive prior-year development of claims reserves for large bodily injury claims, and a higher proportion of reserves benefiting from a lower reinsurance retention.

Tax Management

The Board recognises that the Group has an important responsibility to manage its tax position effectively. The Board has delegated day-to-day management of taxes to the Chief Financial Officer and oversight is provided by the Audit Committee.

These arrangements are intended to ensure that the Group: complies with applicable laws and regulations, meets its obligations as a contributor and a collector of taxes on behalf of the tax authorities, and manages its tax affairs efficiently, claiming reliefs and other incentives where appropriate.

Tax authorities

The Group has open and cooperative relationships with the tax authorities with whom it deals in the countries where the Group operates, namely the UK, the Republic of Ireland, South Africa and India.

Tax policy and governance

The Group's tax policy has been reviewed and approved by the Audit Committee. The Group Tax team supports the Chief Financial Officer in ensuring the policy is adhered to at an operational level.

For more information please see our published Group Tax policy on the Group's website at https://www.directlinegroup.co.uk/en/who-we-are/governance/other-policies.html

Total tax contribution

The Group's direct and indirect tax contribution to the UK Exchequer is significantly higher than the UK corporation tax that the Group pays on its profits. The Group collects taxes relating to employees and customers on behalf of the UK Exchequer and other national governments. It also incurs a significant amount of irrecoverable value added tax relating to overheads and claims.

During 2018 the sum of taxes either paid or collected across the Group was £961.7 million. The composition of this between the various taxes borne and collected by the Group is shown below.

Total taxes borne

At 31 December	2018 £m
Current-year corporation tax charge	114.4
Irrecoverable value added tax incurred on overheads	90.2
Irrecoverable value added tax embedded within claims spend	197.2
Employer's national insurance contributions	39.2
Other taxes	8.7
Total	449.7

Total taxes collected

At 31 December	2018 £m
Insurance premium tax	400.6
Value added tax	12.2
Employee's pay as you earn and national insurance contributions	99.2
Total	512.0

Principal risks and uncertainties

We carefully assess the principal risks facing us. Principal risks are defined as having a residual risk impact of £40 million or more on a 1-in-200 years basis, taking into account customer, financial and reputational impacts.

Principal risks	Management and mitigation examples
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. Key drivers of the outlook for Insurance risk across our business plan include reserve, underwriting, distribution, pricing and reinsurance risks.	– We estimate technical reserves using various actuarial and statistical techniques. Management's best estimate of total reserves is set at not less than the actuarial best estimate – Third party experts review the majority of our reserves – Underwriting guidelines are set for all transacted business, and pricing is refined by analysing comprehensive data – Catastrophe and motor excess of loss reinsurance limits our exposure to events and large losses – We invest in enhanced external data to analyse and mitigate exposures – We set our reserves using the latest internal and external data and trends
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. Key drivers of market risk are the sensitivity of the values of our assets and investments to changes in credit spreads, and our exposure losses as a result of changes in interest rate term structure or volatility.	– We have an investment strategy approved by the Board – We diversify asset classes including by country of risk, and by investing in US dollar assets to broaden the pool of available assets – We set limits on exposure to individual asset classes and the amount of illiquid investments – We carry out an annual matching exercise on our assets and liabilities, which reduces the net impact of interest rate risk as shown in interest rate sensitivities – To limit exposure to credit spread risk, we tightly control individual asset exposures as shown in spread risk sensitivities – We use risk-reduction techniques, such as hedging foreign currency exposures with forward contracts and hedging exposure to US interest rates with swap contracts
Credit risk The risk of loss resulting from default in cash inflows and / or changes in market value of issuers of securities, counterparties and any debtors to which the Group is exposed. This includes the risks associated with inadequately diversified portfolios of assets and / or obligations.	– Credit limits are set for each counterparty and we actively monitor credit exposures – We only purchase reinsurance from reinsurers with at least an A– rating. For liabilities with a relatively long period of time to settlement, this rating will be at least A+ – We have well-defined criteria to determine which customers are offered and granted credit
Operational risk The risk of loss due to inadequate or failed internal processes or systems, human error or from external events. The Principal risks within this category are information security, partnership contractual obligations, change, outsourcing and technology & infrastructure risks.	– We have appropriate operational processes and systems, including detection systems for fraudulent claims and appropriate processes which seek to enable operational resilience – We are continuing to work to improve performance and stability of our IT systems while focusing on developing future systems capability. With significant change underway, we are continuing to monitor risks associated with our IT systems' stability, and resilience, cyber security, and the internal control environment – Our risk management framework is designed to enable us to capture risk information in a robust and consistent way – We monitor how risks are managed in the performance of outsourced and off-shored activities

Regulatory and conduct risk The risks arising out of changes to laws, regulatory rules, policy or interpretation, or to supervisory expectations or approach, that have an adverse operational and financial impact as a result of reputational damage, regulatory or legal censure, fines or prosecutions, and any other type of non-budgeted operational risk losses, associated with the Group's conduct and activities.	– We maintain a constructive and open relationship with our regulators – We use specific risk management tools and resources to help manage our exposure to regulatory risk – We have a strong culture of delivering on our commitments to our customers – Our conduct risk management framework is designed to deliver fair outcomes to customers and minimise our risk exposure – We carry out planned risk-based monitoring of customer processes as well as more targeted thematic reviews which consider strategic or regulatory projects
Strategic risk The risk of direct or indirect impact on the earnings, capital, or value of the business as a result of the strategies not being optimally chosen, implemented or adapted to changing conditions.	– We agree, monitor and manage performance against the Board-approved plan and targets – The Boards lead an annual strategy and planning process which considers our performance, competitor positioning and strategic opportunities – We identify and manage emerging risks using established governance processes and forums

Potential effects of Brexit

The UK is scheduled to exit from the EU, ('Brexit'), on 29 March 2019. At the date of this report there is considerable uncertainty as to how and even whether there will be a Brexit, or at least as to when it will take effect and on what terms. Accordingly there is corresponding uncertainty as to the effect of Brexit on the Group.

If Brexit takes place smoothly, for example involving a transition period during which work would take place at the government level to agree a future trading agreement between the UK and the EU, and accordingly without significant disruption to the UK economy and to business generally, then any adverse impact on the Group (if any) would also not be expected to be significant, at least until the end of the transition period and the future trading arrangements between the UK and the EU being clarified. If, however, the UK were to leave the EU in such a way as to involve or lead to significant disruption, as has been conjectured in the event of a 'hard' no deal Brexit at the end of March, then the impact on the Group could correspondingly also be disruptive and potentially material.

Following the EU referendum result in 2016, which saw the UK vote to leave the EU, the Group established a Brexit Working Group comprising representatives from across the Group. It was identified that there was a risk that the UK could enter a prolonged period of reduced growth due to Brexit, potentially reducing insurance sales and the value of our investment portfolio. Whilst our operations are based mainly in the UK, Brexit-related issues which could impact adversely on the Group could include: changes to the value of sterling which impact claims and non-claims supplier costs; inflation; impacts on credit spreads which in turn could impact on the Group's investments and capital; recruitment and retention of people; impacts on the speed of delivery and cost of goods and services required by the business including for fulfilling insurance claims made by customers, for example because of delays at borders caused by increased border regulations and by additional costs caused by increased tariffs and devaluation of sterling; availability of reinsurers authorised to write business in the UK; data transfers; the removal of the European Health Insurance Card ("**EHIC**") leading to greater reliance on travel insurance; travel disruption; increased use of Green Cards (internationally recognised certificates that act as proof of insurance, including in the EU); potential changes to direct and indirect tax; and the regulatory impact on our capital position.

The Group has proactively considered a variety of possible implications of a disruptive 'hard' Brexit, including of a financial and operational nature; for example:

The impact on the Group's investment portfolio and in particular credit spreads related to its debt securities and therefore Group solvency: A sensitivity analysis relating to credit spreads is provided in the Group Annual Report & Accounts. The Group has also considered Brexit in its Investment Committee, and further information is provided on the work of the Investment Committee in the Group Annual Report & Accounts. A disruptive Brexit could impact adversely on the Group's investments and therefore capital and the solvency capital coverage ratio and the appropriateness of paying dividends.

Procurement and supply chain: In particular as part of the Group's ability to deal with claims made under insurance policies, the Group needs to acquire a wide range of goods and services. A significant amount and spread of goods, for example such as car parts, are sourced from within the EU. The Group has been in discussion with principal suppliers who have taken some steps to increase stocks within the UK in the event of a 'hard' Brexit leading to disruption at borders. However, the Group's ability to deal with claims in its normal ordinary course of business manner could be adversely impacted and there could be delays and extra costs.

The Group has a small amount of business in the Republic of Ireland, servicing a small Irish part of a UK partner's wider business. The Group is well advanced in establishing a formal third country branch in the Republic of Ireland in order to be able to continue with this business post a 'hard' Brexit, and expects the branch to be authorised for business by the Central Bank of Ireland by the current deadline of 29 March 2019, should that become necessary.

The Group has also been focusing on Brexit from a potential crisis management perspective, with the objective of maintaining operational resilience in the event of a disruptive Brexit and with a view to being able to react better to events as they unfold.

Emerging risks

The Group’s definition of emerging risks is new or developing risks which are often difficult to quantify; they are also usually highly uncertain and external to the Group. Emerging risks are identified by management and the latest information is maintained within an Emerging Risk Register. Each emerging risk is owned by a business subject matter expert and members of the second line of defence provide challenge and oversight of activity taking place. The Group reports emerging risks to the Board Risk Committee for review and challenge. The Group’s emerging risks processes aim to:

- identify emerging risks on a timely basis;
- manage emerging risks proactively;
- mitigate the impact of emerging risks which could affect the delivery of the strategic plan; and
- reduce the uncertainty and volatility of our business’s results.

The Group considers our main emerging risks to be:

Climate change

Climate change poses a range of financial risks to the Group. These can be divided into three categories:

- Physical risks include many weather-related risks arising directly from climate change. These include changes in the frequency and severity of events, floods, storms, freeze, subsidence or wildfire. The Group's use of catastrophe reinsurance mitigates against many of the worst potential impacts and the Group regularly reassesses its use of external catastrophe models to ensure they fully capture climate-related risk.
- Transitional risks arise from efforts to mitigate or adapt to climate change. These include the strategic and operational risks from the transition towards electric-powered vehicles. Whilst insuring electric vehicles doesn’t fundamentally change the business model, the business seeks to develop the new processes, skills and technical knowledge required to keep pace with these changes in technology.
- Liability risks arise when parties, who have suffered losses from climate change, seek to recover from those they believe may have been responsible. There is some potential exposure to liability risk through commercial liability insurance. However, Pollution and Professional Indemnity covers, which carry the highest risk, are almost fully reinsured.

There are also potential physical, transition and liability risks arising through the investment portfolio. During 2018 a significant new initiative was approved to strengthen further the Group's investment strategy with regard to environmental, social and governance issues. More information can be found in the Investment Committee’s report in the Group’s Annual Report & Accounts.

Technological developments change consumer needs for insurance

New car technologies, such as crash-prevention aids, car sharing and driverless cars, could significantly affect the size and nature of the insurance market and the role of insurers. The Group continues to build strong collaborative relationships with key manufacturers, and has established an ‘In-Car Technology’ programme to help manage the response to developing car technology.

Furthermore, the Group’s strategic pillars of being a great retailer, smart and efficient manufacturer and leading disrupter, as well as our aim of multi-channel success, help position us to take advantage of changes in technology and customer behaviours, through the development of new capabilities, new partnership capabilities, and by enabling us to have the flexibility to adapt/react to these changes.

Fairness and pricing practices

The FCA is conducting a market study into Fair Pricing in Financial Services and the Competition and Markets Authority has announced plans to take forward a ‘package of reforms’ to address the ‘loyalty penalty’ for long-standing home insurance customers, but has concluded that it will not be conducting its own market study at this time.

The Group remains up-to-date with developments from the FCA and the Competition and Markets Authority work on pricing practices and will keep the review in focus throughout 2019 as well as seeking to ensure that the Group continues to maintain fair pricing principles.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Gross earned premium	4	3,306.7	3,339.7
Reinsurance premium	4	(217.2)	(204.7)
Net earned premium	4	3,089.5	3,135.0
Investment return	5	154.6	175.4
Instalment income		119.9	116.4
Other operating income	6	72.1	62.9
Total income		3,436.1	3,489.7
Insurance claims	7	(1,966.9)	(1,571.1)
Insurance claims recoverable from / (payable to) reinsurers	7	55.1	(183.1)
Net insurance claims	7	(1,911.8)	(1,754.2)
Commission expenses	8	(200.4)	(286.4)
Operating expenses	9	(722.2)	(806.3)
Total expenses		(922.6)	(1,092.7)
Operating profit		601.7	642.8
Finance costs	10	(19.1)	(103.8)
Profit before tax		582.6	539.0
Tax charge		(108.9)	(105.0)
Profit for the year attributable to owners of the Company		473.7	434.0
Earnings per share:			
Basic (pence)	12	33.5	31.8
Diluted (pence)	12	33.1	31.5

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2018

	2018 £m	2017 £m
Profit for the year	473.7	434.0
Other comprehensive income		
Items that will not be reclassified subsequently to the income statement:		
Actuarial gain on defined benefit pension scheme	2.7	2.1
Tax relating to item that will not be reclassified	(0.4)	(0.4)
	2.3	1.7
Items that may be reclassified subsequently to the income statement:		
Cash flow hedges	0.5	(1.1)
Fair value (loss) / gain on AFS investments	(121.4)	8.8
Less: realised net gains on AFS investments included in income statement	(19.5)	(23.2)
Tax relating to items that may be reclassified	23.9	2.5
	(116.5)	(13.0)
Other comprehensive loss for the year net of tax	(114.2)	(11.3)
Total comprehensive income for the year attributable to owners of the Company	359.5	422.7

CONSOLIDATED BALANCE SHEET

As at 31 December 2018

	Notes	2018 £m	2017 £m
Assets			
Goodwill and other intangible assets		566.8	471.1
Property, plant and equipment		156.2	174.4
Investment property		322.1	309.3
Reinsurance assets	14	1,208.7	1,178.5
Current tax assets		–	0.1
Deferred acquisition costs		171.0	185.4
Insurance and other receivables		875.9	981.2
Prepayments, accrued income and other assets		128.0	146.2
Derivative financial instruments		48.2	84.4
Retirement benefit asset		17.0	14.4
Financial investments	15	4,737.8	5,040.4
Cash and cash equivalents	16	1,154.4	1,358.6
Assets held for sale		–	4.2
Total assets		9,386.1	9,948.2
Equity			
Shareholders' equity		2,573.1	2,715.1
Tier 1 notes	18	346.5	346.5
Total equity		2,919.6	3,061.6
Liabilities			
Subordinated liabilities	19	259.5	264.7
Insurance liabilities	20	4,005.9	4,225.7
Unearned premium reserve	21	1,505.5	1,600.3
Borrowings	16	62.0	54.1
Derivative financial instruments		25.9	12.0
Trade and other payables, including insurance payables		554.1	658.0
Deferred tax liabilities		7.6	31.1
Current tax liabilities		46.0	40.7
Total liabilities		6,466.5	6,886.6
Total equity and liabilities		9,386.1	9,948.2

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2018

	Share capital (note 17) £m	Employee trust shares £m	Capital reserves £m	AFS revaluation reserve £m	Foreign exchange translation reserve £m	Retained earnings £m	Shareholders' equity £m	Tier 1 notes (note 18) £m	Total equity £m
Balance at 1 January 2017	150.0	(34.3)	1,450.0	92.1	1.4	862.3	2,521.5	–	2,521.5
Profit for the year	–	–	–	–	–	434.0	434.0	–	434.0
Other comprehensive loss	–	–	–	(11.9)	(1.1)	1.7	(11.3)	–	(11.3)
Dividends paid (note 11)	–	–	–	–	–	(225.3)	(225.3)	–	(225.3)
Shares acquired by employee trusts	–	(19.6)	–	–	–	–	(19.6)	–	(19.6)
Credit to equity for equity-settled share-based payments	–	–	–	–	–	14.8	14.8	–	14.8
Shares distributed by employee trusts	–	19.8	–	–	–	(19.8)	–	–	–
Tax on share-based payments	–	–	–	–	–	1.0	1.0	–	1.0
Issue of Tier 1 notes	–	–	–	–	–	–	–	346.5	346.5
Balance at 31 December 2017	150.0	(34.1)	1,450.0	80.2	0.3	1,068.7	2,715.1	346.5	3,061.6
Profit for the year	–	–	–	–	–	473.7	473.7	–	473.7
Other comprehensive loss	–	–	–	(117.0)	0.5	2.3	(114.2)	–	(114.2)
Dividends and appropriations paid (note 11)	–	–	–	–	–	(503.8)	(503.8)	–	(503.8)
Shares acquired by employee trusts	–	(19.5)	–	–	–	–	(19.5)	–	(19.5)
Credit to equity for equity-settled share-based payments	–	–	–	–	–	21.0	21.0	–	21.0
Shares distributed by employee trusts	–	18.4	–	–	–	(18.4)	–	–	–
Tax on share-based payments	–	–	–	–	–	0.8	0.8	–	0.8
Balance at 31 December 2018	150.0	(35.2)	1,450.0	(36.8)	0.8	1,044.3	2,573.1	346.5	2,919.6

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2018

	Notes	2018 £m	2017 £m
Net cash generated from operating activities before investment of insurance assets		4.2	204.0
Cash generated from investment of insurance assets		468.1	341.9
Net cash generated from operating activities		472.3	545.9
Cash flows used in investing activities			
Purchases of property, plant and equipment		(13.3)	(22.4)
Purchases of goodwill and other intangible assets		(142.4)	(73.2)
Proceeds on disposals of assets held for sale		13.8	–
Proceeds on disposal of property, plant and equipment		0.1	0.3
Net cash used in investing activities		(141.8)	(95.3)
Cash flows used in financing activities			
Net proceeds from issue of Tier 1 notes	18	–	346.5
Repayment of subordinated liabilities		–	(326.8)
Dividends and appropriations paid	11	(503.8)	(225.3)
Finance costs		(19.3)	(31.7)
Purchase of employee trust shares		(19.5)	(19.6)
Net cash used in financing activities		(542.6)	(256.9)
Net (decrease) / increase in cash and cash equivalents		(212.1)	193.7
Cash and cash equivalents at the beginning of the year	16	1,304.5	1,110.8
Cash and cash equivalents at the end of the year	16	1,092.4	1,304.5

1. Accounting policies

Basis of preparation

The financial information included in this preliminary announcement has been prepared in accordance with the recognition and measurement criteria of International Financial Reporting Standards ("**IFRS**"). However, this announcement does not itself contain sufficient information to comply with IFRS. The financial information set out in this preliminary results announcement does not constitute the statutory accounts for the year ended 31 December 2018. The financial information is derived from the statutory accounts, which comply with IFRS, within the Group's Annual Report & Accounts 2018. These accounts were signed on 4 March 2019 and are expected to be published in March 2019 and delivered to the Registrar of Companies following the Annual General Meeting to be held on 9 May 2019. The independent Auditor's report on the Group accounts for the year ended 31 December 2018 was signed on 4 March 2019, 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. This audit opinion excludes disclosures surrounding capital adequacy calculated under the solvency II regime as these are outside of the audit scope.

Going concern

The Directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 12 months from the date of this report. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

Adoption of new and revised standards

The Group has adopted the following new standards and amendments to IFRSs and the International Accounting Standards ("**IAS**") that became mandatorily effective for the Group for the first time during 2018, however these had no material impact on the consolidated financial statements or performance.

IFRS 15 'Revenue from Contracts with Customers' introduces new recognition and disclosure requirements. Entities are required to recognise revenue as goods and services are transferred to the customer in proportion to the total consideration it expects to receive in exchange for those services. The Group has adopted the standard on a fully retrospective basis. This has not had a material impact on the consolidated financial statements as insurance contracts are out of scope of IFRS 15.

Amendments to IFRS 4 Insurance contracts 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' was issued on 12 September 2016 and endorsed by the EU on 3 November 2017. These amendments permitted insurers who satisfied certain criteria to defer the effective date of IFRS 9 'Financial Instruments', to coincide with the expected effective date of IFRS 17 'Insurance Contracts', to 1 January 2022. The IASB permitted this option having considered potential asset and liability mismatching and temporary profit and loss volatility caused by introducing these new standards in different periods within a short period of time.

When first published, Amendments to IFRS 4 required insurance entities to evaluate whether their activities were predominantly connected to insurance as at its annual reporting date immediately preceding 1 April 2016, providing an option to defer adoption of IFRS 9 if liabilities connected to insurance comprised a predominant proportion of its total liabilities as at that date. The Group concluded that it satisfied the criteria that the carrying value of its liabilities connected to insurance was greater than 90% of the carrying value of its total liabilities at 31 December 2015. In making this conclusion, the Group determined that the subordinated debt of £521.1 million and derivative liabilities of £46.4 million represented liabilities connected with insurance but not liabilities arising from contracts within the scope of IFRS 4. There have been no significant changes in the Group's activities since this assessment to require a reassessment of the criteria.

Accounting developments

The IASB issued IFRS 16 'Leases' in January 2016 to replace IAS 17 'Leases' and will be effective for reporting periods beginning on or after 1 January 2019, applied fully retrospectively from this date. IFRS 16 sets out the principles for recognition, measurement and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. There are two exemptions: for leases of a low value and for leases of a short-term nature of 12 months or less. At the start of the lease a lessee will recognise a liability for the lease payments and an asset, representing the right to use the asset during the lease term. Lessees will be required to separately recognise the interest on the lease liability and the depreciation expense on the right-of-use asset. Lessor accounting under IFRS 16 is substantially unchanged from the current approach under IAS 17.

The Group expects to recognise right-of-use assets of approximately £150 million on 1 January 2019 and lease liabilities of approximately £165 million. The reduction to equity after tax is approximately £15 million. From 1 January 2019 lease charges previously recognised as rental expenses in profit or loss will instead comprise depreciation and finance costs. The profit or loss impact, had this standard been adopted on 1 January 2018, would have been a reduction in operating expenses of approximately £5 million and an increase in finance costs of approximately £7 million in the 2018 consolidated income statement.

The actual impacts may differ from the amounts presented above when the Group presents its first financial statements from the initial date of application.

2. Critical accounting estimates and judgements

Full details of critical accounting estimates and judgements used in applying the Group's accounting policies are outlined on pages 125 to 126 of the Annual Reports & Accounts 2017. There have been no significant changes to the principles or assumptions of these critical accounting estimates and judgements during the year ended 31 December 2018.

3. Segmental analysis

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2018.

	Motor £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
Gross written premium	1,671.2	606.9	422.8	511.0	**3,211.9**
Gross earned premium	1,684.3	698.0	416.6	507.8	**3,306.7**
Reinsurance premium	(142.5)	(30.2)	(1.9)	(42.6)	**(217.2)**
Net earned premium	1,541.8	667.8	414.7	465.2	**3,089.5**
Investment return	105.9	15.9	5.2	27.6	**154.6**
Instalment income	89.2	21.9	2.5	6.3	**119.9**
Other operating income	48.3	2.7	15.8	5.3	**72.1**
Total income	1,785.2	708.3	438.2	504.4	**3,436.1**
Insurance claims	(1,026.7)	(421.0)	(277.1)	(242.1)	**(1,966.9)**
Insurance claims recoverable from / (payable to) reinsurers	46.7	7.7	(0.1)	0.8	**55.1**
Net insurance claims	(980.0)	(413.3)	(277.2)	(241.3)	**(1,911.8)**
Commission expenses	(30.9)	(62.6)	(19.0)	(87.9)	**(200.4)**
Operating expenses	(359.1)	(149.3)	(98.6)	(115.2)	**(722.2)**
Total expenses	(390.0)	(211.9)	(117.6)	(203.1)	**(922.6)**
Operating profit	**415.2**	**83.1**	**43.4**	**60.0**	**601.7**
Finance costs					**(19.1)**
Profit before tax					**582.6**

Underwriting profit	**171.8**	**42.6**	**19.9**	**20.8**	**255.1**
Loss ratio	63.6%	61.8%	66.8%	51.8%	**61.8%**
Commission ratio	2.0%	9.4%	4.6%	18.9%	**6.5%**
Expense ratio	23.3%	22.4%	23.8%	24.8%	**23.4%**
COR	**88.9%**	**93.6%**	**95.2%**	**95.5%**	**91.7%**

Note:

1. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment.

3. Segmental analysis continued

The table below analyses the Group's revenue and results by reportable segment for the year ended 31 December 2017.

	Motor[1] £m	Home £m	Rescue and other personal lines £m	Commercial £m	Total Group £m
Gross written premium	1,670.4	799.1	421.1	501.5	3,392.1
Gross earned premium	1,603.0	819.4	419.2	498.1	3,339.7
Reinsurance premium	(132.4)	(28.9)	(1.6)	(41.8)	(204.7)
Net earned premium	1,470.6	790.5	417.6	456.3	3,135.0
Investment return	117.9	21.1	4.6	31.8	175.4
Instalment income	85.3	23.1	2.1	5.9	116.4
Other operating income	43.0	0.9	12.9	6.1	62.9
Total income	1,716.8	835.6	437.2	500.1	3,489.7
Insurance claims	(717.1)	(403.3)	(273.8)	(176.9)	(1,571.1)
Insurance claims (payable to) / recoverable from reinsurers	(135.8)	2.8	0.5	(50.6)	(183.1)
Net insurance claims	(852.9)	(400.5)	(273.3)	(227.5)	(1,754.2)
Commission expenses	(36.7)	(139.7)	(22.9)	(87.1)	(286.4)
Operating expenses	(430.8)	(166.6)	(97.4)	(111.5)	(806.3)
Total expenses	(467.5)	(306.3)	(120.3)	(198.6)	(1,092.7)
Operating profit	396.4	128.8	43.6	74.0	642.8
Finance costs					(103.8)
Profit before tax					539.0

Underwriting profit	150.2	83.7	24.0	30.2	288.1
Loss ratio	58.0%	50.6%	65.4%	49.9%	56.0%
Commission ratio	2.5%	17.7%	5.5%	19.1%	9.1%
Expense ratio	29.3%	21.1%	23.4%	24.4%	25.7%
COR	89.8%	89.4%	94.3%	93.4%	90.8%

	Motor[2]	Total Ongoing[2]
Loss ratio	60.9%	57.4%
Commission ratio	2.5%	9.1%
Expense ratio	28.5%	25.3%
COR	91.9%	91.8%

Notes:

1. The Motor segment for the year ended 31 December 2017 includes restructuring costs and the Run-off segment, which were total income of £0.7 million, net insurance claims of £43.1 million and operating expenses of £11.9 million.
2. Comparative ratios for the Motor segment and total Ongoing operations, prior to re-presentation of restructuring costs and the Run-off segment. Ongoing operations for 2017 comprised total Group operations less restructuring costs and the Run-off segment.

4. Net earned premium

	2018 £m	2017 £m
Gross earned premium:		
Gross written premium	3,211.9	3,392.1
Movement in unearned premium reserve	94.8	(52.4)
	3,306.7	3,339.7
Reinsurance premium:		
Premium payable	(223.5)	(208.4)
Movement in reinsurance unearned premium reserve	6.3	3.7
	(217.2)	(204.7)
Total	3,089.5	3,135.0

5. Investment return

	2018 £m	2017 £m
Investment income:		
Interest income from debt securities	124.0	137.5
Interest income from cash and cash equivalents	6.2	3.0
Interest income from infrastructure debt	6.9	6.8
Interest income from commercial real estate loans	6.2	3.6
Interest income	143.3	150.9
Rental income from investment property	15.9	16.2
	159.2	167.1
Net realised (losses) / gains:		
AFS debt securities	19.5	23.2
Derivatives	(32.2)	175.0
Investment property	–	1.6
	(12.7)	199.8
Net unrealised gains / (losses):		
Impairment of loans and receivables	(6.0)	(9.5)
Derivatives	1.4	(202.0)
Investment property	12.7	20.0
	8.1	(191.5)
Total	154.6	175.4

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

	Realised 2018 £m	Unrealised 2018 £m	Realised 2017 £m	Unrealised 2017 £m
Derivative (losses) / gains:				
Foreign exchange forward contracts[1]	(102.6)	(41.3)	107.8	62.5
Associated foreign exchange risk	72.6	41.3	68.4	(259.1)
Net (losses) / gains on foreign exchange forward contracts	(30.0)	–	176.2	(196.6)
Interest rate swaps[1]	22.1	(1.8)	1.8	(1.7)
Associated interest rate risk on hedged items	(24.3)	3.2	(3.0)	(3.7)
Net (losses) / gains on interest rate derivatives	(2.2)	1.4	(1.2)	(5.4)
Total	(32.2)	1.4	175.0	(202.0)

Note:
1. Foreign exchange forward contracts are measured at fair value through profit and loss and interest rate swaps are designated as hedging instruments.

6. Other operating income

	2018 £m	2017 £m
Vehicle replacement referral income	17.2	16.9
Revenue from vehicle recovery and repair services	11.7	11.3
Legal services income	11.2	11.0
Other income[1,2]	32.0	23.7
Total	72.1	62.9

Notes:

1. Other income includes salvage income and fee income from insurance intermediary services.
2. Other income includes a £9.6 million gain on the sale of a property in Bristol in January 2018.

7. Net insurance claims

	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	2018 £m	2018 £m	2018 £m	2017 £m	2017 £m	2017 £m
Current accident year claims paid	1,308.5	(0.2)	1,308.3	1,165.0	(0.2)	1,164.8
Prior accident year claims paid	878.2	(30.9)	847.3	847.0	(13.8)	833.2
(Decrease) / increase in insurance liabilities	(219.8)	(24.0)	(243.8)	(440.9)	197.1	(243.8)
Total	1,966.9	(55.1)	1,911.8	1,571.1	183.1	1,754.2

Claims handling expenses for the year ended 31 December 2018 of £192.9 million (2017[1]: £174.8 million) have been included in the claims figures above.

Note:

1. Results for the year ended 31 December 2018 are based on total Group operations including the Run-off segment. Comparative data has been re-presented accordingly.

8. Commission expenses

	2018 £m	2017 £m
Commission expenses	188.5	225.4
Expenses incurred under profit participations	11.9	61.0
Total	200.4	286.4

9. Operating expenses

	2018 £m	2017 £m
Staff costs[1]	269.9	280.1
Other operating expenses[1,2]	253.3	273.6
Marketing	121.2	113.7
Amortisation and impairment of other intangible assets[3]	46.7	111.0
Depreciation	31.1	27.9
Total	722.2	806.3

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. Amortisation and impairment of other intangible assets includes a £1.5 million impairment charge for year ended 31 December 2018 (2017: £56.9 million), which relates to capitalised software development costs for ongoing IT projects primarily relating to development of new systems.

The table below analyses the number of people employed by the Group's operations.

	At 31 December		Average for the year	
	2018	2017	2018	2017
Insurance operations	8,583	8,267	8,569	8,431
Repair centre operations	1,368	1,272	1,326	1,238
Support	1,278	1,269	1,266	1,280
Total	11,229	10,808	11,161	10,949

9. Operating expenses continued

The aggregate remuneration of those employed by the Group's operations comprised:

	2018 £m	2017 £m
Wages and salaries	374.9	363.6
Social security costs	41.2	40.4
Pension costs	28.7	25.5
Share-based payments	21.0	14.8
Total	465.8	444.3

10. Finance costs

	2018 £m	2017 £m
Interest expense on subordinated liabilities	23.1	44.8
Net interest received on designated hedging instrument[1]	(3.8)	(8.0)
Unrealised losses on designated hedging instrument[1]	5.0	10.4
Unrealised gains on associated interest rate risk on hedged item[1]	(5.6)	(11.7)
Realised gain on associated interest rate risk on hedged item[1]	–	(11.3)
Premium paid to repurchase subordinated liabilities and associated transaction costs	–	77.4
Amortisation of arrangement costs and discount on issue of subordinated liabilities	0.4	2.2
Total	19.1	103.8

Note:

1. As described in note 19, 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 floating rate of 3-month LIBOR plus a spread of 706 basis points, which increased to 707 basis points with effect from 29 July 2013. On 8 December 2017, the Group redeemed £250 million nominal value of the notes.

11. Dividends and appropriations

	2018 £m	2017 £m
Amounts recognised as distributions to equity holders in the period:		
2017 final dividend of 13.6 pence per share paid on 17 May 2018	186.1	–
2016 final dividend of 9.7 pence per share paid on 18 May 2017	–	132.4
2018 first interim dividend of 7.0 pence per share paid on 7 September 2018	95.8	–
2017 first interim dividend of 6.8 pence per share paid on 8 September 2017	–	92.9
2017 special dividend of 15.0 pence per share paid on 17 May 2018	205.3	–
	487.2	225.3
Coupon payments in respect of Tier 1 notes[1]	16.6	–
	503.8	225.3
Proposed dividends:		
2018 final dividend of 14.0 pence per share	192.5	–
2017 final dividend of 13.6 pence per share	–	187.0
2018 special dividend of 8.3 pence per share	114.1	–
2017 special dividend of 15.0 pence per share	–	206.3

Note:

1. Coupon payments on the Tier 1 notes issued in December 2017 are treated as an appropriation of retained profits and, accordingly, are accounted for when paid.

The proposed final and special dividends for 2018 have not been included as a liability in these financial statements.

The trustees of the employee share trusts waived their entitlement to dividends on shares held to meet obligations arising on the Long Term Incentive Plan, Deferred Annual Incentive Plan and Restrictive Share Plan awards, which reduced the total dividends paid for the year ended 31 December 2018 by £2.4 million (2017: £1.6 million).

12. Earnings per share

Earnings per share is calculated by dividing earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the year.

Basic

Basic earnings per share is calculated by dividing the earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the period, excluding Ordinary Shares held as employee trust shares.

	2018 £m	2017 £m
Earnings attributable to owners of the Company	473.7	434.0
Coupon payments in respect of Tier 1 notes	(16.6)	–
Profit for the calculation of earnings per share	457.1	434.0
Weighted average number of Ordinary Shares (millions)	1,366.5	1,366.1
Basic earnings per share (pence)	33.5	31.8

Diluted

Diluted earnings per share is calculated by dividing the earnings attributable to the owners of the Company less coupon payments in respect of Tier 1 notes by the weighted average number of Ordinary Shares during the period adjusted for the dilutive potential Ordinary Shares. The Company has share options and contingently issuable shares as categories of dilutive potential Ordinary Shares.

	2018 £m	2017 £m
Earnings attributable to owners of the Company	473.7	434.0
Coupon payments in respect of Tier 1 notes	(16.6)	–
Profit for the calculation of earnings per share	457.1	434.0
Weighted average number of Ordinary Shares (millions)	1,366.5	1,366.1
Effect of dilutive potential of share options and contingently issuable shares (millions)	15.8	12.9
Weighted average number of Ordinary Shares for the purpose of diluted earnings per share (millions)	1,382.3	1,379.0
Diluted earnings per share (pence)	33.1	31.5

13. Net assets per share and return on equity

Net asset value per share is calculated as total shareholders' equity (which excludes Tier 1 notes) 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.

	2018 £m	2017 £m
Net assets	2,573.1	2,715.1
Goodwill and other intangible assets[1]	(566.8)	(471.1)
Tangible net assets	2,006.3	2,244.0
Number of Ordinary Shares (millions)	1,375.0	1,375.0
Shares held by employee share trusts (millions)	(10.4)	(9.9)
Closing number of Ordinary Shares (millions)	1,364.6	1,365.1
Net asset value per share (pence)	188.6	198.9
Tangible net asset value per share (pence)	147.0	164.4

Note:

1. Goodwill has arisen on acquisition by the Group of subsidiary companies and on acquisition of new accident repair centres. Intangible assets are primarily comprised of software development costs.

13. Net assets per share and return on equity continued

Return on equity

The table below details the calculation of return on equity.

	2018 £m	2017 £m
Earnings attributable to owners of the Company	473.7	434.0
Coupon payments in respect of Tier 1 notes	(16.6)	–
Profit for the calculation of return on equity	457.1	434.0
Opening shareholders' equity	2,715.1	2,521.5
Closing shareholders' equity	2,573.1	2,715.1
Average shareholders' equity	2,644.1	2,618.3
Return on equity	17.3%	16.6%

14. Reinsurance assets

	Notes	2018 £m	2017 £m
Reinsurers' share of general insurance liabilities		1,159.9	1,141.1
Impairment provision[1]		(54.7)	(59.9)
Total excluding reinsurers unearned premium reserves	20	1,105.2	1,081.2
Reinsurers' unearned premium reserve	21	103.5	97.3
Total		1,208.7	1,178.5

Note:

1. Impairment provision relates to reinsurance debtors allowing for the risk that reinsurance assets may not be collected or where the reinsurer's credit rating has been significantly downgraded and may have difficulty in meeting its obligations.

15. Financial investments

	2018 £m	2017 £m
AFS debt securities		
Corporate	3,916.0	4,170.5
Supranational	43.2	43.9
Local government	29.5	12.2
Sovereign	156.9	224.8
Total	4,145.6	4,451.4
HTM debt securities		
Corporate	101.0	103.6
Total debt securities	4,246.6	4,555.0
Total debt securities		
Fixed interest rate[1]	4,211.1	4,540.1
Floating interest rate	35.5	14.9
Total	4,246.6	4,555.0
Loans and receivables		
Infrastructure debt	289.6	316.4
Commercial real estate loans	201.6	169.0
Total	4,737.8	5,040.4

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 31 December 2018 was £1,206.1 million (2017: £1,591.5 million).

16. Cash and cash equivalents and borrowings

	2018 £m	2017 £m
Cash at bank and in hand	157.4	258.0
Short-term deposits with credit institutions[1]	997.0	1,100.6
Cash and cash equivalents	1,154.4	1,358.6
Bank overdrafts[2]	(62.0)	(54.1)
Cash and bank overdrafts[3]	1,092.4	1,304.5

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 and transactions flowing through the accounts at the bank.
3. Cash and bank overdrafts disclosure note is included for the purposes of the consolidated cash flow statement.

The effective interest rate on short-term deposits with credit institutions for the year ended 31 December 2018 was 0.58% (2017: 0.29%) and average maturity was 10 days (2017: 10 days).

17. Share capital

	2018 Number millions	2017 Number millions	2018 £m	2017 £m
Issued and fully paid: equity shares				
Ordinary Shares of 10 $^{10}/_{11}$ pence each[1]	1,375	1,375	150.0	150.0

Note:

1. The shares have full voting dividend and capital distribution rights (including wind up) attached to them; these do not confer any rights of redemption.

Employee trust shares

The Group satisfies share-based payments under the Group's share plans primarily through shares purchased in the market and held by employee share trusts.

At 31 December 2018, 10,432,376 Ordinary Shares (2017: 9,945,473 Ordinary Shares) were owned by the employee share trusts with a cost of £35.2 million (2017: £34.1 million). These Ordinary Shares are carried at cost and at 31 December 2018 had a market value of £33.2 million (2017: £38.0 million).

18. Tier 1 notes

	2018 £m	2017 £m
Tier 1 notes	346.5	346.5

On 7 December 2017, the Group issued £350 million of fixed rate perpetual Tier 1 notes with a coupon rate of 4.75% per annum.

The Group has an optional redemption date of 7 December 2027. If the notes are not repaid on that date, a fixed rate of interest per annum will be reset. The notes are direct, unsecured and subordinated obligations of the issuer ranking pari passu and without any preference amongst themselves.

The Tier 1 notes are treated as a separate category within equity and the coupon payments are recognised outside of the profit after tax result and directly in shareholders' equity.

The Group has the option to cancel the coupon payment which becomes mandatory upon breach of non-compliance with the Group SCR, a breach of the minimum capital requirement or where the Group has insufficient distributable reserves.

19. Subordinated liabilities

	2018 £m	2017 £m
Subordinated guaranteed dated notes	259.5	264.7

The subordinated guaranteed dated notes with a nominal value of £500 million were issued on 27 April 2012 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 for a floating rate of 3-month LIBOR plus a spread of 706 basis points which was credit value adjusted to 707 basis points with effect from 29 July 2013.

On 8 December 2017, the Group repurchased £250 million nominal value of the subordinated guaranteed dated notes for a purchase price of £330.1 million including accrued interest of £2.7 million and associated transaction costs of £0.6 million.

The remaining notes, with a nominal value of £250 million, have a redemption date of 27 April 2042 with the option to repay the notes on 27 April 2022. If the notes are not repaid on that date, the rate of interest will be reset at a rate of the 6-month LIBOR plus 7.91%.

The Group has the option, in certain circumstances, to defer interest payments on the notes but to date has not exercised this right.

The notes are unsecured, subordinated obligations of the Group, and rank pari passu without any preference among themselves. In the event of a winding-up or of bankruptcy, they are to be repaid only after the claims of all other senior creditors have been met.

20. Insurance liabilities

	2018 £m	2017 £m
Insurance liabilities	4,005.9	4,225.7

Gross insurance liabilities

Accident year	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	Total £m
Estimate of ultimate gross claims costs:											
At end of accident year	3,823.3	3,941.7	2,698.1	2,372.7	2,184.0	2,094.5	2,118.1	2,157.7	2,217.3	2,300.1	
One year later	121.6	(117.1)	(99.3)	(163.3)	(117.6)	20.7	(30.0)	(86.7)	(116.2)		
Two years later	(37.0)	(99.1)	(94.6)	(118.9)	(153.0)	(38.4)	(143.5)	(53.3)			
Three years later	(14.0)	(50.3)	(89.3)	(49.3)	(21.0)	(144.9)	(62.4)				
Four years later	(101.5)	(105.5)	(60.9)	(9.9)	(102.1)	(50.2)					
Five years later	(38.8)	(57.7)	(21.2)	(79.2)	(50.8)						
Six years later	(80.8)	(25.9)	(60.3)	(36.2)							
Seven years later	(27.3)	(50.0)	(25.1)								
Eight years later	(14.0)	(17.6)									
Nine years later	(36.4)										
Current estimate of cumulative claims	3,595.1	3,418.5	2,247.4	1,915.9	1,739.5	1,881.7	1,882.2	2,017.7	2,101.1	2,300.1	
Cumulative payments to date	(3,474.6)	(3,323.4)	(2,172.8)	(1,862.3)	(1,655.4)	(1,592.6)	(1,547.7)	(1,554.6)	(1,471.4)	(1,174.0)	
Gross liability recognised in balance sheet	120.5	95.1	74.6	53.6	84.1	289.1	334.5	463.1	629.7	1,126.1	3,270.4
2008 and prior											655.5
Claims handling provision											80.0
Total											4,005.9

Net insurance liabilities

Accident year	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	2018 £m	Total £m
Estimate of ultimate net claims costs:											
At end of accident year	3,790.6	3,902.0	2,644.4	2,271.8	2,093.9	1,971.0	1,926.7	1,922.2	2,016.9	2,125.9	
One year later	70.0	(125.2)	(131.5)	(146.7)	(123.6)	(29.7)	(67.0)	(18.9)	(79.7)		
Two years later	(17.4)	(120.4)	(82.1)	(107.8)	(134.4)	(42.0)	(77.8)	(38.2)			
Three years later	(54.1)	(44.0)	(76.5)	(35.6)	(27.8)	(100.7)	(30.4)				
Four years later	(67.0)	(93.6)	(48.7)	(11.6)	(64.3)	(41.3)					
Five years later	(29.6)	(52.3)	(37.3)	(54.2)	(38.9)						
Six years later	(74.6)	(43.9)	(37.0)	(30.4)							
Seven years later	(38.2)	(24.8)	(20.4)								
Eight years later	(0.4)	(17.4)									
Nine years later	(35.1)										
Current estimate of cumulative claims	3,544.2	3,380.4	2,210.9	1,885.5	1,704.9	1,757.3	1,751.5	1,865.1	1,937.2	2,125.9	
Cumulative payments to date	(3,441.4)	(3,308.2)	(2,149.3)	(1,845.4)	(1,637.1)	(1,585.0)	(1,544.1)	(1,548.8)	(1,470.3)	(1,173.7)	
Net liability recognised in balance sheet	102.8	72.2	61.6	40.1	67.8	172.3	207.4	316.3	466.9	952.2	2,459.6
2008 and prior											361.1
Claims handling provision											80.0
Total											2,900.7

20. Insurance liabilities continued

Movements in gross and net insurance liabilities

	Gross[1] £m	Reinsurance £m	Net[1] £m
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 1 January 2017	4,666.6	(1,278.3)	3,388.3
Cash paid for claims settled in the year	(2,012.0)	14.0	(1,998.0)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,389.9	(200.3)	2,189.6
Arising from prior-year claims	(818.8)	383.4	(435.4)
At 31 December 2017	4,225.7	(1,081.2)	3,144.5
Claims reported	3,003.7	(742.5)	2,261.2
Incurred but not reported	1,142.7	(338.7)	804.0
Claims handling provision	79.3	–	79.3
At 31 December 2017	4,225.7	(1,081.2)	3,144.5
Cash paid for claims settled in the year	(2,186.7)	31.1	(2,155.6)
Increase / (decrease) in liabilities:			
Arising from current-year claims	2,490.4	(174.2)	2,316.2
Arising from prior-year claims	(523.5)	119.1	(404.4)
At 31 December 2018	4,005.9	(1,105.2)	2,900.7
Claims reported	3,001.0	(809.8)	2,191.2
Incurred but not reported	924.9	(295.4)	629.5
Claims handling provision	80.0	–	80.0
At 31 December 2018	4,005.9	(1,105.2)	2,900.7

Note:

1. Included within the incurred but not reported claims provision is a £55 million net release (gross: £175 million release) relating to assumed changes to the Ogden discount rate which have not yet been reflected in claims reported (31 December 2017: gross and net £nil; 1 January 2017: £217 million net provision increase; £542 million gross provision increase).

Movement in prior-year net insurance liabilities by operating segment

	2018 £m	2017 £m
Motor[1]	(276.3)	(318.6)
Home	(32.6)	(23.7)
Rescue and other personal lines	(16.1)	(6.8)
Commercial	(79.4)	(86.3)
Total	(404.4)	(435.4)

Note:

1. Results for the year ended 31 December 2018 are based on total Group operations including the Run-off segment. Comparative data has been re-presented accordingly to include Run-off segment prior-year claims movements within the prior-year Motor segment (2017: £43.1 million).

21. Unearned premium reserve

Movement in unearned premium reserve

	Gross £m	Reinsurance £m	Net £m
At 1 January 2017	1,547.9	(93.5)	1,454.4
Net movement in the year	52.4	(3.8)	48.6
At 31 December 2017	1,600.3	(97.3)	1,503.0
Net movement in the year	(94.8)	(6.2)	(101.0)
At 31 December 2018	1,505.5	(103.5)	1,402.0

22. Related parties

Transactions between the Group's subsidiary undertakings, which are related parties, have been eliminated on consolidation and accordingly are not disclosed.

Full details of the Group's related party transactions for the year ended 31 December 2017 are included on page 163 of the Annual Report & Accounts 2017.

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.

Statutory accounts information
The Annual Report & Accounts 2017 were signed on 26 February 2018 and were delivered to the Registrar of Companies following the Annual General Meeting held on 10 May 2018. The Annual Report & Accounts 2017 is available at:
https://www.directlinegroup.co.uk/content/dam/dlg/corporate/images-and-documents/investors/results-and-reports/2018/FY2017FullResults/annual-report-and-accounts-2017.pdf.downloadasset.pdf

Term	Definition and explanation
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 120 of the Annual Report & Accounts 2017.
Average written premium	Average written premium is the total written premium at inception divided by the number of policies.
Capital	The funds invested in the Group, including funds invested by shareholders and retained profits.
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 settling 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 operating expenses, compared to net earned premium generated. A ratio of less than 100% indicates profitable underwriting. Normalised combined operating ratio adjusts loss and commission ratios for a normal level of expected major weather events in the period.
Commission expenses	Payments to brokers, partners and price comparison websites for generating business.
Commission ratio	The ratio of commission expense divided by net earned premium.
Company	Direct Line Insurance Group plc (the "**Company**").
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.
Direct own brands	Direct own brands include Home and Motor under the Direct Line, Churchill and Privilege brands, Rescue under the Green Flag brand and Commercial under the Direct Line for Business brand.
Earnings per share	The amount of the Group's profit after deduction of the Tier 1 coupon payments 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.
Financial Conduct Authority ("FCA")	The independent body that regulates firms and financial advisers.
Gross written premium	The total premiums from contracts that began during the period.
Group	Direct Line Insurance Group plc and its subsidiaries ("**Direct Line Group**" or the "**Group**").
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.
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.
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.
Investment income yield	The income earned from the investment portfolio, recognised through the income statement during the period 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 48 alternative performance measures).
Investment return	The investment return earned from the investment portfolio, including unrealised and realised gains and losses, impairments, and fair value adjustments.
Investment return yield	The return divided by the average AUM. The average AUM derives from the period's opening and closing balances. (See page 48 alternative performance measures).
Leverage	Tier 1 notes and financial debt (subordinated guaranteed dated notes) as a percentage of total capital employed.
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 (including Tier 1 notes) 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.
Net earned premium	The element of gross earned premium less reinsurance premium ceded for the period where insurance cover has already been provided.

Term	Definition and explanation
Net investment income yield	The net investment income yield is calculated in the same way as investment income yield but includes the cost of hedging. (See page 48 alternative performance measures).
Ogden discount rate	The discount rate set by the Lord Chancellor and used by courts to calculate lump sum awards in bodily injury cases.
Operating profit	The pre-tax profit that the Group's activities generate, including insurance and investment activity, but excluding finance costs.
Periodic payment order ("PPO")	These are claims payments as awarded under the Courts Act 2003. PPOs are used to settle some large personal injury claims. They generally provide a lump-sum award plus inflation-linked annual payments to claimants who require long-term care.
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.
Restructuring costs	Restructuring costs are costs incurred in respect of the business activities where the Group has a constructive obligation to restructure its activities.
Return on equity	Return on equity is calculated by dividing the profit attributable to the owners of the Company after deduction of the Tier 1 coupon payments by average shareholders' equity for the period.
Return on tangible equity ("RoTE")	Return on tangible equity is adjusted profit after tax divided by the Group's average shareholders' equity less goodwill and other intangible assets. For 2018 profit after tax is adjusted to include the Tier 1 coupon payments dividend and for 2017 profit after tax is adjusted to exclude one-off costs in relation to the buy-back of subordinated liabilities. It is stated after charging tax using the UK standard tax rate of 19% (2017:19.25%). (See page 48 alternative performance measures).
Run-off	Refers to the lines of business no longer underwritten by the Group including Tesco Motor and Personal Lines Broker.
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.
Solvency capital ratio	The ratio of solvency II own funds to the solvency capital requirement.
Underwriting result profit / (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 the IFRS measures, to aid the user of the Annual 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 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 and reconciled to the most directly reconcilable line items in the financial statements and notes. Note 3 on page 33 of the consolidated financial statements presents a reconciliation of the Group's business activities on a segmental basis to the consolidated income statement. All note references in the table below are to the notes to the consolidated financial statements on pages 32 to 44.

In 2018, the Group ceased presenting APMs for the following measures:

- adjusted diluted earnings per share;
- operating profit from Ongoing operations; and
- adjusted profit before and after tax from Ongoing operations.

These APMs no longer provide relevant information, as 2018 results are based on total Group operations including the Run-off segment and restructuring costs which are included in the Motor segment.

Group APM	Closest equivalent IFRS measure	Definition and / or reconciliation	Rationale for APM
Current-year attritional loss ratio	Net insurance claims	Current-year attritional loss ratio is defined in the glossary on page 45 and is reconciled to loss ratio (discussed below) on page 13.	Expresses claims performance in the current accident year in relation to net earned premium.
Combined operating ratio	Operating profit	Combined operating ratio is defined in the glossary on page 45.	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 45 and is reconciled on page 48.	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 45 and is reconciled on page 48.	Expresses a relationship between the investment return and the associated opening and closing assets net of any associated liabilities.
Loss ratio	Net insurance claims	Loss ratio is defined in the glossary on page 45 and is reconciled in note 3.	Expresses claims performance in relation to net earned premium.
Net investment income yield	Investment income	Net investment income yield is defined in the glossary on page 46 and is reconciled on page 48.	Expresses a relationship between the investment income and the associated opening and closing assets adjusted for portfolio hedging instruments.
Return on tangible equity	Return on Equity	Return on tangible equity is defined in the glossary on page 46 and is reconciled on page 48.	This shows performance against a measure of equity that is more easily comparable to that of other companies.
Tangible equity	Equity	Tangible equity is defined as equity (excluding Tier 1 notes) less intangible assets within the balance sheet and is reconciled on page 48.	This shows the equity excluding Tier 1 notes and intangible assets for comparability with companies who have not acquired businesses or capitalised intangible assets.
Tangible net assets per share	Net assets per share	Tangible net assets per share is defined as tangible equity (as above) expressed as a value per share and is reconciled in note 13 on page 38.	This shows the equity excluding Tier 1 notes and intangible assets per share for comparability with companies who have not acquired businesses or capitalised intangible assets.

Additionally, the current-year attritional loss ratio within the analysis by division section has also been identified as an alternative performance measure, similarly reconciled to the financial statements and notes on page 13, and defined in the glossary.

Return on tangible equity[1]

	2018[2] £m	2017[2] £m
Operating profit	601.7	642.8
Finance costs	(19.1)	(103.8)
Profit before tax	582.6	539.0
Finance costs adjustment for one-off subordinated debt buy back	–	66.1
Coupon payments in respect of Tier 1 notes	(16.6)	–
Adjusted profit before tax	566.0	605.1
Tax charge	(108.9)	–
Tax charge (using the 2017 UK standard tax rate of 19.25%)	–	(116.5)
Adjusted profit after tax	457.1	488.6
Opening shareholders' equity	2,715.1	2,521.5
Opening goodwill and other intangible assets	(471.1)	(508.9)
Opening shareholders' tangible equity	2,244.0	2,012.6
Closing shareholders' equity	2,573.1	2,715.1
Closing goodwill and other intangible assets	(566.8)	(471.1)
Closing shareholders' tangible equity	2,006.3	2,244.0
Average shareholders' tangible equity[3]	2,125.2	2,128.3
Return on tangible equity	21.5%	23.0%

Investment income and return yields[1]

	Notes[4]	2018 £m	2017 £m
Investment income	5	159.2	167.1
Hedging to a sterling floating rate basis[5]	5	(30.8)	(27.0)
Net investment income		128.4	140.1
Net realised and unrealised gains excluding hedging		26.2	35.3
Investment return	5	154.6	175.4
Opening investment property		309.3	329.0
Opening financial investments		5,040.4	5,147.0
Opening cash and cash equivalents		1,358.6	1,166.1
Opening borrowings		(54.1)	(55.3)
Opening derivatives asset / (liability)[6]		55.1	(5.8)
Opening investment holdings		6,709.3	6,581.0
Closing investment property		322.1	309.3
Closing financial investments	15	4,737.8	5,040.4
Closing cash and cash equivalents	16	1,154.4	1,358.6
Closing borrowings	16	(62.0)	(54.1)
Closing derivatives asset[6]		11.8	55.1
Closing investment holdings		6,164.1	6,709.3
Average investment holdings		6,436.7	6,645.2
Investment income yield		2.5%	2.5%
Net investment income yield		2.0%	2.1%
Investment return yield		2.4%	2.6%

Notes:

1. See glossary on pages 45 and 46 for definitions.
2. Results for the year ended 31 December 2018 are based on total Group operations including restructuring costs and the Run-off segment. Comparative data has been re-presented accordingly to include restructuring costs and Run-off segment profits in the 2017 operating profit. The adjusted profit after tax reported in 2017 was £462.9 million and the return on tangible equity was 21.7%.
3. Mean average of opening and closing balances.
4. See notes to the consolidated financial statements.
5. Includes net realised and unrealised gains / (losses) of derivatives in relation to AUM.
6. See footnote 1 on page 16 (Investment holdings).

We confirm that to the best of our knowledge:

1. the financial statements within the Annual Report & Accounts, from which the financial information within these Preliminary Results have been extracted, are prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the undertakings included in the consolidation taken as a whole; and

2. the management report within these Preliminary Results includes a fair review of the development and performance of the business and the position of the Group, and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties faced by the Group.

Signed on behalf of the Board

PAUL GEDDES
CHIEF EXECUTIVE OFFICER
4 March 2019

PENNY JAMES
CHIEF FINANCIAL OFFICER
4 March 2019

LEI: 213800FF2R23ALJQOP04