

# Corporate governance



Mike Biggs,  
Chairman

"We have a strong team in place to continue delivering our strategy, to capitalise on opportunities and meet the challenges ahead."

## Dear shareholders and other stakeholders

### Our commitment to good corporate governance

As Chairman, I want to ensure that Direct Line Group is well governed. I am pleased to report that we have complied with substantially all of the provisions of the UK Corporate Governance Code (September 2012). The Board has worked hard during the year seeking to ensure that high governance standards have been maintained throughout the Group.

The following Corporate governance report gives shareholders a clear and comprehensive view of the Group's governance arrangements and how we have operated within them over the past year.

### The way we do business

The way we do business and our underlying values are central to Direct Line Group's success. Our Code of Business Conduct governs the way we interact with our stakeholders and our values determine our behaviours. Both determine how we do business throughout the Group and define our corporate identity. They also influence our business relationships and reputation, which are key to our long-term success. Our Code of Business Conduct is set out below, our values are on the following page and you can also view them and our Ethical Code for Suppliers at [www.directlinegroup.com](http://www.directlinegroup.com).

### Relationship with RBS Group

It was another significant year for Direct Line Group. On 27 February 2014, RBS Group sold its entire remaining shareholding in the Company, save for a small number of shares it retained to satisfy long-term incentive awards issued by RBS Group to Direct Line Group management. As explained in last year's Annual Report, a European Commission obligation required RBS Group to sell its shareholding by the end of 2014. As such, Direct Line Group is no longer owned by RBS Group and our operations are now largely separate. The sale does not affect our business strategy. We will continue our journey towards our goal of becoming the leading personal and small business general insurer in the UK.

## Our Code of Business Conduct

### Business practices

We shall engage in honest, professional and ethical conduct and maintain effective procedures to prevent confidential information being misused.

### Dealing with customers

We shall treat customers fairly, openly and honestly, and operate an effective complaints process to address any perceived departure from these standards.

### Dealing with shareholders and other stakeholders

We shall seek to maximise shareholder value over time, recognising that wealth generated also benefits customers, employees and the communities where we operate.

### Dealing with employees

We shall maintain a working environment that attracts, motivates and retains employees, and shall be intolerant of any type of discrimination, harassment or victimisation.

### Board composition

A number of changes in the composition of the Direct Line Insurance Group plc Board took place during 2014. Following RBS Group's sale of substantially all of its shareholding in the Company, Mark Catton, RBS Group's nominated Non-Executive Director, stepped down on 7 March 2014.

I would like to thank Mark for his excellent contribution to the Company during his time on the Board and wish him well in the future.

Following a review of the Board's balance of skills, knowledge and experience, and a rigorous selection process, Sebastian James joined the Board on 28 August 2014. With digital marketing and customer service increasingly important to our business, Sebastian brings valuable experience in these fields and is an important addition to the Board. On behalf of the Board, I am delighted to welcome him as a Non-Executive Director of the Company.

You can find further information on diversity at Board level and the Board effectiveness review in the Corporate governance report on page 57.

I am confident we have a strong team in place to continue delivering our strategy, capitalise on the opportunities and meet the challenges ahead.



Michael N Biggs, Chairman  
2 March 2015

## Our values

### Do the right thing

For our people, our customers, our shareholders and our wider stakeholders; make decisions based on what is right, not what is easy; demonstrate personal and professional integrity; do what's right for the long-term sustainability of our business.

### Aim higher

Strive to be the best in every area of the business; be ambitious, courageous and innovative; relentlessly challenge and improve; seek and embrace change; learn from our mistakes; persevere, always deliver our promises and don't settle for second best.

### Work together

Collaborate across all levels and across all functions; leverage the skills, knowledge and experience, irrespective of hierarchy, to deliver the best possible results; develop relationships based upon trusting each other, partnerships and win-wins; recognise and celebrate success.

### Take ownership

Treat it like it's OUR business; take the initiative, if you can see a better way, go and make a difference; take decisions, be accountable for your actions in whatever role you carry out; take responsibility for your own personal development and performance.

### Say it like it is

Be real, authentic and true to self; have adult to adult conversations with all audiences; listen, seek to understand and respect diversity of views; be open, call out issues we see; share information and keep things as simple as possible.

### Bring all of yourself to work

Be the best you can be, the real and whole you; celebrate our diversity of skills, experiences and personalities; be a role model to others, demonstrate 'can do' spirit, have fun and make this a great place to be; be excited about our Company and our future; believe in yourself, feel confident and empowered.

#### Dealing with suppliers of goods and services and business partnerships

We shall maintain the highest possible standards of integrity in business relationships with suppliers and partners by treating them honestly and with respect, and avoiding compromising offers of gifts and hospitality.

#### Dealing with communities and the environment

We shall contribute to the social and economic well-being of those communities where we are an employer, and encourage employees to participate in projects and initiatives to strengthen those communities.

#### Dealing with competitors

We shall compete with competitors honestly and in accordance with the relevant competition law.

#### Dealing with regulators

We shall maintain a constructive and open relationship with our regulators to foster mutual trust, respect and understanding, and will not offer anything to officials in return for favourable treatment.

This report details the role and activities of the Board and explains how corporate governance is operated throughout the Group.

### The UK Corporate Governance Code

Direct Line Insurance Group plc (the “Company”) has complied with the principles and provisions of the UK Corporate Governance Code 2012 (the “Code”) throughout the year, with the exception of the recommendation contained in Provision E.1.1 of the Code to the effect that the Senior Independent Director (the “SID”) should attend sufficient meetings with a range of major shareholders. This is to listen to their views to help develop a balanced understanding of the issues and concerns of major shareholders. The Board received regular updates from the Company’s corporate brokers on the views of its institutional shareholders. Major shareholders have the opportunity to discuss any issues they wish to raise with the Chairman and the Chair of the Remuneration Committee. Additionally, the Chairman has met certain major shareholders during the year and, through the brokers, offered other major shareholders the opportunity to discuss any matters with him or the SID. The Board is satisfied that, on the basis of reports from the Company’s brokers and through the Chairman, it understands the views of the Company’s major shareholders.

Details of how the Company applied the Code’s principles and complied with its provisions are in this report and the Directors’ remuneration report. You can find further information on the Code on the Financial Reporting Council’s website at [www.frc.org.uk](http://www.frc.org.uk).

### Leadership

#### The Board

The Board’s primary role is to organise and direct the Group’s affairs in a manner that is most likely to promote its long-term success for the benefit of its shareholders as a whole. The Board supervises the Group’s operations, ensuring they are effectively managed, that prudent controls are in place, and that risks are assessed and managed appropriately. The Board sets the Group’s strategy and monitors management’s performance and progress against the strategic aims and objectives.

The specific duties of the Board are set out in the Schedule of Matters Reserved for the Board (the “Matters Reserved”). The Matters Reserved are reviewed annually by the Board and contain those items that are specifically reserved for consideration and approval by the Board. Matters requiring approval by the Board include:

- The Group’s strategic aims and objectives
- The annual operating and capital expenditure budgets
- Corporate governance matters
- Capital structure, financial reporting and controls, including dividend policy
- The system of internal controls and risk management, including the Group’s risk appetite statements
- Major capital projects, major investments and contracts that are either materially strategic or above the Chief Executive Officer’s delegated authority

- Board and Committee membership and succession planning
- The remuneration policy for Directors and senior executives
- The 12 Group policies which form part of the high level governance framework

In addition to the Matters Reserved, each Board Committee has written terms of reference defining its role and the authority delegated to it. You can find further details on the Board Committees in the Board Committees’ section from pages 61 to 70.

#### Board composition

As at the date of this Report, the Board comprises the Chairman, who was independent on his appointment to the Board, the Chief Executive Officer, the Chief Financial Officer and six independent Non-Executive Directors. All of the current Directors served throughout the reporting period, except for Sebastian James, who was appointed to the Board on 28 August 2014.

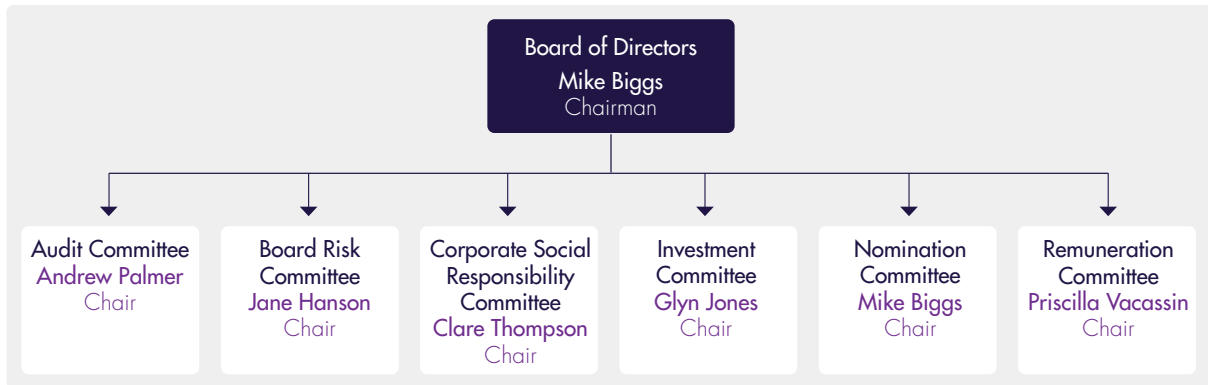
You can find the names of the Directors as at the date of this report and their biographical information on pages 52 and 53.

Mark Catton, who was nominated by RBS Group as a Non-Executive Director in accordance with the terms of the Relationship Agreement between Direct Line Insurance Group plc and RBS Group, resigned from the Board on 7 March 2014. His resignation followed the sale by RBS Group on 27 February 2014 of its interest in the Ordinary Shares of Direct Line Insurance Group plc. This excluded 4,185,643 shares, which were retained to satisfy long-term incentive plan awards previously granted by RBS Group to certain members of Direct Line Group’s management. These shares have since been transferred to an RBS Group Employee Benefit Trust. Since disposing of its shareholding, RBS Group no longer has a right to nominate a director to the Board.

#### Structure of the Board

The Board and its Committees have been established to ensure that an appropriate balance of skills, experience, independence, sector knowledge and diversity exists to enable the Directors to discharge their duties and responsibilities effectively.

All Non-Executive Directors must be able to devote sufficient time to the role to discharge their duties and responsibilities effectively. The letters of appointment for the Chairman and each of the Non-Executive Directors set out the anticipated time commitment of at least three days per week for the Chairman and an average of three days per month for the Non-Executive Directors. The Nomination Committee reviews this time commitment annually.



### Board Committees

The Board has established a number of Committees to help meet its responsibilities. Each Committee plays a vital role in ensuring the Board operates efficiently and considers matters appropriately. The diagram above details the names of the Board Committees and the Chairs.

Each Board Committee has separate terms of reference. The Board reviews these annually. You can find details of the composition, attendance, role and focus of each Committee on pages 61 to 70.

### Chief Executive Officer

Although the Board is ultimately responsible for the success of the Company, Paul Geddes, the Chief Executive Officer, has received delegated authority from the Board to manage the day-to-day operations of the Group and deliver its strategic objectives.

In turn, Paul Geddes has cascaded certain elements of his delegated authority to the members of the Executive Committee. These delegations help ensure that senior executives are accountable and responsible for managing their respective businesses and functions. The delegations also involve ensuring the senior executives have the appropriate financial, and other, authorities needed to manage those business areas.

### Executive Committee

The Executive Committee is the principal management committee that assists the Chief Executive Officer in the day-to-day management of the Group. It supports him in setting performance targets, implementing the Group's strategy and direction as determined by the Board, and monitoring key objectives and commercial plans to help achieve the Group's targets. It also helps him evaluate new business initiatives and opportunities, and receives and considers reports on operational matters, where these are material to the Group or have cross-company implications.

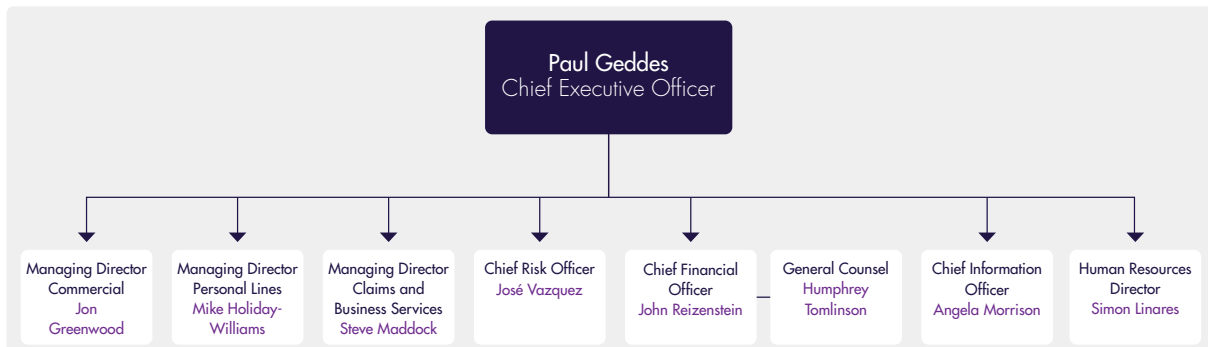
The diagram below depicts the management-governance framework.

### Accountability

#### Financial and business reporting

The Board is responsible for providing shareholders with a fair, balanced and understandable assessment of the Company's position and prospects. The Board is also responsible for the maintenance of adequate accounting records and ensuring compliance with statutory and regulatory obligations.

An explanation from the Directors of their responsibility for preparing the financial statements is set out in the statement of Directors' responsibilities on page 97. The statement by the Company's external Auditor explaining their responsibilities is on page 102.



The Board meets the specific responsibilities that the Code places on it as follows:

- An explanation of how the Company generates value over the long term is included within the business model on page 8 and the strategy for delivering Company objectives on page 16
- How the Board has concluded that the business remains a going concern is discussed on page 96
- The arrangements established by the Board for the application of risk management and internal control principles are detailed below
- The Board has delegated oversight of the management of the relationship with the Company's external Auditor to the Audit Committee. The Audit Committee report on pages 61 to 63 provides details of its role, activities and relationship with the internal and external Auditors

### Risk management and internal control system

The Board oversees the Group's risk management and internal control system. It has complied with the Code by establishing a continuous process for identifying, evaluating and managing the significant risks the Group faces. This process includes risks arising from social, environmental and ethical matters.

The Group operates a 'three lines of defence model', further details of which can be found in the Risk Management section on pages 28 to 31.

During the year, the Board reviewed the effectiveness of the Group's risk management and internal controls. The Group's assessment process included output from a system for reporting on all significant risks that stand in the way of the Group's objectives. The system reported on the nature and effectiveness of the controls and other management processes that manage these risks. The system also sets risk appetites for key categories of quantifiable risk. Additionally, it encompassed risk owners' self-assessment of control throughout the Group. The second and third lines of defence independently challenge their assertions. Furthermore, Group Audit has undertaken reviews in the financial year to support this.

The Board Risk Committee regularly reviews significant risks, their potential impact on the Group's financial position, variations from agreed risk appetites, and the actions taken to manage those risks.

### Internal systems of control

The Board has established a management structure with defined lines of responsibility and clear delegation of authority. This control framework cascades through the divisions and central functions, detailing clear responsibilities for ensuring appropriate controls are in place at an operational level. This includes controls relating to the financial reporting process.

The Group Audit function supports the Board by providing an independent and objective assurance of the adequacy and effectiveness of the Group's operations. It brings a systematic and disciplined approach to evaluating and improving the effectiveness of its risk management, control and governance frameworks and processes.

The Directors know that any system of internal control is designed to manage, not eliminate, the risk of failing to achieve business objectives. It can only provide reasonable, not absolute, assurance against material misstatement or financial loss.

On behalf of the Board, the Audit Committee regularly reviews the effectiveness of the Group's internal control systems. Its monitoring covers all material controls. Principally, it reviews and challenges reports from management, the Group Audit function and external Auditors. This enables it to consider how to manage or mitigate risk in line with the Group's risk strategy. The Committee did not identify or report any major failings or weaknesses to the Board in 2014.

### Remuneration

The Board has delegated to the Remuneration Committee responsibility for the remuneration arrangements of the Group's Executive Directors and for overseeing senior executives' remuneration. Find out more information on the remuneration arrangements and policy in the Directors' remuneration report on page 71.

### Relations with shareholders

The Board believes that actively engaging with the Company's shareholders is fundamental to the Group's business. An active dialogue and ongoing engagement with investors is vital to keeping up-to-date on opinions. It also provides the Company with the opportunity to address any questions and concerns proactively.

The Executive Directors meet frequently with investors and ensure shareholder concerns are communicated to the Board. The Chairman, Senior Independent Director and Non-Executive Directors are available to attend meetings with major shareholders at their request. This gives the Directors the opportunity to discuss governance and strategy with shareholders.

The Company's Investor Relations team facilitates the Directors' ongoing dialogue with institutional investors, fund managers and analysts. The Board receives regular updates on investor relations, including feedback from analysts. The Company's corporate brokers also regularly attend Board meetings to inform the Board of shareholder views.

### Annual General Meeting

The Board views the Company's AGM as a good opportunity for private shareholders to communicate directly with the Board. All shareholders are entitled to attend the AGM. All Directors attended the AGM in 2014.

The Chief Executive Officer presents the Group's results before the Chairman proposes the AGM's formal business. All shareholders are encouraged to ask questions relating to the meeting's business. The Chairman, the Committee Chairs and the remaining Directors are also available at the meeting.



**Priscilla Vacassin,**  
Chair of the Remuneration Committee

## Dear shareholder

As Chair of the Remuneration Committee (the “Committee”), I am pleased to introduce our report on Directors’ remuneration. Our remuneration policy has been in place since the IPO, and received a significant level of support from shareholders at the 2014 AGM (97.5% of votes cast).

You can find a copy of the approved policy on pages 84 to 93 of this report.

### Linking remuneration to performance – key pay outcomes in respect of 2014

As outlined in the Board Chairman’s letter on pages 10 to 11, we have met or exceeded the stretch targets which we set ourselves before the IPO. The incentive outcomes for our Executive Directors, as presented in the annual remuneration report on pages 77 to 83, and for other senior executives and employees, reflect these achievements.

In line with last year’s approach, bonuses under the Annual Incentive Plan (“AIP”) are based on performance against key financial and strategic measures. Bonuses of 75% of the maximum were awarded to the Chief Executive Officer and the Chief Financial Officer in respect of 2014. This reflects the strong performance against our financial targets and the significant progress made during the year in achieving our strategic priorities.

In arriving at this outcome, as in previous years, the Committee has exercised careful judgement, assessing the quality of earnings and the overall context for performance to ensure that bonus outcomes are fair for shareholders and executives. We have provided enhanced disclosure this year in relation to the AIP outcome for 2014 on page 77 of this report.

Under our Long-Term Incentive Plan (“LTIP”), the first awards, which were made following the IPO, and are subject to total shareholder return (“TSR”) and RoTE performance conditions,

are due to vest later in 2015. The performance period in respect of the RoTE element of these awards has now been completed. Subject to final determination by the Committee at the time of vesting, the RoTE delivered in 2013 and 2014 has resulted in achievement of 82% of the maximum opportunity for this element. These shares will not be delivered to Executive Directors until November 2015, when the Committee will also assess performance under the TSR element of the award. Awards will only vest to the extent that the Committee is satisfied at that time that the outcome reflects the Group’s underlying financial performance and there have been no material risk failings.

Separately, this year also saw the completion of the performance period for the last legacy awards under the RBS Group long-term incentive plan (“RBS Group LTIP”). These awards were granted to Executive Directors, and other senior executives, in respect of their work as executives of RBS Insurance, as Direct Line Group was known when it was owned by the RBS Group. The assessment against the performance framework set by RBS Group at the time of grant against financial, operational, risk and strategic measures, has resulted in vesting of 90% of awards. As agreed with RBS Group at the time of the IPO, these awards will be delivered in the form of Direct Line Insurance Group plc (the “Company”) shares, transferred by RBS Group.

The vesting outcomes described above under both the Direct Line Group LTIP and RBS Group LTIP have been included in the single figure of remuneration which is shown on page 77.

### Remuneration approach for 2015

Our remuneration policy has worked well and continues to be aligned with our key strategic priorities. Therefore, we are not making any changes to the approved policy this year but have refined aspects of our practices which do not require shareholder approval and which will help further align our executives and shareholders and will continue incentivising superior and sustainable business performance.

You can find more details of these changes in the section of this remuneration report that describes how we intend to implement our remuneration policy in 2015 on pages 74 to 76.

I would like to highlight the following areas:

- The salaries of both Executive Directors will increase by 2% in April 2015, in line with the average increase to employees across the Group generally. This will be the first increase since their salaries were set in September 2012
- Our approach to measuring performance under the AIP in 2015 will be similar to that followed in 2013 and 2014. We will continue to measure performance using specific financial, strategic and personal targets and carefully assessing payouts using broader judgement. The Committee will continue to consider lead indicators, costs and prior-year reserve releases as part of its overall judgement but there will be no specific weighting allocation to these elements

- To reflect the Group's continued focus on customer experience, in 2015 we will be increasing the weighting of customer measures under the AIP from 10% to 20%. We will also increase the range of customer measures taken into account to better reflect the specific focus for the coming year
- We are not proposing any changes to the performance conditions for 2015 awards under the LTIP. However, we will be increasing the level of RoTE required for 2015 awards to vest from the current range of 14.0% to 17.0% to the range 14.5% to 17.5%. This will ensure that awards to Executive Directors will only vest in full if significant value has been delivered to our shareholders
- To further strengthen the alignment of Executive Directors' and shareholders' interests we have increased the share ownership guidelines for the Chief Financial Officer from 150% to 200% of base salary, aligning them with those of the Chief Executive Officer

During the year, the Committee also considered if it would be appropriate to introduce a requirement to hold any awards under the LTIP for a further period following vesting. The Committee decided that, pending final guidance on the requirements of Solvency II expected during 2015 and which may well include guidance on this aspect necessitating further change, it would not change the policy at this stage. The Committee will review remuneration structures and policy once the final Solvency II requirements have been published.

#### Voting on the annual remuneration report

As we are not proposing any changes to our remuneration policy which would require shareholder approval, the annual report on remuneration will be the only report to be put to an advisory shareholder vote at the AGM on 13 May 2015.

I believe the remuneration our Executive Directors received in 2014 is appropriate and rewards them fairly for their performance and that their remuneration arrangements for 2015 will continue to incentivise them to deliver our strategic priorities and provide our shareholders with sustainable returns.

I hope you find this report informative and welcome any feedback you may have.



Priscilla Vacassin,  
Chair of the Remuneration Committee

## Questions and answers on our executive remuneration policy

### Q How did you determine the bonuses for 2014 for the Executive Directors?

Similar to last year, we began by quantitatively assessing performance under each measure. This gave the Committee an initial view on delivery against the targets set at the start of the year.

We then considered a wide range of additional quantitative and qualitative factors. These included quality of earnings, affordability, the Group's overall performance against the agreed risk profile, performance relative to peers, the wider economic environment plus other factors. This allowed the Committee to consider the overall Group performance and ensure bonuses reflect this.

As described in the Remuneration Committee Chair's letter on page 71, this assessment resulted in achievement of 75% of the maximum opportunity in respect of both Executive Directors.

As in previous years, for both Executive Directors 40% of the awarded bonus will be deferred in Company shares for three years. This is in line with the approach for other Executive Committee members and strategic leaders (our most senior executives, who are responsible for developing and executing Group strategy).

### Q Will the 2015 process be different?

It will be broadly unchanged. Our overall framework for determining bonuses has existed since the IPO, and has proved effective in linking business performance with payments to the Executive Directors. However, we have refined some of its details, making it easier to operate and communicate.

We particularly wanted to broaden the factors the Committee considers when assessing performance. Therefore, to that effect we have moved the consideration of lead indicators, costs and prior-year reserve releases to the overall judgement applied by the Committee in considering outcomes as opposed to applying a specific weighting.

The other change in 2015 will be to increase the scope and the weighting of the customer measures.

You can find more details on these changes on page 75.

### Q Do you comply with the Financial Conduct Authority's Remuneration Code?

As an insurance business, we are not subject to the provisions of the Financial Conduct Authority's Remuneration Code. However, we seek to comply with the core requirements of the Code that we should establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote sound and effective risk management.

As such, significant elements of performance related pay for all our strategic leaders and Executive Committee members, including Executive Directors, are subject to deferral and potential malus and clawback. This is explained further in our policy report.

We also assess bonuses for senior personnel in our control functions independently from the Group financial results. This helps maintain the independence of our control functions.

**Q How are you preparing to comply with Solvency II remuneration requirements?**

Guidance in relation to the pay implications of Solvency II remains draft and high level, with final guidance not expected until after the publication of this report. In 2014, we thoroughly assessed our remuneration arrangements against known guidance with help from external advisers. The results confirmed that we already achieve a high level of compliance with the draft guidance.

When we know the final provisions we will fully review our remuneration policy and practices and consider whether we need to change them. We will disclose any changes affecting our Executive Directors' remuneration arrangements in subsequent remuneration reports as appropriate.

**Q Why are the Executive Directors still receiving shares under RBS Group share plans?**

In line with other Direct Line Group employees previously granted awards under RBS Group employee share plans, Paul Geddes and John Reizenstein were granted awards under the RBS Group LTIP and the RBS Group Deferral Plan prior to the IPO, when they were employees of RBS Group.

In the case of awards under the RBS Group LTIP, the last set of outstanding awards is due to vest in March 2015, as described in more detail in the Committee Chair's letter on page 71. These awards will be delivered in the form of Direct Line Insurance Group plc shares, transferred by RBS Group as agreed at the time of the IPO.

The remaining RBS Group Deferred awards are also due to vest in March 2015 and will be delivered in RBS Group shares. These awards are not subject to any performance conditions as they represent the deferral element of annual bonuses that have already been earned.

**Q How will the sale of the International division affect remuneration arrangements for Executive Directors?**

Completion of the sale of our International division is currently expected in the first quarter or failing which in the second quarter. As this sale was not completed during 2014, we did not adjust the AIP targets for 2014, which continued to include the performance of the International division.

For existing awards under the LTIP, in line with typical market practice, we will not adjust performance targets under the TSR or RoTE elements.

Future performance targets for the AIP and the RoTE element of the LTIP have been set after taking the impact of the sale of the International division, and its impact on our budget and business plans, into account.

**Q Do you offer all your employees the opportunity to become shareholders?**

Yes, we believe it is important for all employees to have the opportunity to become shareholders in the Company. We run a Buy-As-You-Earn Share Incentive Plan (the "SIP") which allows employees to receive one matching share for every two shares they purchase.

In addition, in order to recognise the exceptional contribution of our people to the success of our business, we announced during December 2014 a free share award with a value of £400 per employee in the UK. This award will be made during March 2015 and will be the second offer of free shares to UK employees since the IPO.