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Issuer Comment: Direct Line's ratings (A2 IFSR, stable) unaffected by sale of international operations

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Moody's ratings on U K Insurance Limited ("UKI", A2 insurance financial strength, outlook stable), the main operating subsidiary of Direct Line Insurance Group plc ("DLG" or "Group"), and on DLG's guaranteed subordinated debt (Baa1(hyb)) are unaffected by the sale of its international operations. We view the overall credit implications of the sale as broadly neutral for DLG.

On 25 September 2014, DLG announced the sale of its Italian and German operations to Mapfre, S.A. for €550 million (£431 million) which represents 1.9x 2013 net asset value and around 37x 2013 normalised earnings. The sale concludes the strategic review that DLG initiated earlier in 2014. The transaction is conditional on the approvals of relevant regulatory authorities which are expected to take approximately three to four months.

DLG's international business, which represented around 16% of 2013 gross premium written, has provided the Group with some geographic diversification which will be lost following the sale. However, earnings diversification has been much less with the International division representing only around 3% of the Group's 2013 ongoing operating profit, and reporting a relatively high combined operating ratio of around 104% for 2013. Furthermore, with its focus on private motor insurance, a core business line for DLG, the International division's contribution to the Group's business diversification has been relatively limited. In light of this, we see the impact of the sale on the Group's business profile and profitability as being relatively limited.

DLG is expecting to recognise a pre-tax gain from the sale of approximately £160 million, but expects that substantially all of the net proceeds will be returned to shareholders. This, together with the relatively small size of the international business, leads us to conclude that the impact of the sale on the Group's risk-based capital coverage ratio, which at 30 June 2014 was at the top end of its risk appetite range at 148.8%, is unlikely to be material.

One small positive aspect of the sale in our view is that it will free up senior management time to focus even more on the Group's core operations in the UK.

Moody's A2 IFSR on UKI reflects DLG's very strong position in the UK personal lines market, a relatively conservative investment portfolio, good capitalisation, and relatively low financial leverage. These strengths are off set by relatively weak geographic and business diversification, and the challenge of sustaining recent performance improvements within the very competitive UK motor market, which remains vulnerable to bodily injury claims inflation, albeit mitigated to a certain extent by recent legal reforms and DLG's claims improvements.

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