MOODY'S
RATINGS

Rating Action: Moody's Ratings affirms Direct Line's Ratings, outlook stable

22 October 2024

London, October 22, 2024 – Moody's Ratings (Moody's) has affirmed the A2 insurance financial strength rating (IFSR) of U K Insurance Limited (UKI), the key operating entity of Direct Line Insurance Group plc (DLG). In the same action, we affirmed DLG's subordinated debt rating of Baa2(hyb) and its restricted tier 1 securities – preferred stock non-cumulative rating – of Ba1(hyb). The outlooks on both issuers remain stable.

RATINGS RATIONALE

The affirmation of DLG's ratings reflect (i) its position as a leading personal lines property and casualty (P&C) insurer in the UK, with powerful brands and good market share in motor and home insurance, and (ii) the group's strong solvency position, relatively conservative investment portfolio and low financial leverage. These strengths are offset by (i) underwriting performance which, while historically strong, is recovering following a significant deterioration due to claims inflation and difficult pricing conditions in 2022 and 2023, and (ii) concentration in the UK personal lines P&C market.

DLG has established a new management team, with significant experience in UK personal lines, which we consider credit positive. While initial steps taken to expand distribution, focus on DLG's key strengths and reduce costs will defend its market position and reduce costs over time, they would result in greater concentration in motor and home if its strategic review leads to the exit of its pet and travel businesses. The group is bolstering its pricing capabilities and digitalising and simplifying its business, however we view this as necessary to defend the group's top-tier market position rather than credit positive.

The group's performance has been weak in the last couple of years, following a history of consistently strong performance. We expect to see profitable underwriting performance in 2024 and 2025 following strong pricing actions, but there is still some execution risk in restoring profitability to historical levels. The group was subject to regulatory scrutiny by the Financial Conduct Authority (FCA) in the form of reviews into pricing and claims payments in 2023, however we consider the risk of reputational damage from FCA reviews to have abated.

DLG has restored its solvency position, largely through the disposal of its brokered commercial business in 2023, alongside a return to strong operating capital generation. We expect solvency coverage to be maintained at around 180% over the medium term to mitigate future uncertainty. Performance issues, weather-related losses, property devaluations and widening credit spreads led to DLG's solvency coverage falling to around 140% in 2022, and the suspension of the group's final dividend. Additionally, DLG initially overestimated its year-end 2023 solvency, however the adjusted figure remained substantial at around 190%.

Outlook

The stable outlook reflects our expectation that DLG will maintain solvency coverage at around 180% and continue improving profitability over the outlook period while maintaining its strong market position.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The following factors could lead to an upgrade: (i) material strengthening of the group's franchise, evidenced by improved market share and greater diversification leading to materially lower concentration in UK personal lines; (ii) profitability sustainably restored to historical levels, evidenced by low-90% combined ratios and return on capital in excess of 10%; (iii) maintenance of the group's Solvency II ratio at or above 180%; and (iv) adjusted financial leverage consistently below 20%.

The following factors could lead to a downgrade: (i) ongoing weak profitability of the business, evidenced by combined ratios nearing 100% and return on capital consistently below 5%; (ii) material weakening of the group's franchise; (iii) Solvency II ratio remaining at 140% or below; and (iv) adjusted financial leverage consistently above 35%.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Property and Casualty Insurers published in April 2024 and available at https://ratings.moodys.com/rmc-documents/418354. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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Will Keen-Tomlinson
VP-Senior Analyst
Financial Institutions Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Simon James Robin Ainsworth
Associate Managing Director
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London, E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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