S1 2019 Earnings Call

Company Participants

- David Horton, CEO & Executive Director
- Ian Fantozzi, Chief Operating Officer
- Lou Ann Layton, Head of Broker Relations and Marketing Designate
- Nick Hayes, Group Property Director
- Sally Lake, Group Finance Director & Executive Director

Other Participants

- Andreas van Embden
- Andrew Ritchie
- Edward Morris
- Joanna Parsons
- Jonathan Urwin
- Kamran Hossain
- Nicholas Johnson

Presentation

David Horton {BIO 5697110 <GO>}

Good morning, ladies and gentlemen, and welcome to our Interim Results Presentation. If we look at what we're going to run through over the next few minutes, so I'm going to give you an overview on business update and then I'm going to hand over to Sally Lake, who's going to take us through the financials. Our special guest for 2019 is Lou Ann Layton, who's recently taken over as the Head of Broker Relations and Marketing from Dan Jones, who retired at the end of June. And then I'll come back for the outlook and then we'll be open to questions.

So, if we look at the numbers briefly. We've seen good top-line growth in the first half of the year, so up 12%. That has been driven by a more favorable rating environment, so rates are up 5% year-on-year. That of course has been driven to some extent by more claims. So we've seen more claims in 2018 than 2017. We've seen some of those catastrophic claims continue to increase into 2019. We seen claims in the marine division and to some extent in our liability division, so we'll look at that in a bit in a second.

Prior reserve leases, Sally will take us through, as we indicated a couple of months ago, lower than they were last year. A great year for investments. Again, Sally will go through that. And as usual, the interim dividend is up 5% to 4.1%.

So, we give a brief business update. We've seen growth across all platforms and most divisions at the half year, so a good half year for growth. So all platforms is in the US, here in Lloyd's, on our London platform, and in our Irish company platform, the Beazley Insurance Company in Ireland.

Specialty lines, we got more disclosure. We've broken that down as we said we would do into the underlying specialty lines going deep and running specialty lines. And everything that's not cyber or executive risk is in our current specialty lines. Cyber and executive risk we've broken out under Mike Donovan. That's because we believe there is a cross-sell opportunity with those two lines of business that can be board decisions over buying management, liability and cyber. And you can see a bit more disclosure on that, although you cannot see the cyber loss ratio within that. You can see cyber and executive risk combined.

There's been some management changes, Martin obviously stepped down as CFO at the end of May, and Sally took on that role. And Mark Bernacki, our Head of Property left us at the end of April. And Richard Montminy joined us from Zurich and prior to that Marsh at that time, he took at the property division.

As I mentioned, we've done more claims in the first half of the year, pockets of US liability, specifically in healthcare and D&O. The catastrophes claims have crept out a bit. We also got some of these risk excess losses in the first half and we serve more claims in our US tracking book, which happens to sit within the marine division.

This others have seen as well, and we have the infamous pricing disciplines. We see prices holding up, and we've seen the rate of rate increases continue to accelerate. So the rate increase we're getting at the beginning of the year was positive, and we're getting more rate increase as the year goes on. And our belief is that is going to continue into 2019. As we do the planning for 2020, our expectation is we're going to see rate rises into 2020.

I'll now hand over to Sally, who'll take us through the financials.

Sally Lake {BIO 20925273 <GO>}

Good morning, everyone. For those who don't know me, my name is Sally Lake and I'm Beazley's Finance Director. So, I'm going to take you through the numbers briefly, and talking about investments, return, reserves and capital, finally, before I hand on to Lou Ann to talk about broker relations.

So, just a quick recap for what Andrew just said we seen an excellent growth in the first half of the year in gross written premium. The profit has increased, but the make of that profit is very different to what we saw 12 months ago, and I'll take you through that as we go through.

The dividend has gone up in line with our strategy of 5% to 10% and by 5% up to 4.1p. So, if we start with investment return, this is known as my favorite graph of the presentation.

So Stuart and his team have done excellent work in the first half of the year and we've had an investment return of $170 million in the first half of the year.

Now, if we go to our portfolio, there's really two things driving that. Firstly, we've had a higher running rate on our fixed income portfolio. At the end of 2018 the running yield was 3.3%. And so obviously that's higher than it has been in previous years. On top of that, during the six months we've had a number of mark-to-market gains as the yields have reduced over time and that has led to a mark-to-market positive impact on our profit and loss account.

At the -- after six months of that we are at a running yield of 2.4%, so almost 1% down on where we were six months ago. So whilst that has helped in the first half of the year, it's important to note that going forward our expectation from our core portfolio has reduced compared to six months ago.

So that's it, the 85% of our core portfolio. In our capital growth assets, we've also seen really good performance within those areas and all areas of our portfolio have seen improvements in return in the first half of the year. Whilst it doesn't look like much has changed over the six months, it's worth noting Stuart, who stood at the back there, has made some really good tactical decisions during that period in order to get some really good return out of that section of our portfolio. So I thank Stuart for my first interim presentation for the work that him and his team has done.

So, if we go onto reserve releases, you'll have all noticed that the first half of 2019 is lower than you would normally expect from Beazley. Now, reserve releases have continued, albeit at lower rate from four of our divisions, but they have been offset by some strengthening in our reinsurance division and in our marine division. And Andrew already mentioned that the loss creep within a few of our catastrophes, in particular typhoon Jebi and one of the wildfires, along with some strengthening in our risk aggregates excess policies within the reinsurance book has led to a strengthening during the first half.

Within marine, there's been lots of positivity within marine. The thing that has made the difference in the first half of the year is that US trucking portfolio that we started to write in 2016 has performed worse than we were initially expecting, and that has led to some strengthening within that book, which has affected the overall reserve releases within marine.

If I now go to the graph, that you all know that I'm very familiar with. So just to remind everyone, this graph compares the reserves that we hold to a ground up actuarial number, which in itself has some prudence within it. And what it aims to show is that we reserve a consistent margin over time at Beazley.

So, obviously over the last couple of years everyone will be familiar with the fact that we are towards the bottom end of this range, and that's because of the claims activity that we've been mentioning for a number of years now, and we've definitely seen that continue in the first half of the year. Along with when we have catastrophes there is an effect on this graph which subdued the margins somewhat.

The other thing that happens at the half year, Jahan, who's replaced me as Group Actuary has an allowance for the catastrophes that we could have in the second half of the year as we enter the wind season and that should unwind over time as we go through the catastrophe period of the second half of the year.

So, as we get more rate, as Andrew has already mentioned 5% year-to-date, along with the underwriting action we're taking to areas where we're seeing more claims, the overall actuarial numbers should update for that. That takes some time to do, and we are working hard to continue improvement within the underwriting area. During that period we are continuing to open our loss ratios, particularly in our SL and CyEx divisions at a higher level similar to what we did in 2018 to ensure that we have the level of prudence that we are used to at Beazley.

And finally, talking about capital. So, there's a few ways we monitor capital internally. The main way that we look at capital is with reference to the Lloyd's economic capital requirement or the ECR. And we have a target range of 15% to 25% above that measure. So, we expect -- it's not finalized yet, but our expectation is to be in the center of that range at the half year. And this is supporting our growth that we grew by 12% last year. We've grown by 12% year-to-date. And we are -- given that we're expecting the rate environment to continue, we are supporting a great deal of growth at the moment within our capital.

And so, it's really good that we're in this position, so we can continue to grow as we see the opportunities come from the market. We also continue to have the letter-of-credit facility that's unutilized, but there if we need it. In terms of debt, we have a retail bond that we're planning to redeem in September. And we're currently considering new debt issuance in the second half of the year. So, on that note, I'll pass over to Lou Ann.

Lou Ann Layton

Thanks, Sally. Good morning, everyone. Andrew asked me to come here today, and talk about the role of broker relations at Beazley. Before, I do that, as Andrew mentioned, I'm new to Beazley, I've been here all of eight months. Prior to that, I had a 31 year career at Marsh, so I was Beazley's client for many, many years. I started out at Marsh as a D&O broker. And the last third of my career I spent running P&Ls in the geography both in the West and in the South. So, I'm very familiar with the clients across the US and Beazley products.

The role of broker relations at Beazley was started in 2010. And really our main remit is to -- the next slide, I guess, our remit is really to develop the close relationships with our broker partners, to understand how they want to do business and make sure that our distribution strategy evolves to meet their needs. Can we have the next -- oh sorry. I get an F in instructions. Sorry. Okay. And there you go. Sorry. Thank you for your help. I appreciate it. So, really as I talked about, it is our job to develop those long relation --

strong relationships. We work with the executive team, the underwriters and product leaders to make sure they have the access to all the brokers that we're working with.

As we think about footprint at Beazley, in the United States I think you know we hit our $1 billion revenue mark last year, which was very exciting. And in order to continue that growth trajectory, we're building out our offices in Boston and Houston, which means we're putting in more underwriters into those offices, and we are opening offices in Seattle and Denver Colorado. At the hour we will add people to those offices such that we can open these new avenues of distribution, making new relationships with the brokers in those communities.

I did note cross-sell on here. Cross-sell is an important part of the Beazley growth strategy. At Beazley, our underwriters are experts in what they underwrite. And in BR we are to be not experts, but have a deep knowledge of all the products at Beazley, so that when we meet with our broker partners we can uncover areas where we might not be currently serving that broker or the client community. As you probably know the brokerage community has been organizing more around industry, which really plays to our strengths in that when we sat down with somebody who's focused on a particular industry, we can talk about all the products and services that Beazley can offer that particular industry.

And finally, we spend a lot of time not just talking to the brokers, but also our clients. And in these conversations we uncover new areas of risk to them or risks that they have that are emerging that aren't yet insured. And I would say that a lot of the innovation at Beazley comes through and out of these conversations with our clients.

Turning to technology. Technology is playing an increasingly important role, not just in underwriting but in brokerage and the insurance industry as a whole. It's providing us with faster and more efficiencies, but it's also allowing us to avoid what I would call duplication of tasks, reducing human error, and giving us platforms to trade that we haven't traded before. We look at it at Beazley as bringing what I call a special -- specialty underwriting expertise to the lower end of the risk scale, because we can do it through technology. And we're doing that across the global markets. And while efficiency is a strategy across the United States, Europe and other places, it is particularly important in London that we drive a more efficient market.

And that's where you're going to begin to see a greater bifurcation between the lead and following market. As you probably know, the -- historically the following markets are in the same amount of money or relatively the same as lead markets, even though the lead underwriting -- underwriters have more responsibility in the underwriting process as well as the claims process. And so to be more efficient about that, we set up Smart Tracker or Syndicate 5623, which is strictly a following market. It is to lower the cost of insurance, to be more efficient and in-turn pass those cost savings off to our clients. You will see us have more digitalization, not just in that Smart Tracker, but also the type of products that we put on our technology platform called MyBeazley. We are putting more products on there to serve that smaller end of the risk platform today.

And then finally, I would say that insurtech plays a very important role, not just for us the underwriting community, but also the brokerage community. And we see them bringing new solutions to the entire value -- insurance value chain. And Beazley is taking advantage of that and we've invested in two insurtech funds, Sandbox and Eos.

Let me, switch gears and talk about broker consolidation, as we do see consolidation going on in the broker community every year. I'd like to maybe set that into some kind of perspective in that, despite consolidation there is quite a bit of competition in the brokerage space. Today, there are 315 brokers at Lloyd's, and compared to 226 in 2015, so, there's actually been an increase. And if you add in the entire UK market, you get 2,000 brokers. Compare that to the United States, where there's 5,300 brokerage firms today. At Beazley, you might be surprised but we trade with just 485 firms. So there's a lot of opportunity for us still.

And when you're talking about consolidation, about six years ago, Beazley did its own consolidation by reducing the number of partners that we deal with. We almost halved the number of partners that we trade with. We did that because as a small specialty broker you can't be all things to all people. So, we try to pick those brokers whose product mix align more with our products. But, when acquisitions do occur, BR's job is to create new relationships, understand the new management team and really try to understand if there's changes in their overall placement strategy so that we ensure that we're evolving to work with them. We also create new broker appointments, as new brokers emerge onto the landscape.

I guess, you can't talk about consolidation without talking about increased pressure on commission. I'm on the other side of the table now, and I can say I feel it every day. There's an increased need by the brokers to have us pay them more money. So, I don't -- we don't see that just in consolidation. There are other reasons that brokers ask us for more commissions. It could be uniqueness of risk, the total market capacity, the market itself. There are a lot of reasons that they ask us to pay more commissions. At Beazley, I think we've always paid very fairly to our brokerage community, and of course, we follow the protocol set forth by Lloyd's.

I also wanted to mention that there isn't an over reliance on one intermediary, because that tends to be a worry when we see consolidation in the industry. I'd already mentioned that we have been paring back the number of relationships that we have, but 69% of Beazley's business comes from 10 brokers. But not one broker has a high concentration in one product line. So, while we trade with a lot, our 10 partners give us 69% of that business with a wide spread of the products that they write with us.

And then lastly, I think it's important to note that when there is consolidation, not only are we building new relationships with our brokers, we actually get access to new clients, clients that weren't previously exposed to Beazley because their broker did not have a relationship with us or wasn't trading with us in any major way. So, it does create opportunities for new clients as well as new brokers.

So, now that I've given you Beazley's thoughts on the brokerage community, I thought I'd just spend a few seconds here on giving you some feedback that we get directly from our broker partners. On an annual basis, we send out a survey to some 16,000 individual brokers to get their thoughts on how we're doing as a broker compared to our competitors. This survey provides us a wealth of information, I'd like to say it finds our blind spots. It uncovers things that we might not even know about ourselves, even though, I think we do a good job of listening to our brokers. You won't be surprised to know that different things matter to different brokers, not just brokerage firms, but brokers within a brokerage firm and it does vary by geography.

The three things that do matter to all our brokers though are claims, expertise and service. And fortunately, we rate high in all three of those. In fact, on our claims, survey results have been the highest over the years. And that gives us great pride at Beazley because we really have a commitment to paying promptly and fairly and our brokers say we are doing that.

Underwriting expertise is also very important. In fact it's one of the most important things that, from the London Brokerage Community, it ranked second in the US and Canada. But expertise is extremely important to all the brokers. And there again we rate very high. I like to think that's a great source of pride, because I think our whole identity is wrapped up in our ability to underwrite and understand unique risks. And lastly, service and responsiveness is still important to the brokers. It always is. And in fact when brokers write in on the survey, they write most about our responsiveness and service.

So, hopefully I've given you a glimpse into the BR role at Beazley. I hope it gives you a better understanding. But if I was really to think about it, I would hope that you more importantly leave here with a few thoughts that I've given you today. And one is, technology is extremely important and it will be an enabler for Beazley to become more efficient in the marketplace. I look at broker consolidation or we do as more of an opportunity than a threat, because we do think we find more relationships have greater trading partners with our brokerage community as well as access to new clients. And then lastly, you can be sure we'll work -- continually work hard to earn high marks on claims and underwriting. Thank you.

David Horton {BIO 5697110 <GO>}

Thanks for that, Lou Ann. So, let's end with a brief look at the outlook. So, looking at the rates, and we've got the chart -- rate change since 2015, and you can see on the chart how rates decreased for the first couple of years, 2015 to 2017. And then last year we started seeing rates coming back and this year an acceleration, as we mentioned earlier, of rate increases. Of course, our aim is to keep the dotted line, which is the total portfolio as close to, if possibly above the 100% mark. And we try to re-balance the portfolio each year through the business planning process to make the most of those lines of business where the rating in our view is better, and hold back on those lines of business which at this point in time are rated worse.

In 2019, you can see the pink line, the top one, which is our property division, not surprisingly responding to a number of years of rate decreases, the impact of the catastrophe losses and other losses in that property division in 2017 and '18, and not having a profitable position. This year large rate increases, especially in the large risk open market portfolio. And I think it's an interesting thing, Adrian is the new Chief Underwriting Officer. We're trying to grow that division, but I think we still got to be quite cautious with some of these lines of business, but is the rating good enough yet to really put your foot to the floor and grow a lot. And I think we're growing it carefully and thoughtfully as we see the rate increase. And the rate of rate increase in that line of business is accelerating, which is good, and we are looking at how we can grow it further into 2020.

Other lines of business have responded as well. But you can see the marine division is still below the 100% mark it was in 2015. So although we have seen rate increases the blue line in hull and aviation, it's still not back to where it was in 2015. Again, seeing some growth in that area, but possibly more in the future. Reinsurance, which is the blue line, has responded to the losses in 2017 and '18, which is the royal blue line. The black line continues to edge down. I think we've ever shown that line not edged down in the time I've been at Beazley and it has the terrorism book in there, it's obviously not going down as much as it was which is flattening, and haven't been major changes in political risk or contingency because haven't been major losses in political risk and contingency, which are the other two areas of business in that as well as the accident and health book, in the US and here in London.

So, overall outlook combined continued double-digit growth. So we're expecting to achieve double-digit growth. I think at the beginning of the year we were sort of high single-digit, maybe 10%. But now we're more confident of achieving the double-digit growth for 2019, as we've seen the rate increase being greater than we're originally planning for. The 5% is higher than our original plan. We expect the combined ratio to be in the high 90s for 2019, and that's driven by having 100% in the first half. And as Sally said, reserving prudently as we have seen some claims inflation in some of our books and we want to ensure that those book are performing would and want to reserve prudently and release those reserves in the future, if they perform as well as we expect. Sally also mentioned the running yield of 2.4% in the book, so it would be a major surprise to achieve another $170 million of investment income in the second half. Our expectation it will be a 1.2% yield on the book we have.

We are very supportive of Lloyd's prospectus. So Lloyd's has come up with a Future of Lloyd's prospectus. We've got six key initiatives in there. They are very aligned to the Beazley initiatives, particularly the fastest. Market underwriting which Adrian and Ian Fantozzi are running, and our Beazley Digital, which James Eaton and Andrew Pryde are running, looking at data and technology to improve our underwriting in both the large risk business and the small risk business, and the claims that go with those business lines. So, Lloyd's has two initiatives, which we are very aligned to that. We also have one around claims, which is, as Lou Ann has pointed out, incredibly important to our brokers and our insureds. So, we're very supportive of the Lloyd's prospectus and many of us are working closely with them on their initiatives.

And finally, we do believe that this pricing discipline is going to stay with us over a period of time. If we look back over the past five or six years, there've been individual lines of business that have lost money, and rate increases have come in those lines of business for a very transient point of view until more capacities come in. I think this is more market-wide whether it is profitability issues within the marketplace, and some capacity issues in the marketplace, and therefore expectation that rate rises are going to continue through 2019 and into 2020.

We are open to questions. There is a microphone. Say who you are and where you're from, and we'll field the questions.

Questions And Answers

A - David Horton {BIO 5697110 <GO>}

(Question And Answer)

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. It's Kamran Hossain from RBC. First question just is on kind of the rating environment. So out into Q1 you pointed out that rate rises are now growing with 3%, now they're 4% -- then they were 4% at the end of May. Now they're 5%. So it suggests pretty kind of spectacular increase in June. Could you maybe talk through kind of what we're thinking about or what's going on there? Is this just kind of property D&F just going through the refill? And any color around that?

Second question is on the CAT assumption, baked into the reserve surplus just indications of kind of dollar-million amount or kind of percentage. So if we get a light H2 what that looks like?

And then the final question, just what's a good starting point for the combined ratio if we take that half year 100%? Or how should we try and normalize that? Thanks.

A - David Horton {BIO 5697110 <GO>}

Okay. So I'll do the easy questions in there, and I'm sure Sally will have a go at the more challenging ones. Rate rises, I think property D&F of the largest property is a good place to start, because we tend to write more in the middle of the year than we do at the beginning of the year, so it is having a bigger impact on the overall rating position in total. And we are seeing good rate rises in the 10% to 20% mark for the property D&F book, which is great. We are also seeing good rate rises in other parts of our liability book, CyEx book, marine and aviation. So I think we will continue to see that. It is the pace of change is increasing. And it's taking a while for the losses to come through. It takes a while for people to recognize the losses are there, I think we're generally quite quick at recognizing claims coming through. So we have good information about when we're seeing claims. And ideally we would try to move the market more quickly than the market moves. And of course, we can't move it by ourselves. So there's definitely that.

Second question was on...

A - Sally Lake {BIO 20925273 <GO>}

I'll probably take it out from now on. So, the CAT assumption, we don't talk about dollars because the problem we're talking about in isolation is it's not the only thing that happened. So, if nothing else changed and we had absolutely no CAT's we would drift back into the -- more into the middle of the range. That will never happen because other things happen, and it really depends on the claims environment in a broader sense than CAT as well. So you're right to think about it in those terms, but that's not the only thing that will affect the reserving graph.

In terms of combined long-term, it's a question I've been asked a lot and it's a difficult one to put a number on. It depends on how long this momentum continues in terms of rate. It also depends on what happens within the claims environment. So there's been a lot of press recently around claims inflation affecting different places in different ways. And the amount, you're right, we can talk to you for hours about it if you have the time on that one. Depending on how that goes will depend on how the combined ratio moves. But obviously, we're not aiming to be 100%. We want to be back to a more normalized view. And there are various ways we can do that, rate being one, underwriting action, another growing into the areas that we think are profitable and also watching our expenses and doing things there. So there's lots of things happening at the moment and so I think it's quite early to pin down a long-term.

A - David Horton {BIO 5697110 <GO>}

I think we still -- I mean, I agree with that. We still have the long-term plan of being in the low 90s combined, which is what we've done over a number of years, so below 90s. There's no reason, there's nothing we've fundamentally seen within the margins of insurance, which means below 90s can't be achieved. We've got to balance the portfolio to achieve it.

Q - Andreas van Embden {BIO 1795530 <GO>}

Andreas van Embden, Peel Hunt. Just focusing on the specialty lines casualty book, you mentioned that on these classes, you're opening higher. And between 2014 and 2018 you were opening to the -- in the mid-60s. Before that you were opening in the low 70s. So, if I look at 2018, it was 66. How do you open at the first half 2019? And the trajectory towards the low 70s? Or are you settling or happy where you are? On the rates.

A - David Horton {BIO 5697110 <GO>}

This is in specialty lines book as opposed to the CyEx book?

Q - Andreas van Embden {BIO 1795530 <GO>}

Excluding cyber, excluding...

A - Sally Lake {BIO 20925273 <GO>}

Yes, yes

Q - Andreas van Embden {BIO 1795530 <GO>}

The rate increases of 7% in specialty lines, it was quite high sort of acceleration in those rates. Are they covering claims inflation on the specialty lines book? And in which classes are those rate increases more pronounced? And finally the 102% combined ratio in specialty lines, what is driving down the underwriting profitability? And what are you doing to sort of correct that? Thanks.

A - David Horton {BIO 5697110 <GO>}

So I would say the rate increase in specialty line is mainly being driven by healthcare in Lloyd's where Lloyd's has been quite a challenged class for a number of years and now we're seeing the market move more positively. Also as we mentioned earlier on, seeing losses in healthcare, so that is seeing good rate increases. So I would say those are the two main areas that are moving the specialty lines. We're opening the specialty lines. You talked about the 102% combined ratio with the specialty lines, we're opening in our view relatively conservatively, although we need to come back to the opening loss ratio question which links into that, isn't it? So our view is we're opening SL underlying above 100%, and that's why it gives at 102% overall combined at this point in time.

Q - Andreas van Embden {BIO 1795530 <GO>}

The first comparison was between '14 and '18 because we didn't have '14 right now.

A - Sally Lake {BIO 20925273 <GO>}

So what -- you're looking at the new loss development table split between SL and CyEx, aren't you? Yes. So there's a few. Obviously we didn't run the business split out back then, and so the split has led to a few areas that wouldn't necessarily have happened if we were running it separately. I can pick that up with you afterwards. But if you remember, we've always been looking at SL, as we call it SL old together. Now we split it out. There were a few numbers that look slightly odd. Well, I'll pick it up afterwards. But I would say in terms of the trajectory of how things have moved over time, we moved SL and CyEx together last year upwards. And so I would probably look at SL and CyEx combined together last year if you're making a comparison to how we're opening this year versus last to avoid any intricacies of the split, because we didn't have those split out separately.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi, sir. Andrew Ritchie from Autonomous. Where to start? Some of the areas that you've seen loss creep or you've added to reserves, are they kind of a limit loss position now? Or maybe just give us a bit of color if there's further deterioration what would the impact be? I guess, sort of I'm a bit confused on this loss pick discussion, I guess just to keep it simple, do you feel both in the CyEx book, mostly the x bit of the side I guess is where the loss trends are, and then the specialty book that your current loss picks at the half year reflect because they've gone up since the full year, the current uncertain claims environment. I guess that's why you're holding in that. Just to confirm that.

On the debt issue, I guess your wording is deliberately vague on timing. I mean, given where spreads are and where yields are. It would seem like a great time to do it, but maybe just clarify why you're being vague on timing.

Finally, asset allocation, your allocation to high yield bonds went up a lot in the first half. I appreciate you took some risk out from other parts of the book, but maybe just clarify what you're doing there.

And finally for Lou Ann, is technology an opportunity to disintermediate brokers in some ways, in some new facilities, particularly in the small commercial side? I mean the kind of brokers, put a lot of the kind of growth areas on commercial is more kind of online agents rather than brokers. So maybe talk about disintermediation opportunity on technology? Thanks.

A - David Horton {BIO 5697110 <GO>}

Shall I pick that one first or do you want to pick?

A - Lou Ann Layton

Yes, I'll pick it up first, then my answer doesn't have to be as robust, because we won't have time to think about it. Disintermediation is, when you talk about technology those two words I guess go together. I still think there's a place in the value chain for everyone. I just think we all have to get more efficient at it. So I do think things will improve. I don't -- you're going to have online insurance traded that way that might not require the intermediary. But I think in the business that we do here at Beazley, there will be a role for the broker and the underwriter even with the advances of technology.

A - Nick Hayes {BIO 20618229 <GO>}

The question on the loss ratio of specialty lines. I think as you can see we've sort of opened more conservatively than last year, and we are comfortable they are picking up the impact of claims inflation in them I think that's why we have this underlying combined ratio for SL. If you take that at prior year reserve releases, quite a long way over 100. Our view is at some point in the future our plan is at some point in the future those claims will prove to be conservative and the releases will not really come through and that's the plan we have.

A - Sally Lake {BIO 20925273 <GO>}

On the large losses, so the main one we spoke about was Jebi and any further deterioration that would mainly go to our reinsurers now. So that's one thing to note. On the debt -- oh, trucking

A - David Horton {BIO 5697110 <GO>}

Yes, tucking, so trucking that business is going to stop at the end of August. So, our view is we're coming out of US tucking.

A - Sally Lake {BIO 20925273 <GO>}

It was one portfolio that we're out. So, it's one situation on that. On the debt, we've got a retail bond redeeming in September, so, we have been talking about second half of the year. The reason we haven't put a date on it is because we haven't put an exact date on exactly the time now. But I see your point on timing would be sooner rather than later and would be a good idea. (Multiple speakers)

A - Nick Hayes {BIO 20618229 <GO>}

So the aim is to refinance the debt. It's just a question of quantum, how, when. And then there was one on asset allocation of high yield bonds. I can't remember by the half year where we've withdrawn from the loan portfolio. We had so -- we had a loan portfolio which we've removed from and then moved into high yield bonds. I don't think we can see that in the chart. But that's in effect what we've done in the first half. So we have some senior debt in there or senior loans which we've got rid of from a fund and put it into high yield.

A - Sally Lake {BIO 20925273 <GO>}

And that, the senior debt, the senior secured loans have done well for us in the past, but just I think, currently we just think the asset class office has less value than others, so it's just a decision we made -- decision we made currently in the current market.

Q - Jonathan Urwin

Morning. Jonathan Urwin, UBS. Two quick ones. So firstly on your plan, assuming everything goes in line with your expectations, at what point would your reserve buffers approach the midpoint of the range? Secondly, if group pricing is at 5%, where is claims inflation?

A - David Horton {BIO 5697110 <GO>}

Will, you have a go at the first one?

A - Lou Ann Layton

Yes. So as I said earlier, it depends on what happens in the claims. If we have -- if Jahan looks at the claims in the next half year and feels better, then the actuarial comes down. We have no CAT's then. It's likely that by the end of the year we will move upwards. But there's lots of things that will happen, that could happen within that. So we could be as early as the end of the year. Conversely, it could be within next year, depending on the claims environment. I don't want to promise you something and then say that it won't happen. But we're definitely taking the action that we're taking in terms of opening higher. And it's done in part because of the increased claims activity and to ensure that we maintain our prudent level.

Q - Jonathan Urwin

So I guess the message on that is you hope this enhanced currently your prudence will get you towards middle of the range on a 12 to 24 month view roughly?

A - Sally Lake {BIO 20925273 <GO>}

Yes.

A - Ian Fantozzi {BIO 17550035 <GO>}

The claims inflation question. I'm very wary about that. I'm going to sound like someone who's trying to avoid the question, so I will try and answer it. I wish I could say claims inflation was three when we've got rate increase of 5%. But it just varies by line of business. So certain lines of business have a sort of RPI type claims inflation in which we will build into the plan. But a lot of the liability book in CyEx doesn't have claims inflation like that. So it depends on what quarter awards are given. Are the plaintiff borrowers acting in the US and so on, and you can get step change of the claims running along at 1x and will suddenly you're paying at claims of 150% of x or 2x.

Now, what we try to do, when agent does a business planning, is build in a reasonable number of claims inflation for that intra pricing model and it gives us an idea of what price we should charge and what reserve we should plan at. And then we can only see with hindsight whether we actually achieved that. And if we didn't achieve it we may need to put prices up. So, it's very hard to do that. The key in my view, in the claims inflation and liability book is getting good information from your claims managers to feed into underwriters in a real-time basis as you see the potential step change in claims inflation. Because often you will just see nothing, nothing, nothing and all of a sudden it steps up. So it's not that simple to do. We need to have this claims and underwriting link of information, being absolutely core to what we do and respond as quickly as we can when we see it.

Q - Jonathan Urwin

Thank you.

Q - Joanna Parsons {BIO 1558226 <GO>}

Joanna Parsons at Canaccord. One quick question from me. How is the European business developing? If you could give us a bit of color as to where you are in terms of your plans and expectations for the year-end? Thank you

A - David Horton {BIO 5697110 <GO>}

Yes. So I think European business is doing really well. It's in line with what we're planning to do. So we've got the offices up and running in Barcelona, Paris and in Munich mainly, plus the regional UK business in Birmingham. We're doing well on recruiting. It always takes a bit of time to recruit new underwriters. When we opened our office in Barcelona you have to persuade someone to actually be the first underwriter there, and we've done very well with the recruitment we've done. Jo. So from a people point of view it's doing well. From a premium point of view it's doing pretty well. Like everything we would love to have more technology supporting the underwriters as quickly as they would like, which is always instantaneous. And we're doing very well at launching new products on technology as Lou Ann was talking about. But generally it's in line with where we'd expect to be.

It's always going to be tougher to grow those markets, in our view, than the US, because the markets are dominated by large local competitors. We're not as well-known there. I was having a conversation in Paris recently. There is always concern when you go into a new country that we're going to withdraw. And someone was saying that company A went in and withdrew three and a half years later. Well, we can't prove that's not going to happen until we've gone through the time. So we need to prove ourselves with time. In the case of Munich and Paris we've been there over 10 years. In the case of Barcelona we haven't yet. But we're there for a long term and we're doing well with the people we've got and the product is appreciated.

Q - Nicholas Johnson {BIO 1774629 <GO>}

Hi, morning, Nick Johnson from Numis. A couple of questions for me, just following on from Jonny's question really, related to that. Over what timeframe should we expect reserve releases to get back to normal levels? I mean, given the sort of guidance at over ten weeks should get back to the middle of the range on reserve prudence, are those two competing forces. So question is, over what time frame should reserve releases get back to more normalized levels?

And then the second question is on OpEx. I think we're slightly down in the first half this year despite the top-line growth. Just wondered if there's any one-off factors in the operational expenses in the first half and what the underlying operational expense growth rate is? Thank you.

A - David Horton {BIO 5697110 <GO>}

Okay. So the -- on the first one -- and the first one, the theory, Nick, as you'll be aware, is if we get the reserve strength into the middle of the range the reserve releases should normalize. So in theory if we get the reserves release in the middle of the range this year, the reserve release will normalize next year. Because the whole logic of being the 5% to 10% is what we are showing is we're not rating the reserves to give the reserve releases. So if everything prudently reserved, at the same sort of level, the reserve releases should continue and that is the logic of the business model. So that's the theory. Now of course other things can change, and that's what Sally was outlining. But our aim this year is to get the middle of range, assuming we have an average CAT year and everything else is average from '14. Things are rarely average and therefore reserve releases should resume at the same level within the year. The operational expenses.

A - Sally Lake {BIO 20925273 <GO>}

Yes. So the expense ratio as we reported it, at 38% for the half year, so it was 39% at the full year. We've grown. We're still continuing our focus on expenses and so I would suggest similar to last year for expenses for this -- for the full year at this point in time.

A - David Horton {BIO 5697110 <GO>}

I mean, if you're growing the top line at 10% to 12 %, it's relatively easy to get the expense ratio down unless you manage to grow -- well, we are quite good at growing expenses, but quite easy to get your expense ratio down if you can get your premiums growing quicker than expenses.

Q - Nicholas Johnson {BIO 1774629 <GO>}

In dollar terms first half operating expenses?

A - David Horton {BIO 5697110 <GO>}

I think that must be it. Is it an FX issue? We would need to look at the FX impact of that, because sterling expenses were at a low dollar rate.

Q - Edward Morris {BIO 16274236 <GO>}

Thank you. Ed Morris, J.P. Morgan. Can you just talk a little bit more about capital, please? I think at the moment, you said you are at 19% surplus to ECR, I believe in your presentation you're suggesting that was it by year-end you suppose -- you expect to be back at the midpoint? I think you said half year but just to trying understanding the combination of growth and then the debt issuance.

And then thinking more about flexibility. If we were to have another expensive CAT year, would you view 250 million of debt issuance is the upper end of what you'd like to do? I think that would put you at about 25% in terms of leverage multiple. So what are the sort of sources of flexibility are there?

And then the second question is really just about interest rates and the impact on pricing. Has any of the price increase that you've achieved been a reflection of the fact that you are unable to save much on the interest rates? Or is it really been linked to the loss environment? Thank you.

A - Sally Lake {BIO 20925273 <GO>}

So, on the capital position, so at the half year capital position is based on what we expect the it does allow for some things for the year-end, so it does have a view as to how we're going to grow next year within it, but it assumes current debt. So it doesn't take any assumption for what we're going to do with debt in the second half of the year. So there's some year-end but some current. Does that answer your question about kind of the position of it? Okay.

Q - Edward Morris {BIO 16274236 <GO>}

You suggested that you were -- you're expecting around the midpoint at half year, given that you have a number of.

A - Sally Lake {BIO 20925273 <GO>}

Yes. Yes. Sorry, 19 being about the midpoint. Sorry. I think I mentioned the 19%. So yes, that's our expectation for the half year before we do anything debt related. In terms of debt issuance, so I don't -- we haven't -- obviously, we're doing the work in the second half of the year. But we're looking at various amounts of debt at the moment. So we did $250 million three years ago. But depending on what happens when we go-to-market et cetera, we'll see what happens there. But we did $250 million three years ago if you're looking at a model for the end of the year.

A - David Horton {BIO 5697110 <GO>}

I don't think -- on the interest -- I don't think the interest rates are really having a major impact on pricing, I am open to Adrian to disagree with that. So because in theory, if interest rates were rising over the past year or two, pricing should come down. And as interest rates start falling prices should go up. But I just think they're too marginal for the pricing of insurance to respond to it. The pricing of insurance is more driven by the claims rather than the interest rate.

A - Sally Lake {BIO 20925273 <GO>}

And just quickly to answer your question on the flexibilities around capital. So I mentioned the leaser of credit that's renewing this week on the same terms as we've had in the past. Any point in time we can update those -- go back and update those terms. And that's the other flexibility that we haven't utilized, but very open to doing so should the need arise in terms of growth or anything else.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi, sorry. It's me again. I'm Andrew Ritchie. Two very quick follow-ups. If we have a re-run of I mean, never the same types of losses of sort of the active claims environment on the short term side in the second half of this year, can you just remind us where you've got less exposure? I think the risk excess book you implied you stopped writing, but I don't know if you're off risk that or when you stop writing it?

And I guess, property book would be a similar exposure apart from in construction. I don't know if you've taken down any other exposures in reinsurance. Just remind us, like a second half of this year versus what your exposure was running like as we went in to win season this time a ar ago

And the only other question I get, again for Lou Ann, sorry to come back on commission, this kind of your sort of presentation implied there's just an inevitable upward pressure on commission levels. I guess I still have an issue with why that should be the case, especially in a harder market when in theory your capacity is higher valued. And I guess I've always been a bit sort of fed up with this relentless rise in the commission ratio. What was actually going on? Is it a now more nuanced conversation about that and it's not an inevitability? Just a bit of color on that. Thanks.

A - David Horton {BIO 5697110 <GO>}

Okay. On the question of exposure, I think the main difference going in this season compared to last season is going to be the pricing difference. We have looked at certain classes within the property book, Adrian with Richard Montminy looking, and prior to that we're looking at various classes in '17 and '18 that we should -- we-underwrite out off within property. The construction book could potentially pick up some losses --. But January doesn't pick up that much. But you're right, we're out of construction low. A reasonable number of those risks may be still in our books because some of them are longer term anyway. So I think that's definitely mainly surprising. And I don't see it's the risk excess book being a dramatic change as we go into the wind storm season. There's a small change within that but not a massive change. So repricing issue rather than anything else, in my view, summary underwriting in '17 and '18 which had already been done.

A - Lou Ann Layton

On commissions, I guess I would say we'd probably share a bit of your view as to why there is the continued pressure. I think if you look at our double-digit growth and then you look at the growth of a brokerage firm, it's not -- it certainly isn't double-digits. They are trying to create growth and efficiencies. And as such one of the ways to grow is to increase their commissions. And so I just think there will be continued pressure on that. I mean, we look at 5623 where we're trying to create a cheaper way and an easier more efficient way to trade insurance and we think the commissions for that should be lower. But when we have business coming to us, from that they still want the same commissions that they would otherwise ask for the direct. So I think it's going to be changing philosophy and thinking as we think about how we place insurance and what that cost is. And I think there's -- it'll change hopefully over time, particularly with things such as technology enabling us to do things faster. Those costs should be cheaper and given back to the client, and hopefully that will occur. I don't see them letting up anytime soon that's how I would ...

Q - Joanna Parsons {BIO 1558226 <GO>}

Joanna Parsons, again. Question on cyber. There's been quite a lot of talk about the downward pressure on rates in cyber. And I wondered you say you're not giving us the breakdown of the loss ratio as yet. Hopefully, that will come one day. But are you seeing your loss ratio rising as a result of the changes in the market, the increased claims activity, the downward pressure on rates? And how do you feel generally about the product at this moment in time?

A - David Horton {BIO 5697110 <GO>}

Okay. So I think we feel good about it. There's still new buyers coming in, both in the US and outside of the US, which is great. There's definitely a lot more supply than it has been in previous years. So rating is probably flattish in the cyber book in total, maybe down a bit in certain areas. It does vary between large, mid and small, and our focus tends to be on the mid and small. My view in total is profitability is holding up in the mid and small book pretty well. So I haven't -- we haven't seen a major change in the profitability of that book and it's still running well for us.

Q - Joanna Parsons {BIO 1558226 <GO>}

Thank you. Sorry, I just wanted to ask, Munich Re you've got the relationship with them. They've been making quite a lot of noise about going off doing their own thing. That relationship with them.

A - David Horton {BIO 5697110 <GO>}

In cyber or in other things?

Q - Joanna Parsons {BIO 1558226 <GO>}

In cyber in particular, but I'm sure in other things too, but I'm talking specifically about cyber at the moment. Any threat to that relationship?

A - David Horton {BIO 5697110 <GO>}

It seems to be fine. The Munich Re relationship with us has been a 20 year one. It's quite a close relationship. And we...

Q - Joanna Parsons {BIO 1558226 <GO>}

On Cyber?

A - David Horton {BIO 5697110 <GO>}

No the whole relationship with Munich Re. The relationship with Munich Re is much broader than just purely cyber. So I see the cyber relationship as still being a strong one.

A - Sally Lake {BIO 20925273 <GO>}

Probably we're near to 11. So it's probably -- the time.

A - David Horton {BIO 5697110 <GO>}

Yes. Great. It's good to see everybody. Thank you for coming this morning.

A - Sally Lake {BIO 20925273 <GO>}

Thank you.