Q4 2016 Earnings Call

Company Participants

- Inga Kristine Beale, Chief Executive Officer & Director
- John Parry, Finance Director
- Jon Hancock, Director of Performance Management

Other Participants

- Joanna T. Parsons, Analyst
- Rötger Franz, Analyst
- Will Hardcastle, Executive Director

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everybody, and welcome to the Lloyd's 2016 Financial Results Presentation. Joining us today, we have Inga Beale, Chief Executive Officer; John Parry, Chief Financial Officer; and Jon Hancock, Performance Management Director.

Inga is going to begin the presentation by taking you through the strategic and financial highlights of 2016. John Parry, who is then going to follow by taking you through the components of the results in more depth. And Inga will conclude by providing you with insights into Lloyd's plans and focus for 2017. And we have Jon Hancock on hand for the Q&A session.

At the end of the presentation, you will be invited to ask questions and for those listening remotely through the webcast, please use the Submit a Question icon. We ask that you state your name and organization before asking your question and please also note that this presentation is being recorded and will be posted on our website for the audio playback purposes.

I would now like to invite Inga Beale to begin the presentation.

Inga Kristine Beale

Thank you, Nicola, and welcome, everybody. Welcome to those of you who've joined us here in London and welcome all of those who've joined us by telephone. Vision 2025, most of you will be familiar with it, we launched it in 2012 and we've talked now for sometime about the eight key strategic policies under that.

We've been slightly developing our thinking in the last year and this is related very much to the work we're doing around looking at the corporation itself. So the corporation where – what is our goal in terms of the whole of the Lloyd's market? And we've come up with three key aspects. One of those is the protect aspect.

Now, that's very much all about the oversight we do, the sort of supervision, that shared responsibility for regulation that we have with the PRA and FCA here and in some other jurisdictions. And also importantly protecting the central fund, making sure that there's enough capital in the market and indeed potentially to support all the policyholder liabilities. So, that's very much protect aspect.

We're also very well aware that we provide a lot of services. We provide services within the corporation. We also assist with services that are provided across the broader market whether it's provided by outsourced providers, certain systems, and all the rest of it. So, we've put a couple of areas in there which is about the ease of doing business, predominantly a lot about the London market target operating model that I'll touch on in a moment.

But importantly about talent, we in the corporation have our Lloyd's University, we participate a lot in not only sort of technical education programs, but also providing more soft leadership skills and things to the market. So, we've got a certain element of providing services for the market.

And then, of course, we've got this promote aspect and that's all about making sure we've got increased licensing network around the world, that we can access those markets that are attractive when we see we've good opportunities for the future. It's also about making sure that Lloyd's keeps innovation at heart (03:23) we've been renowned for the innovation setting on the product side. And it's so important that we keep that reputation and so promotion and looking at innovation how we can promote that is an important aspect.

Also the brand, vitally important, and when we ask a lot of our capital providers, and particularly the trade players, why they bought in Lloyd's, it's for the brand, they know that Lloyd's brand is one of the strongest insurance brands in the world, and it is truly global, you can go almost anywhere in the world, mention Lloyd's of London and people know who are you talking about, and basically that is a crucial part of what attracts the capital here.

And we also do a lot of work in the corporate social responsibility space. And some of what we're focusing on in that area, we've done a lot of climate change work in the past, but actually we're going to be broadening that and looking at doing business responsibly and coming up with the appropriate responsible business policy here at the Lloyd's market. To simply put, we sort of look at this three Ps as the core essence of what we in the corporation do, and we've aligned our strategic priorities along with those.

Now if I just move on to think about what are the key things that we achieved last year in 2016, let's start on that market oversight piece. Now we knew that there was some worrying signs of our underwriting margins being reduced, combined ratios starting to move up. And so we had a greater focus, really looking at what are those poor performing areas, what are those poor performing products, what are those poor performing classes of business.

We then move in the poorest performing classes, we looked at the poorest performing underwriters within the Lloyd's market. And we have specific discussions and expectations from the underwriters in those areas to reduce their exposures in those areas. And we've also looked at the planning process being very diligent, as to what areas are you going to want to grow in and what justification is there for that being profitable. So, greater focus and I would have said in a very granular way, much more granular than we have done before, but looking at scenes (05:42) in problem areas across the entire market.

When it came to capital, Solvency II now well and truly embedded in the way we run our business, the way we integrate risk and risk appetites together with the capital modeling and that was a key piece of work last year. And we're also alongside, our vision 2025, which is about going into new markets and getting business from new markets, we've also been very keen to expand the geography and the diversity of the capital providers within Lloyd's. And I believe, we've had some success there as well with new capital providers from the new markets.

We look at global market access, I have to say following the referendum outcome, in June last year, we did have to change our priority areas a little bit, so a lot of our focus and (06:39) area for us, a lot of our focus has been on Brexit planning and we announced that we're going to Brussels for our EU subsidiary, we announced at this morning. So that did take up lot of the bandwidth, a lot of the resources, we have in the corporation. However, we are out in India to be up and running up from April, which is a major reinsurance renewal season in India and there are other markets that will be continuing to look at in the future.

But as we start to execute the Brexit plan and set up the subsidiary in the EU, that should also free up resources to start looking again more broadly at perhaps those continents that we haven't actually done much about yet, which is Africa. So while we're in South Africa and we've been there for a many, many years and we've got licensing in a few other countries, we haven't fundamentally looked at a strong strategy for Africa yet. So, once Brexit's up and running and being executed or ESAB (07:35) we'll be able to go into other new markets.

And then the last thing, that I wanted to focus on here was the ease of doing business. When I arrived here three years ago, there was a lot a skepticism about whether we can really modernize the Lloyd's market, the London market and I have to say, we've made terrific progress in those three years. I think it almost exceeding my expectations.

I don't think I could have imagined that last July we would have actually launched an electronic placing system in the Lloyd's market. We went live with terrorism in July, we added financial lines, professional and financial lines to that in November, we added marine this month, we will be adding new lines throughout the rest of this year. And that is going to have a fundamental impact on how business is going to be transacted, it's going to taking cost out. The idea is to have one touch data capture. So all of the different systems will talk to each other, no (08:32) risk information into underwriter systems from the brokers, that's the aim.

Now this is the start. But it's a very important start and we're working on other things such as automated premium and claims processing at the back-end. And I really believe we seem to have turned the corner, where the market has now said yes, this is required, this is necessary. And very importantly, we've got the brokers to work together. That some of the resistance or difficulties of the past, was because the brokers wanted to all be developing their own systems and now they've agreed we're going to have one system for this market. So I think huge progress there, but obviously still some work to do, but great progress.

And then the corporation operating model as I mentioned earlier, that's all about looking at how we structure the organization, the corporation, how we make sure we're all aligned behind those big three Ps, that we're doing the right things, we're not doing things that the market no longer wants, that superfluous services that people aren't requiring or even wanting anymore. But importantly, we are creating centers of expertise, we are creating shared services, which will take out costs. So, we've got cost savings for this year and into the future in the heart of the corporation as well. There we've got to play our part in the pressure on costs that there are across the entire market and for the carrier. So we're doing our piece and we decreased the subscription rate for managing agents by 10%. Again to play our part in the pressure on costs.

Okay. So, moving onto the next slide, slide 5. Here are the financial highlights. So, profit, the same number as a year ago. However, capital resources have gone up and revenues have gone up. So by anyone who can do anything formats (10:34), that means a lower margin. And the return has gone down to 8.1% from 9.1% in the prior year.

And when we look further at the numbers and John Parry will take you through the numbers and will be breaking down the combined ratio which has gone up quite significantly. You're going to see a complete shift of source of that profit.

Last year, we had quite a big chunk of underwriting profit, as part of the profit number, with a smaller element of investment income. This year, or for 2016 it's reversed. Underwriting profit has fallen to below £500 million. Investment income has increased and there's quite a chunky FX impact on that as well. So you'll see that the sources of that profit are very different just in 2016 than they were in 2015 and I have to say there are some worrying numbers there in terms of what that combined ratio is doing.

Lloyd's is very, very strong. We're in an extremely strong position. You can see there by the fact that net resources have gone up quite significantly and that the Central Solvency Coverage ratio of 217%, very similar and flat on the prior year. So overall, still very financially strong. But we've got to start on picking some of those drivers of that profit in that combined ratio to really understand what's going on in the underlying business.

So to explore that a little bit more, I will now hand over to John Parry, who will take you through the detailed financials. Thank you.

John Parry {BIO 18896198 <GO>}

Thank you very much, Inga, and good morning, everyone. So the first slide 7 is really expanding upon those remarks from Inga to explain that this year's £2.1 billion is not the same as the 2015 £2.1 billion. As you can see on the left hand side for the first bar, the profit in 2015 was driven by underwriting performance, remarkably low instance of natural catastrophe claims and very significant releases from prior year's claims reserves.

Moving across, you can see the increase in major claims has reduced the current year or accident year profit by £1.1 billion. We have seen a reduction in the release from prior year's claims and we can talk about that in a moment, but then balanced by a significant increase in investment return as improvement in mark-to-market gains on fixed interest investments and a good performance on the relatively small proportion of equities that we hold increasing investment return by over £900 million year-on-year.

And then, a very significant foreign exchange gain in 2016 compared to a small loss in 2015. The reason for that is the market does hold a small surplus of U.S. dollars compared to liabilities or assets exceed liabilities, and that's slight over matching has given us rise to gains when you translate back into converted sterling given the movement in the dollar rate during the year to end the year at $1.24 to the pound. So the overall profit in 2016 or the underwriting contribution, as Inga has clearly marked, down to less than £500 million or £468 million.

Looking at the overall income statement, you can see the gross written premiums increased by 12% to just under £30 billion in 2016. The largest driver behind that is foreign exchange and we'll breakout the other moving parts in a moment. Net incurred claims will have the same foreign exchange impact, but they've also gone up through that increase in major claims and the reduction in the prior year reserve surplus.

Operating expenses have moved in line with net earned premiums and that is both on an acquisition costs and an admin expenses basis. Costs for Lloyd's are running at about just over 40% of net earned premium across those two drivers. So underwriting results of £468 million and then, you can see the investment gains on foreign exchange producing a overall profit of £2.1 billion.

On the premium movement, on slide 9, you see that the largest contributor to that the year-on-year increase in converted sterling is foreign exchange, increase of 10%. On our renewal book, which primarily (15:20) 0.75 of total, so the data is restricted to renewal business, we can say an overall price reduction of approximately 3% across all classes of business. That being balanced by some modest and controlled growth, small contribution from syndicates established in the last three years joining the platform and an increase of 4% for existing syndicates.

The largest single class increase is cyber, another example of Lloyd's innovation and leadership in developing the products that our clients and policyholders require, and so our cyber coverage is part of that sort of market-leading expertise of Lloyd's contributing to some of that growth to a £29.9 billion total in 2016.

It's a broad mix of business both by class and type, so we have both insurance and reinsurance business, not much movement year-on-year in that mix. We can see that reinsurance is approximately 31.5% of the total premium in Lloyd's. That has reduced slightly over time. If we go back five years or so, it was between 35% and 40%, and some of that really is the sign of pricing of where the price reductions have come through. There's been more pressure on some of those sort of property treaty lines in the last five years from the very high levels they were in the late 2000s and after the 2011 catastrophe experience.

Slide 11 breaks out the combined ratio. So starting on the left hand side, you can see the current accident year, excluding major claims, largely unchanged at 94%. That's made up of the attritional claims ratio of 53.3% and then acquisition costs of 26.6% and admin expenses of 14%. Acquisition costs will largely track your premium income, particularly by currency. Admin expenses will have a slight flattering because of the exchange movement, given that the syndicates will have a largely sterling cost base and yet they're attracting sort of overseas currency business. But overall, expense ratio is flat at 40.6% - more or less flat at 40.6%.

The real movement year-on-year and the other two drivers saw major claims and increased to 9.1% from a remarkably low 3.5% in 2015.

The third bar is the prior year reserve surplus, contributing 5.1% of the combined ratio in 2016. And again, I think when you compare it back to 2015, a release of 7.9% really did need an exceptional actual claims development compared to experience (18:03). We have still seen, in 2016, very good development in claims experience compared to projections.

One thing that did affect Lloyd's quite later on was the recent announcement of the change in the discount rate that will apply to UK liability claims (18:22) Ogden tables. That was a movement from a discount rate of positive 2.5% to a negative 0.75%, and maybe it was larger than most have anticipated.

That is going to affect the Lloyd's market. We estimate the impact at between £400 million and £500 million. A lot of that though has been absorbed within the margins that syndicates hold in their accounts above best estimate for this very sort of situation for unexpected claims experience. So these numbers will come through both in 2016 and in 2017.

So what did that do to that overall reserve surplus? We've got a release and we've also got Ogden. But actually on a high level when we look at the actual development of claims compared to projections, we don't see any material change in the surplus that we see centrally in the market. And in fact if you sum the view from the independent actuaries who applied on all reserves in the market, they also see the surplus in more or less the same place as it was 12 months ago. So we still remain very comfortable with both the process and the adequacy of reserves at Lloyd's.

But that movement year-on-year is driven by these two bars of the major claims and prior year reserve surplus. So you've seen that increase in major claims of 9.1% to the combined ratio, which now exceeds the prior year reserve release of 5.1%.

So, looking at the major claims that hit the Lloyd's market during 2016 totaling just under £2.1 billion. That actually puts us slightly above the long-term average for the first time since 2012. Two largest events with Hurricane Matthew in October 2016, claims net of reinsurance to Lloyd's estimated at £536 million. The second largest event would be wildfires in Alberta, Canada, Fort McMurray earlier in the year with the cost now of £388 million. There have been a series of other events during the year, particularly New Zealand earthquake later on in 2016 in aggregate, that's a further £1.1 billion giving us that £2.1 billion total compared to the rather low 2015 number of £724 million. By no means an exceptional cat year, but slightly above the long-term average.

Now looking at the performance by headline line of business. You can see from the left hand side, so this is ordered by net earned premium. So looking (21:04) at profit in reinsurance, but after accounting for releases from prior reserves. In fact, all of the lines of business on a reported first year, accident year including major claims coming in at over 100%, and that's really driving to the market messaging that we've been talking about during 2016 in Inga's opening remarks here, really is a strong focus for Lloyd's on both the expense and nutritional loss and the catastrophe exposure of the markets, given where market conditions currently are.

So that significant pressure on margin affected by the expenses and claims ratio, Mr. Hancock will have a busy 2017. So how do we compare against competitors? So we have a group of 11, which in aggregate is the best way to mirror of Lloyd's performance between insurance and reinsurance business in geographical spread.

It's an aggregate against an aggregate. In fact we all know that there's different performance in some of the those competitors, equally though in Lloyd's where we have businesses performing quite differently in 2016 depending on the line of business.

In totality though a small outperformance of just an 0.4% in 2016, it's down from previous years. And that's through that flit in the change in our major claims and prior year reserve leases compared to 2015 as a movement year-on-year.

But one of the real focus is for us is the expense cost. So, Lloyd's running a 40.6% of net earned premiums, that is higher than the average for our competitors and that is putting pressure on the underwriting and risk selection. Because of our distribution chain and how we access business, we need to compete (22:50) on risk selection to bear those additional costs. And the question for us in these current market conditions is that that's going to be the focus next year.

Investment return. So we did see a healthy increase in 2016 to £1.3 billion in the return of 2.2%. That's across all of the assets at Lloyd's, which are held in three places. The majority of assets are held at syndicate level in trust to pay future claims. Those portfolios are very much based around the cash and high quality fixed interest disposition. And those fixed interest investments are quite short duration, so it's a pretty conservative portfolio. But even at that short duration, you did see some mark-to-market gains as again there was a full – again in 2016 on yields giving some mark-to-market gains.

The central fund, which takes a longer term horizon made a very strong 5.6% investment return of £170 million. Overall though, the Lloyd's asset base remains a conservative disposition with just 12% in equity and other risk assets.

Looking at the total balance sheet, it's a highly liquid balance sheet, over £67 billion of cash and investments in a total assets that now exceed over £100 billion. Total net resources reaching nearly £29 billion or $36 billion, because one clear thing to bear in mind here is that there is a currency impact in these figures. The Lloyd's market, as explained earlier, holds a slight excess with U.S. dollars compared to its asset, but also matches its capital to its potential exposures, and that's throughout the chain of security.

The Central Fund also has exposure to U.S. dollar movement to match our solvency at potential exposures. So to preserve solvency coverage, we've actually made the Central Fund exposure to U.S. dollars, and that's also helped the large part of that exchange gain coming through the central assets too, but an increase in both members assets and central assets year-on-year. It's a very strong diversified capital base with investment across the trade industry from the U.S., Japan, Bermuda and the like with private capital still a valuable part of the market at 10% of the total.

Long-term metrics, so over the last five years, if you see the pre-tax profits reported, the number I'm pulling out here is that return on capital, and five year average of 12% and in fact over a 10-year period, nearly 13%. (25:46), I guess why is there such pressure on rating? These attractive returns to investors meant that there is an excessive capital in the industry, so an excess of supply over demand leading to that pressure on prices. But out of our five-year and 10-year average, a very strong performance across the Lloyd's.

Solvency coverage. We disclosed our Solvency II capital ratios first I think on our website back in January, ahead of doing a very successful Tier-2 debt issue with the capital markets. We managed to raise £300 million with onus of well over £2 billion, that's subscribing to that debt issue. But then for the first time, we're putting them out in our annual report. There are some detailed disclosures in there. For here, we've disclosed the two ratios, it's Lloyd's, it's a unique capital structure. So there are two measures of capital strength, the solvency capital ratio.

Firstly, for Lloyd's overall, the most comparable as though we were a unit reinsurance company, but clearly we're not. We do need to pass this test and this is a part of the capital base, where Lloyd's looks for capital efficiency. We want to be attractive to investors. So we require capital to ultimate as they are plus 35% uplift.

You will see on those two (27:05) ineligible assets. We hold substantial amounts of letters of credit from highly rated banks as good capital, but they are considered to be Tier-2 capital under Solvency II and the tiering test means nearly £2 billion of those assets are ineligible to count against that solvency ratio. Clearly on demand, they're translated into cash of Tier-1 asset. So we're comfortable with letters of credit held in the market and the counterparties they're provided by.

The other ratio we have is the Central Fund, and this is the cornerstone of Lloyd's Security. This is the basis on which we obtain our financial strength ratings, it underpins every policy issued by Lloyd's and our three rating agents, our rating remains stable and strong at A with A.M. Best, A+ with S&P and AA- with Finch.

We have a risk appetite to cover our central SCL 200%. And as you can see as at December, we were in excess of that with 217%. Two points on that, you can see how consistent that's been year-on-year despite a highly volatile movement in exchange rates and as attributed to the risk management by the market in matching capital to potentially expose it, so as we move the U.S. dollar, these numbers have increased in converted sterling but the solvency coverage is being preserved.

The second and final point is as of now there are no members requiring Central Fund support. We have no insolvent members in the market with any requirement of - undertakings from the Central Fund, first I'm going to have say that's since 2000.

With that, I'll hand back to Inga to conclude please.

Inga Kristine Beale

All right. Thank you, John. And now, just on the final slide, which is slide 22. And this is just to touch on really the focus for this year in terms of what the corporations (29:03). Those worrying trends in the combined ratio and the underlying losses means we're going to have a strong focus on market conditions on that oversight activity. We will continue to see what we can do in terms of analyzing the makeup of the market, see what are those troubling lines of business and take a production on those. But importantly, we're also going to have an increased focus on that cost line.

We've got the administrative costs obviously which we're addressing predominantly through the corporation operating model work that we're doing and the target operating model work that we're doing for the market. But importantly, we're also going to look about acquisition cost line, which you saw has gone up again in 2016.

We want to unpick that. We want to find out the drivers of it. Some of it will be down to, I'm sure, changing makeup of the market, leaving some reinsurance to insurance always increases that line, because the commissions are higher, but we need to unpick that and really understand what the drivers are and see what we can do centrally to reduce that.

Brexit, that remains one of our key priorities. Well, we've now announced the location of the subsidiary, we will start immediately executing on our plans. That means increasing the negotiations with the regulators, defining exactly what is required from them, designing the operating model, how the legal entity will work, how it will interrupt with all the syndicates, how it will interact with all the brokers, with all of the MGAs and cover holders and all the delegated underwriting that we go on.

We'll start hiring people to be based there to run the office and all of that will be underway very, very shortly. The Lloyd's targeting model work will continue and we're also doing apart from our key work streams which we've been quite visible and anyone who wants to go on we have a specific website dedicated to the TOM. You can find out about the oil related news, but there are a couple of key things I think that are going on that beyond the four key work streams that we have, and that is one looking at innovation more generally.

The Innovation Group meets regularly. We have a lots of interaction with InsurTech companies, with FinTech companies to really look at what we can do to ensure that we've got a sustainable business model in the future, and what can we learn and how can we include InsurTech in that future model. And we're also doing a specific pilot at the moment using block chain. We're looking at the claims, settlement process, honing it down, we've got a few partners in the market that wants to be part of this pilot. If that works, we'll have to see where it can go as we're participating on claim settlement with block chain.

As far as Solvency II and capital goes, we are submitting a major model change for approval this year by the PRA and that will go through by the middle of the year, and we're also looking at our central assets and what we can do there. The corporation operating model work will continue and this is a multi-year program, it's not all going to be done at the end of this year, but we are fundamentally looking at the organizational design and we're making tweaks to how we look at IT, how we want the procurement and things like that, just really take or pick some of that low-hanging fruits, see what we can do quickly to reduce some of the costs in the organization. But fundamentally look at how we can make sure we're streamlined in the corporation to provide the services that the market actually wants from us and in the streamline to an efficient way.

So that's all for the moment. We are now finished with the formal presentations. Thank you very much for listening.

Q&A

Operator

So thank you, Inga and John, for taking us through the results. We're now going to move on to Q&A and we'd like to begin by inviting audience in the room to ask your questions. Can I please ask you to use the microphone. I remind you to state your name and organization before asking your question.

Q - Will Hardcastle {BIO 16346311 <GO>}

Thanks. Will Hardcastle, Twelve Capital. A couple of questions. The accident year loss ratio improvement year-on-year is a bit surprising, let's call it, but at one point if we think about the pricing outlook. And I guess there's a bit of FX in there that may have distorted it, I'm not sure. Is it possible to sort of really get a true year-on-year comparison if maybe FX is distortive?

And the second one being, if we think about you taking action on the lines of business - on the performing lines of business, is there any stats you can provide on which lines of business you've taken the most action on and any stats to provide any success on that area?

A - Inga Kristine Beale

Okay. Thanks for the question. So, I'll ask JP maybe to touch first of all on the accident year loss ratio year-on-year development, and I'll ask Jon to comment a little bit on what he can share in terms of underperforming class of business bearing in mind what we kind of can't share in terms of aggregated data for the market can be quite as good at times. So, I will ask Jon to cover that, John Parry first.

A - John Parry {BIO 18896198 <GO>}

So, firstly, on the accident year, I think the impact of foreign exchange is going to be quite limited in terms of the loss ratio, given the matching (34:39) and the fact that it's outside of the combined ratio that you take your foreign exchange gain now under the UK GAAP.

It's a movement, I think, of one point in the underline of it, and I think it's pretty better to look at the overall when you combine it with the major claims, somewhere will be in 2016, you're pulling out more events into that major claims bucket rather than in the general sort of attritional loss ratio. So, while it's a one point when that isolate, I think when you look at it combined, you can see that actually 2016 was up from 2015.

A - Jon Hancock {BIO 18712327 <GO>}

Okay. And on the portfolios, we just sit back and understand that there's a number of lunges to look in that underperformance, whilst one of them, but actually we looked at any portfolio where there's been any material changes and underwrite to the approach or personnel or growth changes. So trying to aggregate it or split it into narrow areas is difficult, but what I can tell you is through those whole review of portfolios over the planned cycle, we've reduced the premium of the (35:41) by about £400 million.

Now that comes with actually, we increased the loss ratio into plan, so that's a good thing, because we think we came up with much stronger and more realistic plans, and also set targets of loss ratio improvements on those and, we have started to see in certain portfolios improvements in loss ratios there already, and you can appreciate lots of those take a while to wash through, and to earn through. And portfolios generally, motor and overseas motor, property international property, international casualty are probably three work, but actually it's much more broader and much more focused than that actually. Okay.

Q - Rötger Franz

Rötger Franz, Société Générale Credit Research. Couple of questions. Inga, you mentioned some worrying signs in the underwriting results. Can you give us some color whether – which lines in particular you are most worried about and whether there is any reserving issue in any class business? And then, your Solvency ratios look quite stable, but can you give us some color on the moving parts in between? And finally, your application for major model change in Solvency II models, can you give us some more detail on it, and what will be the impact on the Solvency ratio and it's sensitivity? Thank you.

A - Inga Kristine Beale

Yeah, sure. Thanks. I'll just cover the first one, and then I'll ask John Parry to go into the Solvency II item. I think this one actually slide in the pack, (37:25) which actually has the high level line of business split, that's on page 14, I think here you can see what's happening. We've got lines of business there that are still over 100% despite reserve releases, that is a worrying sign. And you can see motor that stands out there, but you've also got your fundamental line property, and that's a big volume for the Lloyd's market, £6 billion. Casualty, okay, very long tail and you have reserves sitting in there, marine, aviation is surprisingly good with the release, but it's a very volatile line of very short tail, so probably had a big release with (38:06) activity. That fundamentally is a worrying pitch of this page, I have to say.

Now, however, we do have robust oversight of the reserves in the market. The actuarial team look at those, checks them, we know there has been an increased focus particularly on casualty reserves by the PRA, that's totally in line with what we are doing and what we're checking, and we don't have a fundamental concern about the level of reserves in the market. But for the future in terms of reliance on post or prior releases and you see some of these ratios at the moment, that's the concern for the future. John, on Solvency II?

A - John Parry {BIO 18896198 <GO>}

Thanks, Inga. So, one last point on reserving, I think you'll note that the largest block of reserves are in casualty, and that was the area where we saw that there was less margin being held than we saw in other shorter tail classes, particularly in recent years and that's where our interaction with the market has been. And it seems a strange thing come from it, but it's actually a small release on casualty than on other classes and that is in line with our expectations that it has been performed well, but it's not been a class with as much amount (39:16), but as Inga said, it's a long tailed class. The risks remains and we hold a capital for that. So, on the (39:23) ratios, already the largest movement year-on-year is the movement of foreign exchange of actually translating our risks from U.S. dollar or Yen, or Canadian dollar back into sterling.

In terms of the overall risk profile of the market, it hasn't changed significantly. We've seen that mix of business, reasonably stable, the model will account for changes in underlying mix by syndicate. If the syndicate increases its cat activity or reduces the line of business, that will be in there. So really I think in terms of the stability year-on-year, the movement in size is really about foreign exchange.

You asked about the major model change, we look into Q2, I think that needs to be approved by the PRA. So, I think I'll rather wait and see PRA approval on that before commenting.

Q - Operator

(40:22) Peel Hunt. How concerned are you by the signs of weakening terms and conditions and widening of coverage. If you compare this with other sort of low points in the cycle, is at this time better or worse you think?

And then on casualty, I think you mentioned in your annual report that rate increases are below claims inflation. What are your thoughts on claims inflection and how that could affect the casualty combined ratio, which on an attritional base is above 100% and combined ratio has been for a while now, what can turn that around? Thanks.

A - Inga Kristine Beale

Okay. I'll ask Jon Hancock just to talk on the weak indecencies (41:09). Having – and then John Parry will talk about that claims inflation aspect. I mean, I've been in underwriter for over 35 years, and there have been these cycles in the past. From my perspective, the cycles are – it's quite a different world these days. And particularly with modeling capability, particularly with technology, particularly with big data with facilities, you've got lots of moving parts going on, and some of them I think are here to stay.

Now, I think from (41:46) perspective, it's so important to try and translate whatever you give away in a term or condition, losing up a term or condition that you understand the price that you are giving away or having to increase if you include something. There's probably some work – it's really difficult part of analysis to do, extremely difficult to say if you move deductable, what impact that has on pricing, extremely difficult. We do outmost to check it, we do ask all the underwriters to report risk adjusted rate change, which should take into account this, but how far along in terms of being a sophisticated approach in the insurance sector for stop it is. I think the more we can do – in great state the more we can do analysis to understand that the better will be, but I'll ask John to comment on what's happening in the (42:40).

A - John Parry {BIO 18896198 <GO>}

Okay. Thanks, Inga. So, if you start with price, it is informal so what we are seeing is still continued pressure on price. We saw that at 1st of January renewals and broadly everywhere, but what we have seen is pricing pressure slow down, it's still reducing but it is slowing down. What we focused on and what we syndicate to focus on is that risk adjusted rate is also, we do track it absolutely as Inga said, when you got 50 underwriting companies reporting on the impact of certain cover changes, it's very difficult to track what's a real and specific number, but you can certainly get trends and directions and we are doing some work to improve that data. But what we've seen is probably what I'll describe as normal competitive market and a cover request. So, sub limits and deductibles or sub-limits removed or increased deductibles reduced as you'd expect at this point in the cycle requests for more multiyear deals.

And generally I'd say we track that and the market all resist in that quite hard, obviously, right deals and only where they understand the real price that we see of a risk. Probably what is new right now is the quest for cyber and another covers just to beat automatically including at the end of the market is resisting that very, very hard. So, we track it, we understand it, it's typical completive market conditions where terms and conditions and price are the two trades.

A - Jon Hancock {BIO 18712327 <GO>}

And on claims inflation, I think, it's briefly the – it's a requirement for all of the reporting activities in the market to advisors of how they specifically allow for claims inflation in that reserve setting?

A - John Parry {BIO 18896198 <GO>}

When you look at the Lloyd's history that's plenty of that would claims inflation and I think, maybe one of the reasons why there is surplus being generated and that there is allowance for it and we haven't seen it significantly step up as a general thing across the board. In Lloyd's motto is susceptible to claim inflation, we think it's on the right hand side of the best-in-class because it's 4% to 5% of the total of Lloyd's business. So it's a relatively small part of the total.

Q - Joanna T. Parsons {BIO 1558226 <GO>}

Thank you. Joanna Parsons from Stockdale Securities. Three questions please. Firstly, on the placing system, are all the brokers actually participating in this number, because I know at one point JLT wasn't, and clearly to make it work, you've got to have all the brokers and particularly the large brokers participating. And if they're not, why not?

Secondly, on acquisitions, as it's not unusual at this time of the cycle, the underwriters are putting a lot of blame on the brokers and on the commissions that they're charging, they're also talking about the proliferation of binders and line slips causing issues. And I wonder if you could comment on that please?

And then finally, on the new chairman. There was a lot of talk of the market about having a market practitioner. Could you talk a little bit more about what drove your decision and what you think the new chairman is going to bring to the market? Thank you.

A - Inga Kristine Beale

Okay. I'll cover PPL and the Chairman. I'll ask Jon Hancock just to pick up on the commissions and the binders and line slips. And so PPL, not all the brokers are participating, and it was a decision that across the market that we should still go ahead with it despite not all the brokers being signed up. There were strong signs that brokers will all be signing up.

For whatever reasons, some have chosen for and they've got various reasons that they've got their own internal modernization work going on, their streamlining systems, investing systems, and they're not ready to use it because fundamentally you've got to change your internal processes as we're going to start using it. However, I'm very, very confident that we will get all the major brokers participating on it. We will be releasing adoption data as soon as we can so if you look at the whole baseline that - sorry, the whole - the total population of risk that could go by it (47:11) and how many as a percentage of going through there will be starting to track that. Ideally, we'd like to get up to 90%. That would be our longer term target, but this is such a fundamental change that we cannot expect it to take place overnight. The encouraging thing is that, financial and professional lines seems to have really have taken off.

We've got some system enhancements that are to be released by the middle of the year and they will make life easy. There'll be a whole system re-platforming which will make the system - more state-of-the-art and therefore any changes in enhancements easier in the future, but still we are very, very confident that it's actually going to work this time and we've got commitment beyond some of the big names that you might know, we've got the other brokers using it.

And importantly, for some of the other areas, so the processing of premium and claims at the backend, a lot of that again takes investment in brokers and systems, but we've provided a broker portal, that enables them not to have the data automatically feeding from their systems and they can manually enter it. And we'll be introducing more of that technology to include all the, sort of 250 brokers we've got. And because some of them are not going to be able to change their core systems. But I'm very confident on that.

Yes. The chairman. There was a very disciplined search, I would say. We were very clear that we wanted to look at the - all the options that were - there the population out there. We wanted a combination of somebody who was a very deep strategic thinker and somebody who'd really got experience of many - I am I think excited that (48:52) that Bruce has got the experience of many different sectors, I mean including the banking royalties, money supermarket, he's got a sort of disruptor aspect to him. He's worked in the broking community, so he understands the market here.

I just think Bruce has a lot of important skills and experience that he is going to bring. Both strategic-wise futuristic, I think with his sort of - that coupled with his experience of disruptive forces and embracing technology, I think he is going to be an excellent Chairman for Lloyd's.

A - Jon Hancock {BIO 18712327 <GO>}

And blaming the brokers - I'm not sure I'd say blaming the brokers, but we're certainly seeing some very forthright and strong conversations between underwriters and brokers, which is good thing. And I think we need to have more of those. The reality is the math just doesn't add up, if you add up remuneration and acquisition costs, or admin cost and our claims costs, it doesn't add up to. Hence our focus on we need to improve them.

On, line slips and binders, and I guess facilities per se, because that's where lots of the chatter is. There is nothing wrong with them in principle, so long as they're in place for the right reasons and that's what the underwriters would say, where they are. If they were ever put in place simply to recycle premium one more time, but that's never acceptable and we don't write those and the market wouldn't write those. But those line slips allow the placement of difficult risks already, large risks that give better spread of security and therefore safety to policyholders, all create real efficiencies in the market for placing and putting that security (50:27) quicker, more efficiently are good thing, and I think those are the conversations that are being had around the market.

A - Inga Kristine Beale

I think when I – in my experience of looking around, how much underwriting is automated? We're still quite a long way behind in some market. I was a member going off to Australia years ago, and to be nicely surprised, how digitized their underwriting was and that was in the commercial space, and that was years ago. And if you have correct portfolio analytics and the right controls in place, it's all about understanding what the numbers are doing. And machines and that ability to do sort of fast flow underwriting or machine underwriting I think is perfectly acceptable, but you've got to invest in technology and you've got importantly – the way, have a strong eye in portfolio management and look at the trends, understand the data.

One more question from the room and then we'll move over to webcast. Okay. We have no -

Q - Will Hardcastle {BIO 16346311 <GO>}

Hello. Will Hardcastle, Twelve Capital again. I have one more go on that model application. Is – by being a major model change, it's clearly something that investors will credit – or sort of be looking at ahead of time. Are you able to say anything whether it's on the capital requirement aspect or on the eligibility of our funds. Are you able to give any more color just ahead of time of that?

A - Inga Kristine Beale

Yeah, but we -

A - John Parry {BIO 18896198 <GO>}

Nice try. I think one of the things about it is, it gets the term of a major model change and that's being built into the regulations of I guess AOPA or ORO (52:23) regulators. So, if you hand over the modeling to all firms, they will express concerns about model drift of capital going down. So, I've actually set quite tight thresholds of what you can do without going back.

So, I think we didn't do one last year, we've got over – we've done the IMAP and received approval, actually this is a business as usual part of thing. So, I guess it's a huge piece of work because you've got current approved model and then you're going to work on a development model. So, it's a major model change because you've got to get back to the regulator. But I would – it's not going to be the only the one Lloyd's does.

A - Inga Kristine Beale

No. And I mean many people will be doing this. And in fact, the PRA has hinted that they can't cope if every firm goes back with the major model change, I mean they just won't be able to cope with it, and probably all the firms couldn't either. So, we've got to get that balance right. But, it is also important that you continually upgrading, learning new stuff and changing some of the parameters in the way you view. I mean, so important and we do that. So, we've got to come to a balance that get it right that we must - still in (53:31) half of our models, but know, we're going to get the right approval.

Thank you. So, do we have some questions from the webcast Stuart (53:39)?

A - Operator

Yeah. We've got two questions from Regina Metzler from UBS, who has asked, how is it possible some syndicates have a negative members balance at Lloyd's? And secondly, what are the costs related to the opening of the subsidiary in Brussels?

A - Inga Kristine Beale

Okay. I'll ask John Parry to talk about the negative members. On the cost of opening the subsidiary in Brussels, it will be some additional cost, but it is minimal in terms of our overall cost base in the overall premium of the market. It's going to be an incredibly efficient way for syndicates to continue to trade and write that EU insurance business. And as I said, I think, it's sort of adds something like 0.2% to an expense base or something. I mean, it really is a small amount. And what we're anticipating is that with all of the other work, we're doing on other administrative costs with the TOM (54:30), we'll actually reducing expenses elsewhere. So not a particular worry, but yes, of course, there is some additional cost of setting up a subsidiary.

Q - John Parry {BIO 18896198 <GO>}

Yeah. Our members assets are held in two places, you've got the assets held at syndicate level and then you have funds at Lloyd's that you put up. If the syndicate hasn't required the cash, because they have certain cash, it can, it doesn't have to keep calling, when it has a lot every, every six months so, it was a timing issue, that member would have to put up the capital to cover that loss and that will go into funds at Lloyd's. So, if you looked at member's assets, actually you need to look at in total rather than separating out one part versus another?

A - Operator

And the same question is from Steve Evans, Optimus (55:13). Can you explain what concrete steps are being taken at Lloyd's to increase alternative capital usage and welcome more providers of it into Lloyd's by the end of 2018?

A - Inga Kristine Beale

Yeah. We were looking at alternative capital and how we could really engage with it and that's why we were looking at our index work, because we had a concept that we could have a Lloyd's Index and then capital providers, instead of coming in and getting closer to the risk, we're the risk experts, we do the assessing and pricing of the risk, we do the risk selection, they then can then – in terms of caveat they can play-off an index of Lloyd's.

We have to post that work, because of bandwidth restrictions due to Brexit. We have still got sort of land on this index work as one of our objectives for this year. We do anticipate in the latter part of the year, being able to look at it again and review the situation when we can free up some of the resources. We are also expecting some news about the ILS market opening up in London, it didn't make the budget, but we are still confident that something will come out and then we'll see how Lloyd's and Lloyd's market players brokers, and everyone can then participate in an ILS market, that's actually based here in London.

So we will now conclude today's presentation. I'd like to say thank you to all of those of you who have joined us in the room and thank you those who have listened remotely.

Operator

Thank you.