Y 2019 Earnings Call

Company Participants

- Aki Hussain, Chief Financial Officer
- Ben Walter, Chief Executive Officer, Hiscox Global Retail
- Bronek Masojada, Chief Executive Officer
- Joanne Musselle, Chief Underwriting Officer
- Robert Childs, Chairman

Other Participants

- Andreas Van Embden, Analyst
- Andrew Ritchie, Analyst
- Ben Cohen, Analyst
- Ed Morris, Analyst
- Ivan Bokhmat, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Paris Hadjiantonis, Analyst

Presentation

Robert Childs {BIO 1776179 <GO>}

Good morning, ladies and gentlemen. My name is Robert Childs and I'm Chairman of Hiscox. We have before you the normal panel of executives, but we have a newcomer this year. We have Joanne Musselle, as our Chief Underwriter. If you remember, she has taken over from Richard Watson, who retired last year.

I've been at Hiscox quite a long time, and it's very satisfying having been here this length of time to see that our long-held strategy of balancing the big-ticket business with retail business has paid off. So it allows me this year to announce a very resilient financial performance.

Our gross premium is up 8% in constant currency. PBT 53 million, and the dividend we're going to put up by 3.6%. It's very important to say we have a robust balance sheets support growth, and we were reserved at 9% to 9.5% above the actuarial estimate. We have opportunities ahead, which you'll hear later. It's the third year of rate rises in the London market. In reinsurance, we're disciplined, and we're ready to capture any upside and we're investing for retail growth, already what is a very big business of 2.2 billion.

Anyway to tell you further details about the financials, I'm going to hand you over to Aki Hussain, our CFO. Aki?

Aki Hussain {BIO 19739719 <GO>}

Thank you, Rob, and good morning everyone. I'm Aki Hussain, Group CFO. 2019 has been a challenging year for our business, but with the changes we made and we are making our retail division and with the positive pricing momentum in London market, we're optimistic about the future.

Now turning to our financial performance for the year. Across the Group, we increased our revenues by 8% with each of our divisions delivering growth. We have seen a material increase in loss cost, and this has been driven by a combination of weather-related events in a more general increase in claims. We delivered a profit before tax of $53.1 million and we are increasing our final dividend by $0.01 to $29.6 per share.

Now, as usual, I'll take you through the financial performance of each of our divisions in turn beginning with Retail. Our Retail revenues increased by 7% in the year on an accelerating trend with the second half increasing by 8%. In the US, as we advised last year, in the second half we saw a significant uptick in revenues. Now whilst the full year is 7%, the second half alone is up 11% in terms of revenue. Europe had another fantastic year with revenue growth of just under 16%, and in the UK we delivered a steady headline growth of 4%. The 4% in the UK masks a couple of underlying trends.

In our commercial lines business, we increased revenues by 9%. This has been partly offset by the reduction we saw in our Art and Private Client in high-value home business as a result of taking underwriting and pricing action, which has been successful during the course of the year. We did see lower customer retention that has now stabilized. And as we look forward into 2020, we expect the UK business to pick up the growth rate.

The loss ratio in our Retail business has increased by 5 percentage points to a respectable 49%, and the factors driving this are almost exclusively in our US Retail business. They essentially boiled down to three key items. Firstly, as we advised last year, we have strengthened the reserves on our private market D&O book. We have also in response to slight lengthening of claim settlement periods and increased legal fees, we've adopted a more cautious approach to reserving. And finally, we are seeing a slight increase in severity and frequency on our small-ticket US general liability book. And of course, we have not been idle in the face of these emerging trends. We've taken significant action.

On D&O, as you know, we started taking action some 18 -- 15 to 18 months ago. And in terms of revenue exposure, we've reduced the revenues for the D&O book from a peak of $80 million to under $20 million in 2019. Around that retained book, we're also seeing significant rate increases in excess of 10%. We're also enhancing the capabilities and increase in the resourcing in our US claims department and this will reduce external legal fees as we go through. And of course, we're always taking underwriting action and you'll hear much more from this -- on this from Joe in a few minutes. And for the first time in a number of years, we're also seeing material rate improvements in parts of the US book.

Now these factors, in particular, the reduced exposure to D&O is already leading to a reduction in our current year loss ratios in the US business. We're reporting an overall combined ratio of 98.7%. This is in line with our revised guidance and it will be outside of our normal target range. Notwithstanding this, the upper trajectory of profitability in Retail has continued and at a $178 million we're reporting a profit increase of 22%.

Moving on to Slide 5, our London Market division. We've seen continuous and persistent positive pricing momentum in our London Market division. And we've grown into that rising tide of prices. Overall cost of full year were up 11%, and in the second half, the growth rate accelerated to 16%. We have experienced higher loss cost in our -- in this division, in part driven by weather-related events, in particular hurricane Dorian and some adverse development in the prior year as we reported in June or July last year.

The most significant effect in London market has been as a result of less favorable experience on our property binder portfolio. Now this is something I spoke about last year. This is an area of the business where we have been taking action. The action is having a positive effect, but not in line with our expectations. As a result, we're taking further action in 2020 while we're pushing further rates through this book and we will be reducing our capacity on offer to the property binder business. We've also had some large losses on old E&O account in D&O as well.

Moving on to Reinsurance and ILS on Slide 6. Here we are reporting a 7% growth in revenues. The pricing recovery here has been more modest. It's been in the single digits and our growth is reflecting that. And as we go into the 1/1 in 2020, again the pricing recovery whilst on an upward trajectory has been somewhat more modest and we will remain disciplined.

In 2019, we experienced significant increase in claims, primarily as a result of our exposure to Japan where we set aside net reserves of $130 million for typhoons Faxai and Hagibis. We've also strengthened reserves on healthcare, which is a line of business we exited in 2017. As a result, we're reporting a combined ratio of 164% and a loss of $94 million.

Now for those of you who've been following the business for some time, you'll know that the Reinsurance and ILS division, these are the more volatile end of our business and is much more cyclical in nature. So it's worth considering the performance of the business over a longer period of time. And over the last 10 years, inclusive of the loss in 2019, this division has provided around $700 million of profit to the Group.

In terms of our ILS fund, we continue to report assets under manager -- under management of $1.5 billion, with deployable capital of $1.3 billion. The gap -- the $200 million gap reflects the additional buffer capital we hold back for paying claims. Over the last week, we have received a redemption notice from one of our major capital buckets. We expect around $240 million to redeem for one of our higher-risk ILS funds. This redemption will take place over the next 15 to 18 months. The capital is still available to be written against for the next few months. We expect some of this capital to flow back into one of our lower risk funds, and we also expect to offset some of this outflow with new money that we're attracting during the course of the year.

Moving on to Slide 7 and reserves. We continue to report resilient reserves and a positive aggregate reserve development of $26 million. This is significantly down on the prior year. And as you can see on this chart behind me, that that is coming through as a result of less favorable experience on more recent vintages. We are also disclosing buffer above our actuarial estimate of 9.4%. This equates to around $300 million.

If you move on to the next slide, Slide 8, this provides getting into the more insight into the source of reserve development. And as you can see, we continue to report significant positive reserve development from our Retail business of $46 million. Again, this is down on the prior year, but most of this is explained by the deliberate actions we've taken to slow down the recognition of favorable experience.

The most significant impact of reserve development has come from our big-ticket businesses, and this in essence falls into three categories. Firstly, the natural catastrophes. If you recall in 2017 following Harvey, Irma and Maria, we set aside prudent reserves from which we saw significant releases in 2018. In contrast in 2019, we have some reserve -- adverse reserve development. The combined effect is a year-on-year reduction in reserve releases of $90 million. We've also strengthened reserves on healthcare, and we're seeing less favorable experience on some current lines of business.

As we look forward, we expect the normal reserve to development pattern to emerge over the next two to three years. For 2020 specifically, our expectation is of positive reserve development of between 3% and 5% of opening net reserves that increase to around $100 million to $150 million.

On Slide 9, we have our capital -- our usual capital disclosure. And as you can see, we are well capitalized on all basics. I had to provide some more detail on our regulatory capital position. I'll remind you that our group regulators of Bermuda Monetary Authority, the BMA, and our capital regime is the Bermuda Solvency Capital Requirement which is equivalent to Solvency II.

If you remember from my updates last year that the BMA is strengthening the standard formula, and as a reminder, we are a standard formula company. The strengthening of the standard formula is taking place over three years, 2019 being the first year, 20 -- and then subsequent two years. The strengthening is on a linear basis with an equal one-third strengthening in each of those years. Following adoption of that first stage of strengthening, we're reporting the solvency coverage ratio of 205%. This includes or incorporates in a 11-point reduction as a result of that strengthening, which we've been mostly able to offset through ongoing capital optimization.

If we were to adopt the full strengthening, which is yet to take place over the next 24 months, if we adopted that on our 2019 year-end balance sheet, it would result in an estimated 20 point reduction to our coverage ratio to around 185%. Of course, we expect to offset all of this through ongoing capital generation and capital optimization. So as you can see, we are well capitalized.

On to Slide 9 (sic - 10), and our investment return. 2019 has been a great year for investment returns. And as you can see from the chart on the bottom left, as a result of the search -- continuing search in global equities, we were able to report a return on risk assets of -- in excess of 14%. We've also benefited from falling bond yields. If you look at the chart on the top right, you can see that the mark-to-market gains effectively offset the mark-to-market losses over the last couple of years.

Now falling bond yields, as you know is a double-edged sword. It does result in lower reinvestment yields. And if you look at the chart on the bottom right, you can see that our reinvestment yields or yield to maturity has in fact fallen from 2.4% at the end of 2018% to 1.6%. And as a result, as we look forward to 2020, our expectations of investment income are significantly moderated. In fact, our central scenario for 2020 is of investment income of $115 million. Our investment portfolio continues to be conservatively positioned in short duration.

As you know, we have been investing in our business building for growth given the vast opportunities we see in each of our franchises, and in particularly, in our Retail division. Over the last 10 years, we have invested in excess of $0.5 billion in -- in marketing, and building our brand in the UK, in the continent, and in the US. We expect that investment to continue. We've also been investing in replacing our technology infrastructure. To date, that's -- that has been in excess of 300 million. 2020 will be the final peak year of investment where we expect to invest a further $100 million or so.

By the end of 2020, we expect most of these technology replacement -- the technology replacement to be complete and much of this will be operational and in place. So over the next few years, we expect to sweat these assets and generate operating efficiencies. And as we look forward, our ambition is to reduce the expense ratio for the Group from its current 46% to the low 40s, and to reduce our retail expense ratio from 50% to the mid-40s. We don't expect the reduction in our retail expense ratio to drive a sustained improvement in margins. We continue to target a combined ratio of 90% to 95% of the medium and long-term. But the reduction in expense ratio will provide additional financial flexibility. It will allow us to increase our addressable market and provide further fuel for the growth of the Retail business.

And finally, as we look forward to 2020, our expectation for our Reinsurance and ILS division that we will see a reduction in our gross revenues as a result of a modest recovery in pricing and less third-party capital available for deployment. In our London market, we expect the growth to be fueled by continuing positive pricing momentum, that growth will be moderated somewhat as we continue to underwrite and prune the portfolios that are underperforming.

And then finally on Retail, and it's worthwhile just reflecting the movement on the compounding nature of our retail business. Over the last 10 years, the Retail business has more than doubled in size. 10 years ago, the revenue was around $1 billion, we're now at

$2.2 billion. And over that period, we've delivered profits of $1.2 billion, with most of those coming in the last five, six years as the business reach scale. As we look forward into 2020, we expect the Retail business to continue to grow between in the middle of our 5% to 15% range, and to achieve a combined ratio of 96% to 98%.

And now I'll hand over to Joe Musselle, our Chief Underwriting Officer.

Joanne Musselle {BIO 19106109 <GO>}

Thank you, Aki. Good morning all. I'm delighted to be here as Group's Chief Underwriting Officer for my first results presentation. So many of you will be familiar with this slide -- chart on Slide 14. It's a chart about rating index back to 2010 and on a rolling 12-month basis for our three major segments, Retail, Catastrophe Reinsurance and the London market. And it's an improving picture, particularly in London markets, which is the blue line, we are seeing rates up 11%/. We've experienced the ninth consecutive quarter of rate increase, and that's an aggregate 30% rate up since the low of 2016, 2017. And this is being driven by much needed discipline in the London markets, driven by a reduction in capacity and the Lloyd's Decile 10. And it's not just rating that has shown discipline, we are managing to address the terms and conditions -- and commission creep, there is often a feature of the soft market. So overall rates in 14 out of our 15 lines have seen an increase in 2019, and some lines like D&O, public D&O, we see an increase of 60% and we're seeing this as a good opportunity for growth.

In Reinsurance, which is the red line, -- rate correction has been less pronounced with overcapacities in the feature of that markets. However, we have seen Re's rates up 6%, more in loss affected accounts, and we've not seen the Japanese portfolios renew. They will renew 1-1-4 [ph] and we are expecting a material rate rise after a couple of tough years.

From a Retail perspective, the retail pricing is less cyclical with our homeowners and our business customers much more expecting a more consistent premium from one year to the next. I think the other thing to note on our Retail portfolio is a collection of about 50 different portfolios across 10 different geographies. So what you see in terms of the downward trend, it is much a function of mix as it is in terms of rates -- in terms of rates. Rates are healthy. UK and Europe are flat and we've seen an uptick in our US rates works. We've experienced a 5% uptick in our errors and omissions portfolio and 13 in our private director and officer. So overall, my assessment is that 90% of our portfolio is operating markets with the rating supports the results and the returns that we're targeting.

So another familiar slide to most will be Slide 15 and this is a different view of the world. This is a segmental view, looking at the different parts of our portfolio. I think the most pleasing thing about this slide is despite accessing 200 million of business in 2019 of underperforming business, we've managed to grow each single one of our sub-segments. The one on the far left, our biggest sub segment is small commercial, and that has experienced double-digit growth, and it's now a -- nearly 1.6 billion. That portfolio has doubled since 2015 and we continue our investment in data, technology and people to both fuel and support that growth. We take the opportunity in that small segment as the premiums of most of those portfolios pay less than 1,000 in premium, so that's 1,000 dollars, euros and pounds, and we automate our underwriting. We want to make the underwrite of the small and straightforward freeing up our underwriters time to focus on the more complex and to grow that portfolio through adjacencies.

Another area of growth you'll see is on the far right of the slide and that's global casualty and that is up 28% in the year. The most important thing to note here is, whilst premium is up 28%, exposure is flat and that's because of the rate rises that I talked about earlier through our Lloyd's business. So in summary, we've got 28% more premium, but we are covering the same amount of risk.

And lastly on this slide reinsurance. Our reinsurance is up 11% from a growth point of view. But from a net point of view, it is actually a 3% reduction and that was driven by two things. The first is an increased participation with our quota share providers. And the second thing is, we've -- as Aki have mentioned, we've exited healthcare and that was a net retained portfolio.

So looking into some of the segments in a little bit more detail. So firstly this is the picture for Retail over the last five years and we segment our portfolio into three. The red is what we call course correction, Blue is hold where we're growing but margins are slim as we're more disciplined, and the green is grow where we're seeing good returns for our markets. And I'd say that -- the vast majority of our portfolios are actually in the green and the blue. So 90% of our portfolios are actually in growth phase. We always expect about 5% to 7% in our portfolios for variety of reasons, things change. So as markets change, as markets emerge, therefore, we have to slightly correct our portfolio with regards to risk or rates or exposure.

And also as we enter new things, as we start growing our portfolio, we don't always get it right first time. But the key takeaway from this slide is 90% of our portfolio is in that -- is in that grow and hold of Retail and we see great opportunity.

So London market, so as you all know, the London market is far more cyclical with regards to this business and we are coming out of a softening -- a softening environment. And that softening, not just in terms of rates, but terms and conditions and commission and of course losses, and we have maintained discipline during this periods. We've exited 400 million of premium since 2016, and we've come out of suited lines altogether like aviation, political risk and healthcare. Now we've not always got the timing of the exit absolutely spot on. And what we see this year is some subdued reserve releases of strengthening in some of those existing lines.

But I'm pleased to say that the position as we leave 2019 as we go into 2020, the outlook is really good. Some of those lines, like D&O is a line that we've referenced with a significant uptick in terms of rates, that would have been in the red at the 2017. But market change and market change considerably, and D&O is now one of our growth lines as terms and conditions have reduced and ratings has increased.

So some of the areas that we're still in this of course correction, it was referenced earlier, so our portfolio, our binders portfolio, property portfolio, and we've seen an uptick in terms of attritional loss ratio, plus we have updated our view of risk. We've taken some corrective action. That corrective action will continue into 2020 and we don't expect to see the results full year and through until 2022. But in aggregate, I'm really pleased with the discipline that we've shown and I think we're really well positioned as we enter 2020 with the upturn in rates -- rising rates.

So from a reinsurance point of view, our focus is on disciplined underwriting, but poised to capture any upsides. And we've already shown this discipline at 1/1 where we've reduced some of our portfolio where the risk reward was not there. We've also refocused our portfolio exiting 90 million of healthcare and casualty reinsurance. So back to a focus and re-underwriting our risk portfolio. As I mentioned, we are expecting to see significant rate rise in our Japanese portfolios with renew at 1/4. And this is because, we've updated our view of risk, both the Florida and for California wildfire, but also for the typhoons -- the typhoons in Japan. So that's why you see, as we enter into 2020, a significant mode of our portfolio is in the whole phase as we wait to see how that market reacts.

So looking at Japan in a little bit more detail. As Aki mentioned, the two of largest Japanese windstorms in history happened in 2019, and that was Faxai and Hagibis and we have a 130 million reserved for those two events. We've picked our loss estimates at the upper end of that range. So we're not expecting any adverse development from that 130 million. Japan has been a longstanding relationship for us. We have been there for many years and we increased our presence following the 2011 Tohoku earthquake.

For context, we've had seven profitable years, proceed in the two loss making years of '18 and '19. And to Aki's earlier points, this is the business wherein, in aggregate, the reinsurance accounts has delivered 700 million of profit over the cycle, but it is more volatile. And we do have -- we've had seven profitable years and three not.

As I said in terms of the updated view of risk, we are now (inaudible) now expecting a material rate rise at 1/4 and we'll wait to see how the market reacts, but be sure we will implement our discipline if that's not there.

And lastly, I thought I would just show you how we think about climate change. Our broader ESG framework is in the appendix, but really we think about climate change in three different ways. Clearly as underwriters of catastrophe reinsurance, we have a long history of research -- model in climate change, and we've invested heavily over that in our history and we continue to do that. We're bolstering that investment with the addition of two climate sciences in 2020.

The second way we look at our -- the climate change is on the portfolio. So as our understanding of climate risk change and emerge, so it is our understanding of the impact of that on our portfolio and not just in property in reinsurance for our broader portfolio, so looking into casualty. So as an example, there is no doubt that D&O's will face a greater scrutiny for how they manage the climate risk.

And thirdly as insurers, it's our job to help and anticipate our customers' needs. And so to evolve our product suite so that we help our customers and their businesses become more resilient. And a couple of good examples that we have here is our suite of flood products on our new -- on our wildfire modeling.

So with that, I'm going to hand over to Ben Walter, who is going to talk more about our retail customers.

Ben Walter {BIO 16330248 <GO>}

Thank you, Joe, and good morning everyone. I'm Ben Walter. I'm the CEO of our Retail division. And I'd like to spend a bit of time this morning talking about how we think about the longer-term opportunity in Retail, particularly in the context of this year's results and the investments that we've made. You've all have seen where we ended up on the combined ratio this year at just under 99%. Clearly that's below our long-term ambitions and expectations due to a little bit of volatility on the loss ratio.

What we could have done, but we didn't was to curtail our investment in the division and taken a bit of upside on the expense ratio in order to deliver a lower combined. We didn't do that, we don't plan to do that, because we see the long-term opportunity as significant and we want to continue to invest behind that. And that investment is particularly focused on the small and micro commercial space, an area that is one of our largest now and that we view and I certainly view as one that's likely to follow the form of -- the way the auto insurance market transpire, particularly in the United States where that trend is still in its infancy.

And as context, if you rewind the clock, say, 25 years ago, you would have seen auto insurance being largely manual and a hugely fragmented market with lots of market share strewn across the market in various players, that's changed drastically in the last 25 years. Most of that market is now placed electronically, and as a result of that, you've seen a few scale players emerge, and indeed the top five players in that market now lead with 55% market share. We think something similar is happening right now in micro and small commercial insurance, and our goal is to be one of those five winners.

And we are indeed well on our way. Looking at Slide 22, you can see the growth of that business over the last 10 years to $2.2 billion as we've grown our original franchises in the UK and Europe, and as we've planted flags in the United States and now in Asia. But if you look at the right side of the slide, you can really see why that bag so much investment in operational scale. The business, like I said, has doubled over the last 10 years, but in just the last five, the number of customers has almost tripled. So in that same time period as the business has grown by only 50% in terms of premium, you've seen a tripling of the number of customers. It takes operational scale to be able to run a business with that many customers. As Joe said, these are people who buy a 1,000 dollars, pounds, euros at a time, sometimes less. So it's very operationally intensive, investing in automation and scale becomes very important in order to be able to drive a competitive moat between us and our competitors.

So before I talk about that scale, I'd like to talk a little bit about what's in the book and give a little more of a breakdown. On Slide 23, you can see Retail overall broken up by its component parts. On a personal level, when I move to the UK a couple of years ago and people would ask, what I did and I said I run Retail for Hiscox, people would say, oh, that's the insurance you do for rich people. And it is -- that's certainly a part of our portfolio and it's one that we love. It's the cornerstone of our brand, particularly on this side of the Atlantic. We're going to stay in that business. We love that business and we love what it does for our brand, but today it represents even at $400 million, only about 18% of the portfolio. The balance is all commercial.

And that commercial really drive -- it breaks up into three broad buckets. The first is on the upper right, 25% of the book is small commercial package. That's sold mostly through direct and partnerships, and that is a combination of covers both liability and property driven that we sell to the smallest of businesses. The second bucket is our historically core professional indemnity franchise that we have all across the world. These are in specialties and everything ranging from design, to consulting, to media and entertainment areas that we know well, products that are tailored to the specific verticals that we choose to serve, claim service that is best in breed. And then, finally, the last quarter on the bottom left is our collection of what we call the weird and wonderful. So we still are a specialist insurer, we're not a generalist, and that means we will continue to have certain niche markets in which we play where we have the expertise and we have the history and the distribution to play in those markets. That's a product view.

I'm going to put up now a slide on Slide 24 that you've seen before. This is a size view and this really speaks to what's driven the chart that you saw a couple -- on a couple of slides ago about that growth in customer numbers, where we talk -- Joe calls this volume versus value, which I think is a really great name for it. And what you can see here is, just how much of our customer count is at the bottom end of that. So under 5,000 pounds, euros, dollars, it represents 90% of the volume that we do. We do write some larger companies in Retail. However, our appetite -- our underwriting appetite gets more and more restrictive as you go up the pyramid, and that's what helps us constrain the volatility relative to the big-ticket businesses. But broadly, the bulk of the business from a customer perspective, from an operational intensity perspective, sits at the bottom of the pyramid, and that's where we are doing most of our investment today.

So let's talk about that investment for a bit. There are three big areas that you have to scale, particularly in a direct-to-consumer business. The first are the customer contact centers. That's really the cold phase to our customers. Those are the people who talk to our customers every day. In that area, we've made great progress. We've seen double-digit improvements in productivity each year for the last four years and we do expect that to continue.

The second area that you can really achieve scale is in marketing and distribution. That's the chart that you see here. You can see, the purple line represents our distribution costs in the direct and partnerships business as a percent of premium. And you can see that was declining for a long time, although it's ticked up in 2019. That was a very conscious choice. We did that intentionally, because we see more competition coming in, particularly in the United States. We think we still have very small market shares and room to grow, and we want to put more distance between us and our competitors, but scale does come eventually.

If I can reference the auto market again, one of the numbers I'd like to give is that both Geico and Progressive, two of the biggest players in the market spend less than 10% of their premium on marketing. However, for each of them that less than 10% represents over $1 billion. So you do -- you do reach scale where you're everywhere, but it comes at a very large number. We will continue to invest in that area, although I do expect in time that will start to achieve scale as well. And we're doing some interesting things on the marketing front. So we're doing, in addition to the classic paid search, and internet marketing that lots of online players do, we've done some creative tie-ups with other entities such as Major League Baseball, and we've done some experiential marketing that paid dividends in the -- particularly in the area of cyber in the UK, which you may have seen.

And then the final area is technology and that's where we really haven't begun to achieve scale. We are still very much as Aki said in the investment phase. That peak year will happen this year in terms of cash spend, but then obviously that will start to flow through the P&L in the form of depreciation. And at full run rate, we expect the total spend to amount to about $30 million to $40 million a year in terms of depreciation running through the P&L. However, once those systems are built, we can really start to sweat those assets as premium continues to grow.

As Aki said, we're going live this year. We've already -- we're already live with our UK implementation. We're going live this year in the US, particularly for direct and partnerships, and the European project, those smaller is just starting. But I wanted to give you a sense, in the meantime, of what these systems and the systems that are built around it can do to give you a sense of how we achieve true operational scale in a customer-intensive environment. There are really three areas we've invested pretty heavily in.

So I'll start with robotics. Robotics are everywhere. They are all across the business, and they're already having a huge impact. We do over 2 million transactions a year and that's growing double-digits every year. The more of those we can automate, the more we can grow without having to add headcount, and we've already automated hundreds of thousands of transactions through robotics, repetitive tasks that required people to do them are now being done by the software.

The second area and one that I'm really excited about is natural language processing. We've adopted a platform that's backed by artificial intelligence that can dynamically interpret messages coming into Hiscox and do things like dynamically about them. So as an example, in the UK, we now have a system in place that can take an email that comes in from a broker in the traditional way they would have sent to us. It can read that email, it can dynamically learn based on experience what that email wants us to do and route that to a person who can complete that task in one fell swoop. And increasingly, we can now put that technology together with robotics to have something goes straight to the machine without any human touch at all.

Second is, -- sorry, third is APIs. You're going to hear a lot more about APIs across the insurance ecosystem in general. APIs are really just the way that one machine talks to another, but they are rapidly becoming the standard by which insurance will be traded in an electronic format. To put that in context, five years ago, in all financial services ex-insurance, there were 3,000 industry standard APIs. Today in insurance there are fewer than 300, and it's growing every year. So the insurance industry is slow to catch on, but it is catching up fast. And in the US, we already have over 30 partners live on our API platform and our UK platform has gone live already with its first partner.

And then finally, portals and pre-priced proposals. This is a new way of trading particularly, that's caught on in Europe, and it now represents over 50% of our submissions and it helps us again process large numbers of transactions without the people intensity that used to. So huge investment across the portfolio in automation, in straight-through processing, in APIs, and in various technologies that help us scale the business.

And why are we investing so much, because we see a huge opportunity. This is why I think I have the most fund job in insurance. Today that small business -- small and micro business market across the world represents over $80 billion of GWP. I'm thrilled that we have a 1 million of them, but I'm far from satisfied, because that implies very low market shares. And just as critically, these are really fast growing markets relative to the general economy. Most studies put it at roughly twice the rate of general GDP growth. So it's an attractive large segment with good loss ratios, sub 50%, that when we can run at scale we think there is huge opportunity for us to gain market share and drive the expense ratio down at the same time.

I'll leave you with a picture on the right, which Bob Thaker, who is here today -- who is our new CEO of the UK business likes to use. That's a jar, and every black marble represents one piece of the small business insurance market, and the red marble represents Hiscox. And our goal is just simply to go from one marble to two marbles. And if we can do that, we will go from a slightly over $2 billion business to a slightly over $4 million and on its way to $5 billion business, while still being a relatively small player.

With that, I'll turn it over to Bronek for our business outlook.

Bronek Masojada {BIO 1776109 <GO>}

Thank you, Ben. I think at this point of the presentation, it's always helpful just to take a step back and look at the overall shape of the business. So here on Slide 29, you can see the growth year-on-year of the different major segments. Retail grew in constant currency by 7%, and as you heard from Aki, that was 6% in the first half and then 8% in the second half as the impact of some of the corrective action took place and worked its way through the system.

We thought it would be interesting to show you rather than the geographic split, which is still in the appendix, a channel split. And in the broker-channel, this is in normal currencies, it was pretty flat overall year-on-year. But if you look below the surface, again, that was shrinking in the broker channel in the first half as we took some corrective action in the UK, in the US, and then growth in the second half, which is stronger. If you put it in constant currency, it's positive -- it's more positive than that sort of 0.4%.

But the other interesting segment -- other segment we thought we are interested in is in fact the direct and partnerships. It's now a $0.5 billion business and it grew last year by 25%. It's the area where as you've heard from Ben, we have invested a lot in technology in order to re-platform our UK business. We will be going live in the first six months in the direct and partnerships business in the US. And I know from a investor perspective, that seen as a lot of execution risk, but in our view, there is an even greater execution risk in not doing the investments, because it will restrict our future growth. And as you can see, we're pretty ambitious for that.

In terms of London Markets, it grew by 11%. Again, that was 6% in the first half and over 16% in the second half, which means that if you look back to the chart which Joe Musselle put up, we are growing strongly when the rates were rising the most. And again, we think that sets us up well for the future. And on Reinsurance, in reality, there is no first half, second half split, as over $700 million of that $867 million was written in the first half. So all in all, we think that the Group has done well, but as you've heard, we are pretty optimistic going forward.

Rob started the presentation by effectively saying how the diversification has paid off for us. It certainly has its own strategy which has been the core of Hiscox throughout the 20 years is steadily growing that Retail business and expanding and contracting in the big-ticket business. And that has allowed us to have a very resilient financial performance. But we have to be frank, the results for 2019 are below our ambitions for ourselves, and your expectations of us. And for that, we apologize. And you can hear today that we've taken a lot of action to address that, which we hope will pay off during 2020 and 2021. We've seen, as Aki said, some emerging positive trends, where the actuaries will allow us to recognize us, let's wait -- we have to wait and see, but ultimately, we're not happy and we've done something about it.

The one thing our past conservatism has given us though is a robust balance sheet. The P&L hasn't been great, but the balance sheet is actually in pretty good shape. And that's really to me provides a very good basis from which to launch into 2020. And that from a shareholder point of view means we can -- we well funded to take the returns that we see out there. In terms of the business, as you've seen from Joe, disciplined underwriting still remains a call. We are ambitious to grow, but if underwriters has the choice between good underwriting and growth, we always want them to take the former not the latter.

I think it's probably worth just touching on two of the issues of the day, coronavirus and the flooding and storms. In terms of coronavirus, we don't see this as a material impact for Hiscox. The areas where we must expose are obviously in the events business, and then to a much lesser extent, travel and business interruption.

On the events business, buying pandemic cover is an extra cover that people have to buy, and less than 10% of our customers in events have actually bought that. And in terms of the ability to trigger the cover, that requires government action to actually stop the event. So we're not that worried about the event exposure as we look forward.

We have had some small travel losses obviously, and we had a little bit of business interruption related expense. But again, neither of them, particularly in business interruption, pandemic covers are not a core part of the offering. So whilst it's very newsworthy, we don't think it's going to be material from a financial perspective.

Operationally, Hiscox can actually run the entire business remotely. We've got capacity to run over 3,000 people through remote dial-in. One area we haven't yet cracked is call recording for our UK service centers, but I'm sure the PRI is in the room and the SA [ph] be in the room. I'm sure that if the whole world stops from working from home, there might be a little bit of regulatory easing in that perspective. That's a request.

The other area clearly are the storms and the floods. As of Friday, we had just over 100 flood claims. Some of those are going into flood re, the rest we will retain. But if you take the storms and the floods together, we are into our reinsurance program. So our losses are capped at GBP10 million as of today. So we feel, again, pretty good about that.

One of the broader issues in terms of the coronavirus that people are beginning to worry about is clearly the impact on global economic growth. It's a times like this that I am pleased that we are in the insurance business. When times are really good in the economy, we don't see the big surges of growth, but when the economy slows down, we don't see material reduction either. We're not a luxury goods. If you have a home, if you have a car, if you're in business, you have to care on buying your insurance.

And indeed if you look back to 2008, '09, '10, in the last sort of material slowdown, we actually saw an uptick in the number of those micro businesses that we insure, because people who are made redundant from larger companies often through -- not through choice but through necessity, set themselves up as independent consultants where they need to buy insurance and they come to us. And on the claims front, this was a small uptick, but that happened over two or three years, not to some big overnight surge, and was well within what we thought was manageable at the time.

So I think from an investor perspective, actually if there is a global downturn, general Insurance as a whole, and I've got to say that Hiscox specifically is a good place to be.

As we look forward, in terms of the London Markets, clearly we are into our third year of price increases, and we're seeing positive price movement across virtually every line. And clearly, we are trying to focus our resources where the price movements are the most attractive. In terms of reinsurance, we have to be more selective picking our way through the marketplace. Our insurance volumes were down at 1st of January versus 1st of January last year, as we felt we weren't being paid for the risks that we saw, but that means we have more capacity deployed during the course of the year. The 1st of April for Japan is clearly a material decision date for us. If the market pays the sorts of increases that we're looking for, well, then we will deploy our capital. If it doesn't, we will shrink and that's fine. That's consistent with that long-term strategy of growing the Retail business and only deploying our capital and the big-ticket business when we think it's warranted. We don't have a growth ambition, particularly for that area of business.

On the other hand, the Retail business has been outlined, we are pretty optimistic and ambitious. In the UK business, we want to go from one red marble to a second red marble. That will take a number of years, but the market is there and we think we've got the ability to capture that. Our European business is now about half the size of our UK business, and I can remember when that was 10% of the size of the UK business. It is growing fast, and certainly our ambition is that in the first instance, that the European business should be the same size as the UK business. And as we look at the market structure, in particularly in France and Germany, in the longer term, I personally see no reason why each of those countries shouldn't equal the UK in size.

In a funny way, Brexit has been good for us, because it's created a separate legal entity for the European business with greater focus, greater independence from the UK, and you saw that in the 15% growth that they delivered in 2019. And when we look at America, as Ben said, we see a small business market which is very fragmented at the moment. It isn't a winner take all market, but it will consolidate over time. And our ambition for 20 years or however long it takes is to be one of those top five in the marketplace. We have the product, we have the scale, we have the knowledge to be able to do that.

So if you take a set back and look across all three segments, we are positive. It's never a complete one way street. But we're under no illusions. We determined to do better in 2020 and beyond and we did it in 2019, and we think that we have the capability to capture the upside.

And with that, we will take any questions. Before we go into questions, we are on being recorded. So if you can -- if there is a mic in your seat next to you, and if you could just say who you are and so the people remotely note those questions.

Questions And Answers

Q - Kamran Hossain {BIO 17666412 <GO>}

All right. So it's Kamran Hossain from RBC. Three questions. The first one is just on the reserve release guidance for next year. So you pointed to 3 to 5 points of net reserve releases next year of opening reserves versus the kind of historical, kind of normal, I know it's very difficult to give a historical normal of around 12. How should we think about the transition between the two numbers over time? Do we start about that next year or how do we think about that?

And the second question is just on the expense ratio, and I guess, the low 40s ambition. Obviously, with Retail growing substantially and the suggestion that you, I guess, deploy that additional expense margin into growth, should we expect the overall Group expense ratio to materially benefit, over to say, there is slightly smaller benefit than if you are kind of have that today?

And the third question is, could you talk about any impact on the brand from, I guess, yeah, she is in the US last year, our customers noticing or have there been any kind of NPS impacts there? Thank you.

A - Bronek Masojada {BIO 1776109 <GO>}

Okay. So I'd suggest that Aki takes the first two questions on reserve releases and the expense ratio, and then Ben can talk about the United States.

A - Aki Hussain {BIO 19739719 <GO>}

Thank you, Bronek. In terms of reserve releases, the guidance for 2020 is between 3% and 5%, as I said $100 million to $150 million. I mean, over the longer term, the trend has been, if you can call it a trend somewhere between sort of 8% and 12%. Our expectation is that we would trend back to that over the next three years. So not only media snap back in 2021 -- I run the trend line for the couple of years. It's important to remember where [ph] they are coming from. They are coming from our actuarial estimate and from the margin that we hold above their estimate. The margin has remained intact.

What we have done during the course of 2019 is increase the actuarial estimate, part of it is deliberate, and this is the slower recognition on federal experienced in retail. That is going to take another 18 months to come through. So that's a natural governor on the amount of reserve releases that we will see over the next couple of years.

In terms of expense ratio, our current expectation is that in the business, the Retail business is reaching scale. As you heard from Ben, we are generating efficiencies in our -- in the marketing expenditure. But the big efficiencies are going to come from the nearly $400 million that we've invested in replacing technology around the group. By the end of this year, most of that will be operational and our expectation is that going into 2021 and beyond for the next few years, we would expect to see the retail expense ratio fall by around 1% per annum. That should translate into three quarters or 1% into the Group expense ratio also reducing. That's not forever trend, but I would say for the net -- beyond 2020 for the next three or four years, you could assume that.

A - Bronek Masojada {BIO 1776109 <GO>}

Ben?

A - Ben Walter {BIO 16330248 <GO>}

Yeah, my short answer is no. The longer answer is, if you look at where we've had to retrench, it's mostly been in D&O and media, which our broker only lines. And in most those cases, either specialist brokers focused in those areas, who know the issues very well, largely wholesale driven. So most of our brokers in the US are wholesalers. They're used to a more, I'll call it, warp and weft like you would see in London as opposed to a sort of small ticket retail broker. We haven't had to make wholesale changes like that in our direct and partnerships business, which is the most sort of direct to the consumer and customer facing.

So our NPS scores remain as and when they were. Our brand numbers actually hit an all-time high in the US among that small business population. And then the other thing I would say -- the other place where we -- that's always at risk is in our claim service. And as we've reported to you, we have invested more than we'd like in some cases in outsourcing some of the -- some of the legal expenses that come through, but part of that has been, as the business has grown, we have not been willing to back off of what we still consider an industry-leading claim service and we've invested in that. So our customers who do have claims from us have a good experience and we believe that pays dividends in the long run and that's what the customers are buying.

So broadly speaking, I suppose, if you're a niche D&O broker who lost a bunch of business, you're not too happy with us, but you're professional and you understand how the market works. General customers, we've seen, they continue to go north.

A - Bronek Masojada {BIO 1776109 <GO>}

The next question?

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi. It's Ivan Bokhmat from Barclays. Two questions please. On the retail, could you speak about the the pricing you achieved in connection with the claims inflation that you've seen, maybe separately for US and the rest of the businesses? And I'm wondering, what you saw in 2018 and 2019, whether the numbers are materially different and what do you think would be the kind of the long-term trend for the direct business in particular?

And secondly, Joanne, maybe a question to you. You spoke about growing in D&O right now. Just wondering whether you are seeing -- what risks you are seeing to that strategy, which geographies you focus on and what kind of reinsurance protection you've got? Thank you.

A - Bronek Masojada {BIO 1776109 <GO>}

Thank you. I think both of those actually are for you, Joanne, in terms of the retail claims inflation versus pricing and then the D&O.

A - Joanne Musselle {BIO 19106109 <GO>}

So I mean, just talking about more generally about the retail increase in price, what we've seen is about 5% uptick on our error and omission portfolio and 13% on the refocus private D&O portfolio, as Aki and Ben both alluded to. We've scaled back that private D&O portfolio from 60 to 20. We've picked the 20 of core which actually had been profitable over that period and we are seeing an uptick of 13%, because the wider market is increasing.

More generally, we're not immune, whilst we're not directly impacted by social inflation. We were not immune to that those of the casualty stories in the market. And so therefore, we are seeing a general uptick on our smaller business. I think from a particular social inflation point of view, there is a lot of schools of thoughts around social inflation, but this is really looking at the -- of the jumbo awards, particularly focused in general liability, high excess, and umbrella, and actually across our business even including our bigger ticket business we've got less than 2% of our premium, which is in that area. So the -- so what we see and it's a general uptick in our -- on our premium, which is good news and we're seeing that continue into 2020.

And then, particularly on the London market D&O. So this is the public D&O, particularly focusing US. And as I said, three years ago, that markets was in the course correction. The prices were deflated. Claims were higher than the prices that we were achieving. And also, we were in a soft market with terms and conditions were very wide. But what we have seen is a complete turnaround in that market, obviously, driven by losses and driven by a reduction in capacity. When those two things happen, then obviously the market changes considerably, and we're seeing a sustained increase in rates. We talked about 60% in 2019. We're seeing that continue into 2020. That possibly will slow down during the course of the year. We've not seen that yet.

I suppose the big thing is the exposure that I talked about. So once we've increased our premium, the actual exposure for D&O is gone down. So we use a measure called rate online, which is basically a measure of premium versus the exposure. And our 1% rate online is going to 3% rate online. So you can see that, as our premium increases, our actually exposure has decreased. So we absolutely see that as a market that we want to grow and developing and that's within our plans for 2020.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Small follow-up if possible. In November we spoke about the red part of the portfolio, there was quite a particular focus on that. I'm just wondering over those three months, where do you think is that as a percentage of the book where you need to correct of course overall, and where have you made most gains you think?

A - Joanne Musselle {BIO 19106109 <GO>}

Sure. So in aggregate, across the whole of our portfolio 90% is either in grow or hold. So 90% of our portfolio is not in the course correction area and that slightly varies by the different parts of the portfolio, but that's the view -- that's the thing in aggregate. So we feel like we have come out in particularly London Market, come out of a soft market. We have been disciplined. Since 2016, we've exited 600 million of underperforming business, 100 million in Retail, 400 million in London Market, and a 100 million of Reinsurance. So therefore we feel now the portfolio is positioned on what you see with those graphs at the end of '19, we feel that that portfolio is well positioned as we go into 2020 to take the opportunities as those arise in the different segments.

A - Bronek Masojada {BIO 1776109 <GO>}

Okay, great. Let's take one from the middle and then we will go to (inaudible) and then we will go across the room otherwise. So he is in the middle. Go ahead, Jonny. So you are from the home team, so you should know how to work it.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thanks, Jonny Urwin, UBS. So firstly on the reserve buffers. Thank you very much for the disclosure. That's great. The 9.4%, where does that compare to your kind of comfort range or target level just to get a feel for how happy you are there? And then secondly, on the in-sourcing of the legal function in the US, how is that going? What's the timing? Thank you.

A - Bronek Masojada {BIO 1776109 <GO>}

Okay, great. I think the first one to Aki and then the second one to Ben.

A - Aki Hussain {BIO 19739719 <GO>}

Sure. In terms of the 9.4% coverage or the buffer, that's $300 million roughly, and that's pretty much in line with where we expected to be in a kind of normal sort of operating year.

A - Bronek Masojada {BIO 1776109 <GO>}

Ben?

A - Ben Walter {BIO 16330248 <GO>}

On claims, I think it's important to say, we had never outsourced our claims function even in the US. It has always been in-sourced. But that business grew at a 30% clip for four years in a row. And the reality was, sometimes then the claims don't come in right when you grow, so they come in spurts, and at times, we would outsource components of that from the internal team to keep up. We've started raining that back end. We've hired over 20 people just in the last few months. We had started training and that's all going well. It will take time, but we can already see the numbers of loss adjustment expense coming down.

A - Bronek Masojada {BIO 1776109 <GO>}

Andreas, I'll come then to Andrew. Sorry.

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

Thank you. Andreas Van Embden from Peel Hunt. Three questions please. One on your binder portfolio here in the London Market. You mentioned that further actions are on the way. Could you maybe comment on the size of the book and what actions you're taking? is this a material shrinkage of property binder?

The second question is on capital and the optimization that you're doing. What type of optimization is this? Is this part of sort of the derisking, maybe of the reinsurance book?

And finally on pandemic risk. You disclosed $175 million sort of exposure in worst-case scenarios, Spanish flu in your appendix. Is that all personal accident and is this is a realistic scenario given what you've commented on before about your exposures to travel and business interruption? Is this something separate we would -- would really a cat event rather than what we're seeing now? Thanks.

A - Bronek Masojada {BIO 1776109 <GO>}

Okay. So one to Joe on the binders and maybe the pandemic, and Aki clearly on the capital. Maybe Aki should go first on the capital.

A - Aki Hussain {BIO 19739719 <GO>}

Sure. So in terms of capital, just as a reminder. Solvency coverage ratio is 205% and that includes an 11 point strengthening on the BSCR. So from last year, we have reported to 10, absent any other optimization. We would have seen that coverage ratio reduced to 199. The improvement has come through from a couple of areas. One is just not anything specific, but just a natural evolution of the reinsurance program and how it evolves over the year. But the more deliberate action has been, as the business has grown both in terms of geographically and the types of products we write, there are optimization opportunities which are technical in nature, so I won't go into the whole depth of them. But there is premium diversification coming from what the types of products we write and the geographies in which we write. We've not taken advantage of this in the past and that's something that we have done in 2019.

A - Bronek Masojada {BIO 1776109 <GO>}

So Joanne?

A - Joanne Musselle {BIO 19106109 <GO>}

And then moving on to the binder portfolios. So as we mentioned, we did do some corrective action in 2018. And whilst that had an effect, there was an underlying increase in trends. So it didn't have the required effect that we wanted, particularly attritional loss creep on the -- and that was obviously 2 times [ph] the benefit and we've increased our view of risk. In terms of what difference it will make, we are deploying about 4 billion less aggregate in Florida, as well as change in some of the terms and conditions of the individual binders. As I said, this will take a while to earn through and we won't see the full effect until 2022 but we will start to see the benefit this year and next year.

And then in relation to the pandemic, yeah, you're absolutely right. There is an analogy as at the back of the appendix, which has a gross loss of 350 and then net of 175. I'll just give you some scenario that we view just so you can see the relevance to the current potential pandemic. So we've picked an open source Cambridge risk pandemic, it's very similar -- very similar to Spanish flu.

So in terms of what we look at is, it affects about half of the population, and it has a death rate of about 25 million. So half the population of the world and the death rate is 25 million and it wipes off 17 trillion from GDP over five year periods. So you can see, it's a pretty extreme event. And obviously in comparison to what we're currently seeing, clearly Coronavirus would have a major impact in the western world for us to be anywhere near that. The majority of those losses that we've built in the scenario are driven by events cancellation, et cetera. But yes, in terms of the -- this type of event that we've chosen, it is a analogy asset disaster scenario.

A - Bronek Masojada {BIO 1776109 <GO>}

We're a long way from that level of loss. So I think you can relax a little bit about this one. I saw that and I asked the same question. Andrew?

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi. It is Andrew Ritchie from Autonomous. Four questions I'm afraid. I think the quick ones. On the US, I think Aki said the current year loss ratio is now improving sort of US retail. I'm a bit confused, I thought the current year loss ratio was increased in '19 to reflect some of the issues and you kind of going to hold it there. Obviously, it is a bit of noise from PYD as well, but just understanding, the current year US retail already improving current year, not just current accident year. And I guess, would you expect that to continue improving in 2020? I guess, you would because you think rates ahead of loss cost? Clarity on that.

Secondly, Ben, you said you increased marketing spend a bit because of more competition. Is that specific, I know Boxer [ph] has launched a new small business. Is there anything slightly more scary about recent competitors, I appreciate the market opportunity is huge, but do you think some of your -- the new entrants are getting a bit better?

Thirdly, I think you've got four -- at least four closed books that I can think of. You're holding a big margin reserve best estimate, presume beyond some of those books. I'm sure most people out there willingly take those books for a lower margin as a best estimate. Is a possibility of exiting some of those closed books through other people's balance sheets?

And finally, three people mentioned the reinsurance profit over 10 years. It feels like you're trying to justify the reinsurance business or you feel somehow you need to, I guess my only point would be, maybe it's a good return on capital, because it does consume a lot of capital, not just the profit, do you think the reinsurance business is covering its cost of capital over time? Thanks.

A - Bronek Masojada {BIO 1776109 <GO>}

Okay. Well, that's quite a comprehensive list. So why don't we go with Aki first on the US loss ratios; Ben clearly on the US competitive environment; and Joe on the -- what we're going to do in terms of our run-off books and I'll take reinsurance at the end. So, Aki?

A - Aki Hussain {BIO 19739719 <GO>}

So on US, we saw -- you're right. We have previously said we increased the loss picks, but that is not across the board, that is on some selected lines. When you strip out the effect of prior reserve development and the cautious approach we've adopted to reserving, the underlying loss ratios for the Retail business are improving. They are improving largely driven by the actions that we've taken on the D&O book, which was a higher loss ratio business. And as you've heard earlier, we've significantly reduced our exposure and we're taking rate on the retained book. The other remaining management actions we've spoken about, whether it's further in-sourcing of the legal component of claims or the rate increase that you've heard from Joe, those are not yet reflected in those loss ratios, those will come through over the next few years.

A - Ben Walter {BIO 16330248 <GO>}

In terms of the competitive environment in US small business, it is absolutely heating up. There is no question about that. We've expected that to happen for a long time. My broad view remains that's good for us as opposed to bad for us on balance, because it's validating direct and partnerships as a way to buy the product and it's growing that distribution segment is growing as a share of the overall pie.

In terms of specific competitors, Shawbrook [ph] is out there. There's a big new one called Next, which has done a good job and their backed by Munich Re. But as I like to tell people, you know they -- when they sorted $80 million of run rate premium, Munich Re bought them into $1 billion valuation with the 25% share. So I think that's a pretty good multiple on this type of business. But broadly the space is maturing and that means there will be more competition. I do expect some of the big traditional players eventually or direct players eventually to cotton on and start being part of it. We're prepared for that, and our goal is to have the biggest head start we can in terms of brand and distribution capabilities and product scope before that happens.

A - Bronek Masojada {BIO 1776109 <GO>}

Joe?

A - Joanne Musselle {BIO 19106109 <GO>}

Yeah, so with regard to this loss portfolio transfer that you alluded to in some of the book there in run-off, I mean, yeah, there absolutely is something that we consider. What we've done historically, we have a few that we've actually done that with -- if the deal is rightly rewarded, obviously has a benefit of capital as well. But it is something that we look at on a case-by-case basis and we look at the merits on the individual portfolios to see if it's attractive.

A - Bronek Masojada {BIO 1776109 <GO>}

I'd also add, we have done those in the past. We did one for UKPID in our portfolio, how many years ago was that Joanne?

A - Joanne Musselle {BIO 19106109 <GO>}

So we've about three years ago.

A - Bronek Masojada {BIO 1776109 <GO>}

Yeah, so not even when we were reserved, we were very happy if somebody gives us a bit we think it's worthwhile or actually we just want to CapEx and move on, we're very happy to get into those sorts of transactions.

In terms of the reinsurance, while I was thinking about three insurance capital. If you look at the Re sort of think that in reinsurance, we probably allocating for every dollar of net written premium, $2 of capital. Last year, we had $212 million of net written premiums. So it's about $450 million, $500 million. And on that basis, $700 million over 10 years is a pretty attractive return on equity. What it goes to is actually the benefit for each part of the business from diversification gain from the other parts. If Reinsurance was a standalone business, we will probably need $4 per dollar of net written premium. So being part of the broader group, that's where the capital efficiency of the diversification pays off.

People focus on the P&L impact. We're very aware of both of those. In terms of defensiveness, yes, don't get me wrong, I'm pretty irritated with the performance in the last three years in terms of that. And if you recall after 2017, I tried to lead the market up, because I thought after that year, prices needed to go up. A lot of people didn't agree, so prices didn't go up, but prices need -- we've seen our reaction in the London Market business and the Reinsurance are being squeezed. I think inevitably economics is going to play through. On the one hand, we've had some redemptions and there are less fund, which is from a asset management perspective, a bad -- fees and profit commissions are bad thing. But from a market discipline perspective and even better thing. So to that extent, we have within our amendment the ability to change course and adapt to changing capital flows and that really is what the business can do really well.

So, Ben, and then he will come across Paris.

Q - Ben Cohen {BIO 1541726 <GO>}

Thanks. Ben Cohen from Investec. I think Andrew asked most of my questions, but just a follow-up on

A - Bronek Masojada {BIO 1776109 <GO>}

Oh legally [ph].

Q - Ben Cohen {BIO 1541726 <GO>}

On the Reinsurance side, where -- what sort of current level of margin do you think that business is capable of earning and if it's a sort of a multi-year story to get it to the sort of target margins that you would like over how many years do you think that will likely happen? Thank you.

A - Bronek Masojada {BIO 1776109 <GO>}

Ben, I think the reality of Reinsurance is a far more one-year repricing deal. That's why we've been quite clear that if they don't hit the margin this year, we will shrink. So I do think that in the last year, if you took an expected loss ratio norm on a long-term, Reinsurance was an attractive place. You have this on -- the other thing which does muddy the waters a little bit is we have internally updates of Hiscox view of risk which is a moving feast as well, but we think that the book will end up within calendar 2020. If we have a normal last year, it will be attractive margins. So we don't think it will like a long time. It's different to the Retail business and the speed with which you can reprice that.

So, Paris?

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes, good morning. From my side as well. Paris from Exane. A few questions. So firstly on ILS fees. 25 million impact this year. Did you do flag some redemptions basically from next year onwards? What kind of payback are you going to get there or how much of these 25 million you are actually going to be making buck?

A - Bronek Masojada {BIO 1776109 <GO>}

Okay.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

And then I need to come back on this buffer over actuarial best estimate. You are flagging 300 million as a comfortable level. But you are saying that over the long term, you are targeting this 8% to 12% reserve releases, which should mean that from next year you are actually expecting this 300 million to go up, because we are releasing the less on 8% to 12%.

And then lastly, just a clarification on the Retail business. When we last met you at the nine-month trading update, I think you were saying that you are going to review the whole portfolio and because you have been growing quite a lot, there were certain lines of business that you might have to look? You are only flagging D&O and media. Is there anything else that you think you have grown too fast or profitability doesn't really go your way and you will be taking a step back? Thank you.

A - Bronek Masojada {BIO 1776109 <GO>}

Okay. I think for the first two on the ILS fees and the buffer, Aki, that's for you. And then on the portfolio for Joanne.

A - Aki Hussain {BIO 19739719 <GO>}

Okay. So let me start with the ILS fees. Now there is a -- there is a kind of irony here. So as money leaves the investment funds to the ILS funds and new money is attracted, the new money is -- there is much high probability that new money pays PCs, profit commissions, which the old money that's left that was subject to high watermark and so on. So actually money recycling out of the fund will accelerate the pace at which we go back to earning $25 million, $30 million, whatever the number is for profit commissions.

In terms of how you should kind of think about modeling this, the thing to note is, not all of the either -- some of the ILS funds are below what we call a high watermark, but some are not. Some are earning profit commissions today. So I would say the best way to do this is assume a trend that we get back to a normal profit commission level again over the next -- probably next three years.

In terms of the buffer and the reserve releases. You're right, we do have a buffer of $300 million and that equates to about 9.5%. But when you think about reserve releases, in essence come from two sources. They come from a variable experience relative to actuarial estimate, and also as the margin is released on all the years of account.

Now as we've mentioned earlier, we are -- we have refined the reserving approach for Retail business, where we're taking longer to recognize the favorable experience. That is acting as a natural governor on the pace at which we can release from our reserves. That does not necessarily mean the margin will go up, because that favorable experience is held within the best estimate.

A - Joanne Musselle {BIO 19106109 <GO>}

And with regards to the Retail portfolio, I think if you recall, we've got 90% of that portfolio in grow and hold. So there is about 10% which is in corrective action. I suppose what we -- I would talk about is that, we constantly course correct portfolio. As you know, the risk change, the market changes, so we're always slightly tweaking up our portfolio. What we've referenced is some of the more extreme course corrections, the downsize of the portfolio from 60 to 20 on the D&O account is what I call more extreme course correction. There is always more subtle in temporary course correction that happens in our portfolio.

A good example would be the UK homeowners portfolio. At the back end of 2017, we saw an uptick in -- with the rest of the market in terms of the escape of water. And so that portfolio is being corrected. With regards to rate rises, over the last 12 to 12 months to account for that uptick in escape of water. And obviously that portfolio is now back in hold phase.

So picking up the US particularly, we haven't got any extreme course correction going through. What we do have is more subtle. So we have -- I've mentioned on the slide, GL, in our blue color segments, again, this is not a segment that we don't think is profitable, we absolutely do, but this is some tweak [ph] and change into maybe our questions that are just slightly tightening up some of the things that we do from an underwriting point of view, but it's certainly not at the extreme level.

The course correction that we have been in Retail is constant and is much more around that sort of subtle in temporary rather than this only extreme in or out that you might see on some of the bigger ticket.

A - Bronek Masojada {BIO 1776109 <GO>}

I think to use slightly a sailing analogy, it's like changing small -- changing when the wind changes, which is what we call course correction. What we did in D&O and Americas, what I call a crash jibe, and we all prefer for those who would be on sailings this small course corrections in crash jibes. And so that's our ambitions to -- lots of little rather than seldom and often -- sorry seldom and extreme. And in case if we get it wrong and that was clearly the case in D&O, but most of the times is a noise. A new exposure comes and your lost cost comes and new opportunity comes and you're changing the wordings to reflect that a little.

Q - Ed Morris {BIO 16274236 <GO>}

Thanks. Ed Morris, JP Morgan. First question just on the homeowners block. FCA, I think is scheduled to publish its market study in Q1. Just wondering how you sort of view your product offering, which is a little bit more at the premium end? Do you see any specific questions that I may pose and have you done anything on pricing in the last few years that is -- as we're thinking about here?

And second question, just a quick one on the catastrophe budget. So you mentioned that your view of risk has changed but also that the renewals you pulled back a little bit. So how has the CAT budget changed in general [ph]?

A - Bronek Masojada {BIO 1776109 <GO>}

So I think the first one, Joe, would you like to fell comment on the FCA, and Aki on the budget?

A - Joanne Musselle {BIO 19106109 <GO>}

Yeah. So we are awaiting the market study, as you know, in terms of pricing. Clearly, we've been involved in that for a while, and we're keeping abreast of what that would look like -- look like. I think the most important thing to say from our point of view is some of those pricing methodologies that have been talked about it's not something that we do. That's of low to high point. We don't have targeted low to high pricing and we certainly don't target vulnerable customer group.

So in terms of some of the philosophies that have been talked about, that's not something that we engage in. However, we are not immune to the market and obviously it does depend on what they come out with regard to some of the remedies and obviously that could affect. We are looking into that and -- but as I say, in terms of the high level strategies that have been talked about, that's not something that we do.

A - Aki Hussain {BIO 19739719 <GO>}

In terms of the CAT budget, there isn't a material change year-on-year, slight increase. For London Market, we expect the rating environment will offset the increase in our view of risk. And for Reinsurance and ILS, as you heard from Bronek and from me and from Joe like that is a bit of a wait and see how your risk has gone up. And if the pricing follows, then we'll will be writing more business.

A - Bronek Masojada {BIO 1776109 <GO>}

Great. Are there any more questions? So thank you very much for coming. I hope that's given you a degree of confidence in Hiscox. We're pretty confident of about where we're going, and I hope that in a year's time, we have vast numbers to announce to all of you then. Thank you very much.