Q2 2015 Earnings Call

Company Participants

- David Andrew Horton
- Martin Lindsay Bride
- Mike Donovan

Other Participants

- Barrie Cornes
- Eamonn M. Flanagan
- Fahad U. Changazi
- Kamran Hossain

MANAGEMENT DISCUSSION SECTION

David Andrew Horton {BIO 5697110 <GO>}

Good morning, everyone. Welcome to our results presentation for the half year ended 30th of June 2015.

If I move through the disclaimer quickly on contents, I'm going to give you a brief overview of the numbers, a short business update. I'm then going to hand over to Martin, who's going to go through various elements of the financial performance, investments capital and some reserves capital and so on.

And then, we have our special guest of 2015, which is Mike Donovan. Now, Mike was intending to get here yesterday and unfortunately, his flight from San Francisco was cancelled and therefore had to be diverted through Washington. He has made it this morning. Unfortunately, his clothes did not follow him. So, he has arrived not completely without clothes. We're pleased that he did bring some clothes just in case. So two counts he made it here, which is fantastic, so well done Mike, and he's wearing clothes. Great things on both counts.

Mike knows everything about the technology world. He's been heading our Technology, Media and Business Services division for the past 10 years or 11 years, designed to Beazley Breach Response product. So we're going to focus on cyber this morning. And then, I'm going to come back for the outlook.

So, if I give you an overview of the numbers, you'll see that the profit before tax is up 16% over last year at $154.5 million. And why is that? We've seen a relatively quiet claims environment, especially on the business we wrote in 2014, particularly in the short tail classes, and within that, the catastrophe exposed classes. So, we could see prior year reserve releases across all lines holding up to similar level to last year. And that's delivered the 86% combined ratio.

The underwriting return, combined with relative benign investment world up until the end of June and the excitement over Greece and China, meant we deliver a similar investment return over 2014. And the combination of the underwriting and investments means we've delivered a good return on equity at 20%. And out of that, we continue with our dividend strategy of growing them between 5% and 10%. So, the interim dividend is up £0.002 at £0.033.

The one challenge in this market, it's very competitive and growth is really tough, so raising top-line growth at 2%. So, it is difficult to grow in this environment, and our aim is to continue to try to grow at mid-single digits going forward into 2015 and 2016.

If I give you a flavor of where the growth has actually come from, we continue to focus on smaller lines of business. We continue to focus on our U.S. business. So, our U.S. source business has grown by 25% year-on-year. And if you remember, we grew that in 2014 over 2013 by 19%. How have we done that? We continue to open further offices. We've opened an office in Los Angeles which sort of finalizes our U.S. footprint focusing on New York, Chicago, San Francisco, Los Angeles, Dallas, which we opened last year, and Atlanta. So, adding to our office footprint and slowly filling up each of those offices with the product lines we want to write within the U.S.

The accident and health business, which we've been investing in for several years now based out of a small office in Minneapolis, is starting to write premiums. I think last year, it was $1 million or $2 million. Now, it's up to $14 million. Our aim is for that to continue to grow.

We also announced early this year, I think April, a partnership with Korean Re, where we have agreed to cede about 1% of our premiums to them, so about $20 million. And now, they're giving us $20 million of Korean business which is very difficult for us to access. The main aim of the partnership is not purely a premium swap of $20 million for $20 million. It's actually partnering with them and looking at product development we can deliver to the Korean market and giving them expertise of what we are doing within Lloyd's.

Andrew Pryde, our Chief Risk Officer, has already lead the first delegation out to Seoul, and we've come up with about a dozen ideas of where we could work more closely together on product.

We continue to attract more people. M&A, which I'm sure we will talk about on the Q&A, M&A in the market, I think, is good for Beazley being an organic growth company because people always fall out of mergers and acquisitions transactions. So, there is always an opportunity to recruit good people who fall out of other organizations when M&A takes place, and we are gearing up to ensure we make the most of that.

On that note, I'm going to hand over to Martin to talk about the financials.

Martin Lindsay Bride {BIO 15458196 <GO>}

Thank you. Thank you, Andrew. Good morning, everyone. I'm Martin Bride, Finance Director. So, what I would like to do is just spend a couple of minutes on a few of the finance KPIs and then to go through my usual trio of investments, reserve releases and capital.

So on the finance KPIs, just a couple of points I'd like to draw out, the ones on the first slide. I'm very pleased with the net earned premium growth, 7%. So, that's a strong growth from my perspective. In particular, our U.S. business started growing strongly in the second half of 2013 and particularly, that aspect of the business is now flowing through the earned premium line. So, that's a good outcome from the team.

The other highlight for me here, I mean there is a helping FX effect, but the NTA per share, shareholders have £1.35 this time last year. They received a £0.212 in dividends and they've now got £1.566 in the company. So, that's a big increase in NTA over a 12-month period which is testament to the achievement of the teams at Beazley.

So, on the investment front, remarkably a similar picture to 2014. We've achieved 1% in the six months, so an annualized 2% return, and it's pretty much business as usually. If you look at our portfolio, we remain with a core portfolio, 85% of it conservatively invested and generating, given the very low interest rate environment except for returns. And then we have about 15% seeking slightly higher yield in what we call our capital growth asset portfolio.

We are in the process of implementing a few minor changes within that portfolio, and you can see between December and June a slight evolution in the weightings there. But overall, it's a very consistent strategy and we're pleased with the way it's performed in the first half of the year. We, nevertheless, continue with very low U.S. interest rates and are hoping at some point that that perspective changes and rates actually go up which is - be great for the economics of our business, although it will create some investment losses as and when it happens.

Moving on to the claims reserve picture. Reserving is a key part of Beazley results presentation. Our philosophy as a company is always to reserve prudently across all our lines of business. And therefore, on average, you should expect to seek reserve releases coming from the claim reserves as they are paid out, and that is the case in the first half of 2015. You can see it's very much in line with our long-term average coming from most divisions of the company are contributing to that reserve release picture, so we're very encouraged with that.

And just as important as the releases that have been made in the half year is the question of is that likely to continue, and that's why we show you this graph, which is giving you an indication of how we view the strength of the reserves that remain on our balance sheet. As you can see, we are in the corridor that we're targeting. The graph is relatively sensitive, so I don't get too excited by minor movements in it. I think the big picture takeaway for me is that the reserve strength of the reserves in our balance sheet remains consistent within the corridor that we've targeted. And therefore, all other things being equal, those reserve releases that you see coming through our P&L are sustainable and should continue as we go forward.

Finally, an update on our capital position. We have a strong capital position. The board saw fit to declare an interim dividend of £0.033. That's an increase of just over 6% over the same time last year. The philosophy of Beazley is to review capital positions at the year end, once we have a clear view of the business plan for the next 12 months and the full-year results. So, we're very pleased with the strong capital position we have at the half year, and that will be reviewed towards the end of the year.

So Mike, over to you.

Mike Donovan {BIO 21247195 <GO>}

Thanks, Martin. Hi. I'm Mike Donovan. I lead the Technology, Media and Business Services team at Beazley, and we focus on ensuring technology companies and also providing solutions, data breach solutions, in the marketplace.

We focus on both large and middle market accounts over $35 million in revenue. We have a separate business unit that focuses on the same products within under $35 million. We have three main products: Technology Errors & Omissions which is we have a forum that, first, we brought out in the year 2000, and we focus mostly on the larger end of the technology E&O space. We're a leading market in insuring large technology and firms. We insure some of the largest in the world. We work with our brokers to develop through our expertise and understanding the client's needs. We're working a lot of bespoke programs, and that's been a very successful line of business for us for many, many years.

The segments that we write in are quite diverse across technology-related companies, service providers and associated companies that are in that space. It is an area that a number of those companies do have exposures to breaches. And indeed, some of the breaches that occurred in the early 2000s to mid-2000s is where we first started to become aware of and learn about how data breach has occurred and gain some expertise in that area.

The Beazley Breach Response product is a product that is an integrated product that integrates both the service offering and also the insurance. And it is aimed at companies that collect personal information. This is a product that is aimed primarily on the middle market with revenues up to about $3 billion.

We also have an Information Security Insurance product that is an indemnity-based product. And so, it does not have the services component to it, and it focuses more – the target market for that is generally the larger companies, who are large enough to the service component, is not something that they need. So, those are the three products that we focus on in TMB.

This slide here shows the growth of TMB over time starting in 2007 and a few points on that. One, you can see that kind of the pink and reddish lines are the ones that represent our information security in BBR products, and you could see the growth from a very small part of our portfolio to the predominant source of revenue over the last few years. The E&O component has been more stable. The E&O business is a more mature market, and so we have been maintaining our position, and that market has been growing slowly over time, but it's just a more mature market.

The other thing to point out on, this is in the last year 2014 to 2015, we've seen a marked increase in demand for our products in the breach response and information security space. And that's on the back of all the news reports that you've read on the various large breaches. It has really created increased demand, both among large accounts and also into the mid market and smaller end of the business.

This shows just dramatically where our underwriters are located. We have 10 in London, 4 of those underwriters in London focus on non-U.S. business which we see as a potential growth area in the future, and we are working to build business primarily within the EU and the UK. And in the U.S., we have underwriters that are distributed across all of our main hub cities in the U.S. with some key underwriting groups in Farmington, Connecticut; New York and San Francisco.

We also have a dedicated breach response services team that now has five professionals, three of which are based in Philadelphia, that's where our leader is Katherine Keefe, along with two service managers, and then one in Atlanta and one in San Francisco.

I wanted to focus on BBR services for a minute, BBR being the product that we are best known for in our team. It was launched in 2009. There is approximately 9,000 policies currently in force. Of those, the large majority of those are small accounts in the under $35 million range, although the large majority of the premium is in the accounts within the TMB unit in the over $35 million.

We have – we write into a number of different segments. Healthcare is the largest, though followed very closely by retail and hospitality. We also have strong positions in higher education and financial institutions, particularly credit unions is a very strong area for us. And we write across really all sorts of different companies, charitable organizations. Any organization that collects personal information is a potential client.

The BBR Services team has handled over 25,00 breaches now, large and small, and I thought I would provide a chart to give you an idea of the different types of breaches that they handle. One of the things that we are able to bring to our clients is the great experience that we have in dealing with a very large number of breaches. Breaches happen in all sorts of different ways.

What's interesting to see, looking at the chart there, is that about half, which should be the right-hand side of the graph or the chart, are basically mistakes that people make. Those remain the predominant cause of breaches. These are all the breaches that we handle in 2014, so large and small. Mistakes tend to be mostly smaller breaches, though sometimes they're very large.

You can see a hacker malware and insider behavior is actually a smaller part, though more of those breaches tend to be difficult. And you see the payment card breaches, actually a very small percent. But again, of those, more of those tend to be problematic than in some of the other classes. So that's, I thought, interesting to sort of see the wide variety of different types of breaches that we handle.

This is a slide that gives a little more detail into how our breach response product works. Our BBR Services group is a dedicated business unit within TMB, and they coordinate services that the clients require through a network of external vendors that we contract with and that are part of the team. And the circle there really represents how it works. You have the BBR Services group that basically coordinate and organize all of the other providers who are helping in deal with the breach event.

We've provided our – the clients are able then to have – basically, the breach is taken care of them on a sort of a turnkey basis and we found that as very – it resonates greatly in the middle market because it takes a lot of resources for companies to develop the ability to do this on their own. And so, we're able to bring to them the ability to have it handle in an effective, an efficient and economical manner and also and most importantly to try to help them control both the legal costs that are involved and also the reputational damage.

We also provide our clients with risk management advice and advice on breach preparedness. And at the bottom there, it shows across the time line basically of how we address breaches, first, by helping our clients not have breaches in the first place. And then when we get involved, then there's a time line of basically how we lead them through handling the breach to hopefully a successful – and where they provided a mitigation to the affected clients, patients and customers and are able to successfully manage their reputational issues.

Controlling risk, this is an important part of what we do in managing the portfolio. We control risk, first of all, through having a very diversified portfolio. We work hard to make sure that we have a cross-section of accounts, all the different segments, different sizes and so forth. Those are very important. As I've noted, a large majority of the risks are in the middle market and small account segments. We see that the frequency of events tends to be lower that the severity of events tends to be lower, and a lot of the high-profile attacks that you have read about in the paper are generally, they are brought against very large companies.

BBR Services and the claims team track breach trends and events with our client base and working with all of our vendors. We're usually really on the front line of seeing exposures develop, and the claims are very short-tail. You know when a breach happens immediately. And so, it allows us for a rapid portfolio adjustment, if needed, in response to any changes in trends.

I'll also mention that a lot of the press and government concern has been around infrastructure risk, attacks on the power grid, things of that nature. Our insurance does not deal with that. We're simply – we're dealing with the risk to consumers or for financial loss essentially associated with loss of data. So, our insurance is not focused on any of those infrastructure risk at all.

We do have technical experts that assist us with underwriting and devices needed and also on assessing potential points of aggregated exposure. We model aggregation scenarios and of course, we have reinsurance protection to protect against any kind of aggregated scenarios.

And then differentiators and opportunities. The key differentiators that we have in BBR, one is the focus on the value-added proposition of the services. This is the key value add to the product when we first developed it. It continues to be the key sales point. We were an early mover in the segment and so, it's allowed us to continue to keep ahead of the curve.

We continue to invest in pre-breach services for our clients. We recently relaunched a client portal to enhance our ability to communicate with our clients on risk management. We spend a lot of time on workshops with large clients face-to-face. So, we developed relationships with our clients both to increase the loyalty of our clients and also to hopefully help them increase their ability to prevent breaches and prevent losses.

And then finally, we have built a very strong brand in BBR, and our brand definitely differentiates us from our competitors.

In terms of opportunities for further growth, we see still a large amount of opportunity in the mid market and small account space in the U.S. The last year, where the large breaches that have happened, have really actually increased the size of the market and so, whereas we kind of saw market penetration in one spot a year ago, we actually see it different now because there are so many more buyers in the market than they were last year. So, there is still a lot of opportunity there.

We do anticipate growth in international market. It's been much lower than in the U.S., but we are seeing slow increases in growth and depending on regulations in the EU, that could change significantly over the next year or two.

Aggregated opportunities, what that is, is that we work with a broker on a portfolio of accounts that are potential buyers and we approach them in an aggregated way in order to try to drive purchasing from potential buyers who have not yet bought cyber insurance. We have a dedicated team that works on that.

Embedded insurance, this is where we take the BBR product and we embed it into another insurance company's product. This is aimed generally at micro business, so it might be with a medical malpractice insurer that will embed that into their medical malpractice insurance with very low limits and generally for very small doctors' offices. It may be in a business under protective insurer and again it's embedded, so that provides a – it provides coverage that they can add to all of their policies in bulk. That has been a growing area, one that is an area that we've been focusing on also for growth in the future.

We continue to differentiate our offerings. We spend a lot of time on R&D. We're working on automating in small account underwriting and distribution. As that area starts to continue to grow and become a bigger area of potential opportunity, we're working on more automation area. And of course, we continue to work on investing in building our BBR brand in the marketplace.

And so, that is update on where we are with our TMB and BBR. Thank you.

David Andrew Horton {BIO 5697110 <GO>}

Thanks, Mike. It's an exciting area for us and it's grown a lot historically, and our aim is to continue to grow it. That was not setting Mike's business plan for 2016, I hasten to add, but do keep it in your account when you're reviewing the plans. So, it should be a growth area for us going forward.

Before I look at the outlook, I want to look at the rate change chart since 2001. It's something we look at each year. One of the aims we have in rebalancing the portfolio, looking for the ones with the most opportunity in more challenging markets, pulling back on the ones that are more under pressure is to keep that dotted line as flat as possible, and that is the overall rate change of the portfolio. And you can see, it's been edging down over the past couple of years. But generally, it's been pretty stable for the last decade.

Within that, you can see quite a lot of volatility. So especially, the catastrophe exposed lines, the top line is reinsurance, property reinsurance, about 10% of what we do. You can see that's coming off quite quickly. But that's compensated by the next line down, which is specialty lines sort of the red line where that continues to edge up, and we're seeing some good rate increases in the cyber market in 2015.

Property, pink one, hidden by the dotted line and the pale blue one, being impacted again by mainly the catastrophe-exposed businesses of property and energy, is edged down. Life, accident and health, the black line, is flat and political risk, contingency and terrorism continues to edge down with the terrorism rates having fallen every year since 2002.

So, the outlook. One of the roles of the CEO, I feel, is to be the most repetitive person within the company. Many of my colleagues are nodding in the audience at this point in time. And one of the things that, I think, I've been repetitive on for several years is the returns. It should be expected to reduce. So with a low-claimed environment and with rates under pressure across many lines, the underwriting margin should reduce.

Announcing a 20% return on equity, which is higher than last year, obviously counters that. It is to some extent the balance of the portfolios, so we're doing as much as we can within that. But it is claims being below normal. And claims at some point, we would expect to take up back to whatever the normalized levels are but higher than they currently are. And on the back of that, returns should reduce.

Still, rate pressure. And while the industry is continuing to make good profits, I think there will be continuing rate pressure as people enter the new lines of business with the excess capital they generate. We're continuing to focus on the cyber market, the smaller lines of business which are less volatile and our U.S. business. And as I mentioned earlier on, M&A gives us an opportunity to attract more talented individuals in.

So, if you look to the rest of 2015 and onto 2016, we're hoping for mid single-digit growth if we can. We're just beneath it in the first half, although it has been impacted by foreign exchange, aiming to this 5% growth into 2015 and the first Q of 2016 is to continue to do that. The main aim is to try and to protect margin rather than go for all-out growth. And I think historically, we have been very good at rebalancing the portfolio to deliver the best return to our shareholders that we can.

And on that note, we'll open to questions. There is a microphone, I think. Maybe there isn't, then you can shout.

Q&A

Q - David Andrew Horton {BIO 5697110 <GO>}

I had two questions sort of related on the specialty business. The combined ratio there is kind of improved quite nicely to the mid-90s. I just wonder whether there's certain releases aside (28:37), there's any sort of one-off in that or whether you can expect price increases you've been guessing or that combined ratio should improve going forward. And the second question I had was in terms of the onshore growth in the U.S., the 25% that you talked about. If you strip out the greater savings in cyber, where is the growth coming from and who are you winning – taking the business from?

Okay. So, if I do the first one, I think one of the reasons the combined ratio in specialty lines has come down is we're opening at a lower loss ratio than we were post-recession. We feel more comfortable with that in the new (29:15) years. The other element to why it's coming down is a lot of Mike's class, certainly the data breach business, is shorter tail, and we opened that at a low loss ratio and we settled claims more quickly so we can recognize exactly where the cyber business is settling quicker than we used to with the Tech E&O, the blue bar that Mike was showing. So I think the combination of those is bringing the specialty lines business down. So we hope the overall business of specialty lines have been writing since 2012 (29:41) release more reserves going forward. So that's driven specialty lines down.

The second on the U.S., we've seen growth in the life, accident and health I will guess (29:50) and health part of the U.S., as I mentioned, that's a (29:53). But actually, we're starting to see some growth in some of the more traditional, more difficult businesses such as architects and engineers which has had a tough time post the recession.

Property market (30:04). We're looking for growth in property on both the pure property play and construction. We continue to grow the environmental. So it's been a combination thing that's been adding more people, more offices and products which historically we've had few resources, adding more resource to it and getting deeper penetration of those markets in the States. And the markets were also large, but you don't need to grow that much proportionately for us to actually increase the Beazley numbers in the States.

Where are we getting from? It does come from a variety of the specialty competitors. I mean probably, most of them, don't have them inside the market where we've got the premiere (30:42) position. But we don't notice (30:43) we're already taking business away from them, so it's not that we're attacking one insurer. The great feature about the U.S. is there isn't one dominant insurer. There are many insurers and therefore we're nibbling away a variety of insurers over there.

Q - Kamran Hossain {BIO 17666412 <GO>}

Morning. It's Kamran Hossain from RBC. Really interesting kind of points on the breach products. Just had a few questions on it. You mentioned European regulations. Could you just talk about if the EU does bring in kind of similar kind of breach regulations, the ones in the U.S., how big that market might be, first of all? The second question is what's your market share in the U.S. at the moment and kind of where do you see that going? And then thirdly, if these are so (31:32) the enormous potential for growth there, do you have enough capacity at Beazley to actually write that business?

A - David Andrew Horton {BIO 5697110 <GO>}

So, what's the third one again?

Q - Kamran Hossain {BIO 17666412 <GO>}

Do you have enough capacity to kind of to (31:45) that growth come in to Beazley?

A - Mike Donovan {BIO 21247195 <GO>}

I can take the first two. In the EU, we do hope that developing regulations in the EU will create more of a marketplace for cyber insurance and data breach products. We're already starting to see some increase in demand, where just the expectation that it is actually going to happen. This was something that's been talked about for years, and it does now appear much more likely than it will happen. And so, we're actually starting to see a bit of demand increase just in the expectation of that. So, I do believe that there will be definite growth in the EU over the next few years. We have a team that's been working very hard to build distribution channels and be ready to take advantage of that when it occurs, very hard to predict exactly how big it will be. But certainly over time, it could be a marketplace that could (32:42) the U.S. in size.

And the second point was the U.S. – what market share it is. It's very hard to know. I've seen all sorts of different numbers as to what the cyber market is in the U.S and so, it's very difficult to say. I do know that where we focus on in the mid market and particularly in some of the areas, such in the healthcare space, we do have a significant market share.

It's hard for me to say how much. But it's in the areas that we've really focused on, we have become a very strong leading insurer in those segments. And that's the last...

A - David Andrew Horton {BIO 5697110 <GO>}

(33:26) I hope I'm answering it correctly. I mean from a U.S. and UK perspective and elsewhere, we're building the infrastructure on people to be able to write more business, and Mark has gotten the piggybank enough capital to ensure we can grow. So I think we have enough of the resources to continue to grow across most of the lines we want to grow in. So we're not short of anything, and we've become quite an attractive place to join. So, we seem to be able to attract more good people.

Two question on capital. Your capital requirements increased around 4% for the half year. Your premium growth is around 2%. Can you break down the ingredients of the growth of capital requirement?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

I need to come back to give you a detail though. So I mean I think the capital is set using the internal model, which it does get updated at economic scenario generators and things like that. So, there's been no step change in capital requirements for the Lloyd's of London. What would have happened over that six-month period is there will be slight adjustments to the portfolio and slight changes to the output of the internal model, but I think that's sort of 2%, 4% growth is what you should expect as the – going forward will be a little bit of volatility in those numbers.

A - David Andrew Horton {BIO 5697110 <GO>}

I mean I think the key point Andrew (34:53) is we're going to see volatility in the internal model and then we hold our buffer to manage that volatility. And we're pretty going to see more volatility over the Solvency II model than historically we did. And that's one of the reasons we have to hold this buffer at 15% to 25% above it.

Okay. Thank you. Maybe a second question just on the 2% increase in the casualty rates. Which lines of business with specialty we're driving those rate increases? Was it across the board, or were there some lines which showed significant rate increases in other lines or slowly sort of softening?

I think Mike's large info sec (35:27) would have seen roughly major rate increases on the back of breaches, so that will be one of the main drivers. A lot of the lines are close to zero. So, a lot of them are sitting really as expiring. I guess the line is probably close to flat. So, most of them have small movements, plus or minus a few percent, and the cyber is the one that's had the largest increase.

And I think we've also seen on the EPLI some...

Yeah, losses post the recession including perhaps its liability as they continued to see rate increase on that.

A - Mike Donovan {BIO 21247195 <GO>}

We're definitely in the U.S. not seen the rate pressure that we were seeing a couple of years ago. Rates tend to be either flat or a lot of the teams are able to get some rate increase. So, the rates across the board have been stronger than they have been over the last couple of years.

Q - David Andrew Horton {BIO 5697110 <GO>}

Just one quick question, sorry, if I've missed it in the presentation. What are our current type of premiums, how big are they as a proportion of your specialty lines portfolio?

So the cyber premiums?

Yeah.

That was what we were showing on the chart. So, it'd be on the chart 16.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah. Chart 16 is an underwriting year vision. So, it's probably roughly $200 million of Beazley's full-year GAAP premiums this year are going to be coming from Mike's team.

A - Mike Donovan {BIO 21247195 <GO>}

Yeah. The chart there shows just the TMB portion. And if you add in the cyber premiums from the other lines of business in the small account space, then it would come out to about $200 million or 10%.

Q - David Andrew Horton {BIO 5697110 <GO>}

Hi there. Johnny Owen from UBS (37:15). Two questions please. The first on expenses. Can you just talk a bit about what's going on with the expense ratio, what you can do to lower it going forward? Obviously, there's been a lot of stuff in the press about what lawyers can do generally to take out a bit of cost to make things more efficient, maybe a levy to raise the restructuring charges needed. Talk a bit about that please, that'd be great. And also, I saw that the talks are still ongoing with regard to a decision to (37:46). I just wondered if you could tell us a bit more about that as well.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah. Well, thank you. It's great to get a question on the expense ratio. It's actually gone down. The reason for that is primarily that the dollar is stronger against sterling. The real dynamic in Beazley is that we're building an infrastructure to support much bigger business. We are controlling our expenses very carefully. Our biggest expense by far is our people, and we've just passed a 1,000 mark and we like every single one of them and want to retain them all.

So, there's not an area of our expenditure that is inefficient that we are going to cut. So, the real question of how our expense ratio will evolve is our ability to grow the top line.

We believe that we could support a significantly larger portfolio with the current team of people and infrastructure. So, what you should expect in terms of the evolution of our expense ratio is really dependent upon how we can grow the top line.

As far as the discussions in the London market about investment to make the market more efficient, those are clearly going on, and I'm sure that Beazley will pay its fair share, I should say, of those initiatives. Even though the headlines are quite large numbers, they're not going to be very significant expenditures for us. So I would not expect the London market modernization efforts to cause a step change in the overall Beazley Group expense ratio over the next couple of years.

Then your final question kind of was on the (39:34). We believe it's certainly feasible for Beazley Plc to return to the UK and we're looking very carefully at that to make sure that we have analyzed it for more angles and there's nothing we haven't thought of. That process I would expect to complete over the next six months or so months at which point you should expect some firm comment from us either we are going to make a change or in fact we've concluded that staying as we are is the best thing to do.

Q - David Andrew Horton {BIO 5697110 <GO>}

May I ask what the strategic reason is behind the increase in the reinsurance portfolio where you've put more one-third of the growth of the insurance premiums back to retrocession? Is it de-risking or are you taking advantage of weakness in the reinsurance rate?

So, it's increasing reinsurance spend, John (40:39).

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah, in the reinsurance account.

A - David Andrew Horton {BIO 5697110 <GO>}

In the reinsurance account, yes. So we have taken a view to reduce our risk appetite in 2015, and therefore we've ceded more of our reinsurance out this year. So rather than – we have the choice. That means (40:53) if we want to reduce our exposure, we're actually taking a smaller position in the marketplace or taking – writing less. So as you know, we will continue to write what have been as good business and see more of a doubt (41:04) to reduce our overall risk budget down to $560 million and a one in (41:08) $250 million.

Q - Barrie Cornes {BIO 2389115 <GO>}

Morning. It's Barrie Cornes, Panmure. A couple of questions. First of all, Solvency II, I wonder if there's an update, give us any flavor for how you feel ahead of the 3rd of January. Secondly, M&A. Andrew, I think you mentioned that M&A opportunity – given your opportunities for picking up people, which is good, what about your own staff? Just wondered if there's going to be any pressure on expenses, what you're going to need to do to retain some of your key staff which could be looking to be poached.

A - David Andrew Horton {BIO 5697110 <GO>}

Are you going to pick Solvency II?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah. So, Solvency II. Beazley is applying to have its internal model approved. That application went in on the 1st of April to the Central Bank of Ireland. And we await – we remain in close and continuous discussion with the Central Bank. That's been the case for last three years our four years. I mean we believe we got an excellent model and excellent risk and capital modeling team. But at this stage, we just wait and see what the feedback from the Central Bank is once they've concluded.

As far as our – we are already setting capital using that internal model. So, we're relatively comfortable with our capital levels. Obviously, the other important model application that's going on is that of Lloyd's of London to the PRA, and that question needs to go to (42:43) as to the status there. But clearly, that product set also is very important for us.

A - David Andrew Horton {BIO 5697110 <GO>}

Barrie, on the people front, I mean, another key point, we're touching around it before. I think while most organizations want to grow, one of the ways of growing is doing M&A and (43:03) with that. And the other one is poaching people. The aim of Beazley, as we are very people-centered organization, is to continue to create an environment where people want to join and want to stay. And I think it's key that we continue to focus on that, while we continue to add new product and continue to grow. Our profitability is good. I think we create the right environment. We don't (43:24) we're obviously going to lose some people as we do each year. Interestingly, turnover for the first half has been one of its lowest halves for a while which is great.

Morning. Just a quick question on pricing. There's been a step down, another step down in energy, property and reinsurance rates this year. Could you just give us a feel for how you're responding to that? All lines of business still viable. Are you conceptually happy to carry loss-making segments through a downturn?

So, is that your one question? I thought you were (44:04) another one next to that. So it's a great question, so I think, as I mentioned, we lowered our risk appetite this year. And our expectation based on the rating environment for next year is to lower risk appetite further. So in other words, we still think there was some profitable (44:18) in there, not as many as they were. And therefore, we're not going to write as many as we did.

Now, not surprisingly in a falling environment, that means there are people who are more optimistic than us who are willing to write it at lower prices. So, our aim is to stay through the recruited great people in those lines of business, and we have to wait for the margin as to fall to such a point when they then return. But our aim is to lower exposure on those lines this year or next year.

Q - Eamonn M. Flanagan {BIO 14018002 <GO>}

Hi, it's Eamonn Flanagan at Shore Capital. Morning. Can we just come back to the Barrie's question, Solvency II, if I may? And Martin, you're referring slide 13 to your surplus capital including Solvency II adjusted. Were those Solvency II adjustments material, what were they, and was it net effect positive or negative with regard to that surplus capital position?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah. So in Solvency II world, capital sought (45:16) about what's called a Solvency II balance sheet, where you make a number of adjustments to compare to a normal GAAP balance sheet. The most important one is that you strip all margins out of reserves and you discount them. So, viewed in the Solvency II world, Eamonn, there's more capital than on our IFRS GAAP balance sheet. And then as I said a few years ago when we just started this journey, in the Solvency II world, you have more capital and you have a higher capital requirement than in the old-fashioned ICA well.

So, yeah, those – when you restate Beazley's balance sheet to a Solvency II basis, capital is quite a lot larger than it is on an IFRS balance sheet, as is the case for the Lloyd's market as a whole, who do occasionally presentations to show that effect, and it is stating reserves on a discounted best estimate basis. That's the primary driver of that.

Q - David Andrew Horton {BIO 5697110 <GO>}

Good morning. Thank you. (46:27) from KBW. If I just – can I ask a couple of questions on premiums from life, accident and health? You are quoting that you are growing your GAAP protection for a large part. At the same time, we are seeing that gross premiums are actually coming down. Why is that and should we expect a double-digit growth that we have been seeing in the past there? And the other is again on capital. If I look at your U.S. insurance company, which is flat year-on-year, is that because you are calculating that on an RBC basis, so is it an equivalent Solvency II model? Thank you.

Okay. So, the life, accident and health has been impacted by two things. One is the growth in the U.S. and one is the shrinkage in Australia to some extent by dropping unprofitable business and to another extent by the fact the Australian dollar has fallen through the floor in terms of the exchange rate. So the growth in the U.S. has just been compensated by shrinkage in the other part of it. The London book is relatively steady, so it's a three-pronged business.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

And as far as the capital for the U.S. insurance company is concerned, the amount we carry in the company is the amount we require to get the A.M. Best rating that's necessary for the company. So, that's actually significantly in excess of its regulatory or risk-based capital requirements. And until our U.S. business gets a lot bigger, that $107 million is sufficient capital, so that's why it's stable because we have an A8 A.M. Best, and we need to be in a three-figure capital position to get that 8 (48:10) size rating.

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Thank you. Good morning. Fahad Changazi from Nomura. I'm sorry, we're just focusing on Solvency II on UK life. But for non-life, so what discount rate will you be using? (48:28) determined to discount the liabilities back?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

In a Solvency II world, you discount the liabilities using the market...

Q - Fahad U. Changazi {BIO 15216120 <GO>}

Risk-free.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

...market curves. I mean the sort of discussions between the swaps and the risk-free rates is sort of irrelevant given we're talking one-and-a-half years and – yeah.

A - David Andrew Horton {BIO 5697110 <GO>}

Anything else? Great. It's great to see you all today. Thanks a lot.