S1 2021 Earnings Call

Company Participants

- Adrian Cox, Chief Executive Officer
- Paul Bantick, Head of Global Cyber & Technology
- Sally Lake, Group Finance Director

Other Participants

- Andreas van Embden, Analyst
- Andrew Ritchi, Analyst
- Ashik Musaddi, Analyst
- Faizan Lakhani, Analyst
- Freya Kong, Analyst
- Ian Pearce, Analyst
- Ivan Bokhmat, Analyst
- Kamran Hossain, Analyst
- Nick Johnson, Analyst
- Unidentified Participant
- Will Hardcastle, Analyst

Presentation

Operator

Hello, everyone, and welcome to the Beazley's Interim 2021 Results Conference Call. My name is Emily, and I will be coordinating this call today. (Operator Instructions)

And now, I have the pleasure of handing over to your host, Adrian Cox, CEO to begin. Adrian, please go ahead.

Adrian Cox {BIO 16257010 <GO>}

Good morning, everyone, and welcome to the Beazley interim results. I thought, I'll give a quick overview of what to expect this morning. I will start with the highlights of our half-year numbers. I am quite pleased with them and following that, Sally will go through the numbers in a bit more detail Including the exhibits on capital and reserve strength that we know and love.

We've been talking to a number of stakeholders this year and the two most frequent thematic questions that we get, concern our cyber business and our strategy, given the new CEO. So after Sally, we will move on to the main event and forward answer the big cyber questions.

Cyber insurance is our biggest business. It's about 15% of our premium overall and we launched our flagship cyber product Beazley Breach Response back in 2009. And at that point, I was running specialty lines which housed it and Paul was running the London international cyber business. So we've both been working on this together for a long time now and we are both quite excited about the prospects for it.

This year, we've also been thinking through our strategy, though lastly, I will give a little detail on that. Spoiler alert, it is exciting but not revolutionary as well as some of the attributes of Beazley to which I'd like us to commit. And after that, we will have some time for Q&A.

Before that though I'd like to begin by making a few introductory comments. At the start of the year, I wasn't expecting to be here doing this, but 113 days into my new role, I thought I'd share some reflections. The CEO role had always appealed to me, but I was genuinely enjoying being CUO and had certainly not expected this to happen this soon, but it's been fascinating getting exposure to different parts of the business and getting to know colleagues that I hadn't been spending too much time with before and I've genuinely loved every minute of the job so far.

The executive team continues to evolve and I'm very pleased to welcome Troy Dehmann, our new COO, a couple of weeks ago, and I expect us to be able to announce the new CUO by the end of the summer.

And I have to say I'm pleased with our performance so far in 2021. We've done a lot of hard work these last few years to improve our business mix, to concentrate on what we're good at, remediate or stop where we weren't performing as we should have done, and to invest into opportunity. And I think that work is beginning to reflect in the numbers that we show today.

And it feels like we're beginning to get the old Beazley back. My role I think is to get people here enthusiastic about the opportunities that lie ahead and ensuring that the business has the capabilities and capacity to deliver. But I also have to say that we did misstep last year during 2020. We had underestimated our exposure to the pandemic assuming such a thing that would not cancel the events industry as completely and for as long as COVID-19 did. And it was also disappointing that we had to increase our COVID provisions last September.

Unsurprisingly, I think that has impacted shareholders' confidence in us and our ability to do the hard things well. And one of my ambitions is to demonstrate to you over time that we merit your trust and that the Beazley you knew is the Beazley that you still have and that the future prospects for us are generally exciting.

So with that then, let's move on to the results. Headline profit of $167.4 million, which generates return on capital of 15%, which is our target across cycle returns, so that's good, and a decent level of growth. We added about 4% of exposure growth in the second quarter. So although we continue to take exposures down in some areas including cyber, it's being more than offset by the businesses that we are looking to grow.

Combined ratio is in the mid-90%s, which is what we had guided to and we have an accelerating rate increase although with different drivers to last year which Sally will go through a little bit later. Our COVID provisions remain unchanged at $340 million. The world continues to open up, albeit in somewhat of a staccato fashion, but that was the central assumption we had when we put together the $340 million.

We intend to pay a dividend at year-end all other things being equal, which will take into account the 2021 results as a whole, rather than just the second half. And at that point at year-end, we will also share the future dividends strategy.

And with that over to you Sally.

Sally Lake {BIO 20925273 <GO>}

Thank you, Adrian, and good morning, everyone. My name is Sally Lake and I am the Beazley Finance Director. I am going to get to the right slide. I'm going to take you through some of the more details on the financials that we are reporting today focusing on investments, reserves and capital, before I pass over to Paul to speak in more detail about cyber.

This half we have seen an increase in reserve releases with the underwriting work performed in recent years beginning to show through. The investment return is very similar in dollar terms to this time last year. However, the drivers are rather different. And finally, I will give an update on our capital position which remains in the top half of our preferred range.

Before that, here is some more detail on the numbers. Adrian has already spoken about our top-line growth of 22%, this is less after we allow for reinsurance, as just over a year ago we purchased some new proportional reinsurance on our specialty lines and CyEx book. We have also completed a loss portfolio transfer on our construction and engineering book which we stopped writing recently. And that's a one-off effect that happened in the first half of this year.

Our net earned premium on which our combined ratio is based has grown by 14%. Our claims ratio improved significantly as this time last year we had incurred significant losses around COVID-19 first-party types. And the expense ratio has increased slightly in part due to the reinsurance effects I just mentioned but also given that sterling has strengthened compared to the dollar and a large part of our costs are in pounds this has also put some pressure on our expense ratio.

And now, onto investments, so looking at our investment dispositions and how they have changed during the first half of 2021. Most noticeably, we've seen an increase in our sovereign bond holding with an equivalent reduction in the investment-grade corporate debt portfolio. At the moment, we see the investment-grade spreads as relatively less attractive than in recent times and so the maturing bonds being reinvested into the highly liquid sovereign debt, improving our portfolio flexibility.

Other changes at this summary level are modest. However, during the period we have performed a number of management actions to maximize the return within our relatively prudent risk appetite for investment. So what has this led to in terms of performance? So $83 million, or 1.2%, 2.5% annualized, the half one return is similar to last year.

Low but rising yields created difficult conditions for bond markets and our fixed incomes produced a low albeit positive return in the first half, and that makes up around 85% of our assets. Our capital growth investments did much better returning nearly 8% year-to-date as risk assets rallied, oiled by the improving economic outlook.

Our tactical investment actions have also added value. We reduced duration as yields rose, held more equity exposure for some of the period and have added significant inflation-protected holdings to our fixed income portfolio as inflation expectations grow. Overall, we think it's a really good outcome in view of the market conditions and our risk appetite. In recent years only 2019 saw a materially better first-half return.

Now, moving on to reserve releases and how they have evolved over time. This graph shows split by division and you can see that we are very pleased to see reserve release across all divisions for the first time since 2017. Since taking over in my role in 2019, I have really focused on ensuring that this graph gets to a better position though this outcome makes me very happy. This is a result of the underwriting action that the business has been taking for a number of years, and as a percentage of net earned premium, the releases are around 7%. And as you can see on the dotted line, this number continues to go in a pleasing direction.

So that's looking back onto everyone's favorite graph, what we've got left in the tank. Though to remind everyone this graph compares reserves on our balance sheet to our internal actuarial estimate which in itself is not a best estimate and includes a level of margin. And we aim to hold 5% above this actuarial measure. The reason we show you this graph is to show how consistent we have been in our reserving strategy over time and 6.6% which is the number at half-year 2021 is very much in line with recent times. Though it's great to see this continuing despite improved reserve releases and just show you that we are continuing in exactly the same way as we reserve.

Just before I head on to talk about capital, we just want to take a moment to review the rate change graph. Here you can see that the rate improvements have been impressive this year so far, with a real acceleration caused primarily by the dislocation in the cyber market. The rate change is 20% across all divisions over the past six months.

Most divisions are seeing double-digit rate increases with CyEx seeing 44% rate improvement. So whilst we are continuing to grow the premium, the benefit of rates are being seen when we look at our capital requirements.

Since we last reported on capital, we have started allowing for the growth expected within our 2022 business plan within the numbers we show here. And whilst we continue to work on the business plan over this summer as usual, we are currently expecting similar growth in premiums next year as we planned for this year. And after allowing for this and allowing for other updates to the Solvency II positions, we are estimating a surplus of 23% above our Lloyd's economic capital requirement which is towards the top of our preferred range.

Our capital resources remain unchanged with $550 million of Tier II debt, the banking facility of $450 million of which $225 million remains unutilized. And as Adrian mentioned earlier, the Board remains committed to a dividend payment at the end of the year after taking the whole year into account.

With that, I will pass over for the main event, as we call it, and Paul on cyber.

Paul Bantick {BIO 15979097 <GO>}

Thanks, Sally. Good morning, everyone. For those who don't know me, my name is Paul Bantick. I am the Global Head of the Cyber and Tech business here at Beazley and I have the privilege of leading both the underwriters and the service team that help us provide with the services to our cyber clients globally. I've been here, as Adrian said, about 16, 17 years, and have been part of the cyber team whilst it's been CyEx and also when it was previously SO when Adrian was leading SO.

It's great that Sally and Adrian have asked me to give you an update this morning. I plan to cover a brief history of cyber insurance but also more importantly, its evolution and how it's evolved at Beazley, talk a little bit about how we've seen the threats evolved and what we've seen in the past year, give a highlight of some of the underwriting action that we've been taking, talk about some of the investments that we're making and then talk about what we see the cyber opportunity as moving forward.

So I wanted to start by giving a bit of an overview of this slide, the evolution. You will see that this timeline really shows two things. It shows what's been going on in the outside world and what's been going on at Beazley as cyber evolved. Cyber really started in the US back in 2009, which is when we saw the first real drive and boom of demand for cyber insurance. And it was really focused on data breaches.

At the time, there were lots of large companies that held a lot of data that were been attacked and their data was being stolen. And this was really coupled with regulation and law changes at the time, gave clients a greater need for insurance. They wanted help with protecting the bottom line and these things became very complex and very expensive.

That complexity really gave us another opportunity. Clients weren't just worried about what these were costing. When they had a data breach they were saying how do we manage one of these, how do we respond to one of these, and that's where at Beazley we really saw this change in regulation and the change in what clients were looking for. And we developed a product and service around it. And that's when we launched the BBR product, Beazley Breach Response. And we also created our Beazley Breach Response in-house team. That's an in-house team that we have that is focused on helping clients manage events when they happen.

So BBR was born and it was a product with (inaudible) service around it. As the market continued to grow and we wrote more business, we decided that we needed to invest early into several things. Examples of this were, we invested in our international business. We now have locations all around the world writing cyber business, we have underwriters, claims managers, and breach response people base around the globe.

We also made big investments into risk management. One example is we created Lodestone. It's a cyber-service security company based in the US that's 100% owned by Beazley. Lodestone is now working with lots of our clients in the US, is up to 40 to 50 employees and going very well.

The BBR service team had a huge impact on our clients, but it also had a huge impact for Beazley. We were saving on our losses, we were saving 10% to 20% compared to the market on the costs we were incurring. This is because of the in-house model that we have. This in-house model really enabled us to bring in-house what people were outsourcing to law firms, forensics firms. We had a lot of capability in-house to do it ourselves and it's a model that we've invested in and continue to invest in.

As '17 and '18 years rolled around, we saw data breaches became a little bit quieter. There were some very large ones that went on, that were the high-level names that we will see and know, but it was a little bit quieter. However, during this time, we continued to invest in that team because we knew cyber threats do change and they do change and come and go and we knew that team would bring even greater value moving forward.

In recent times, as I'm sure many people know, the cyber threat has evolved and ransomware in '19 and '20 really is the big shift that we've seen. And ransomware has done several things. Number one, it brings new exposures. If you have a ransomware event, your systems are locked up, someone wants money to unlock your systems, you have to decide as a business what you want to do about that.

That presents new issues and new challenges for clients. Do you pay a ransom, do not pay a ransom, but whilst this is going on, there is the business interruption risk that clients are going through. Clients are experiencing a reputation risk and business interruption. What this does is it brings a lot of new clients to the market looking for support with their cyber insurance. Previously, it was just companies that held data that were worried about cyber insurance and now any organization around the world has an exposure to ransomware or some of the newer cyber threats that we've seen.

Breach response is still very, very critical for these ransomware events and I want to underline that. What we've seen is that clients are now seeing the value of that breach response team again. So the investments we made and we continue to make are bringing back those benefits that we saw as we did with data breach.

But as the threats evolve and as we see ransomware, we've also been looking at how do we help clients with resilience. Cyber threats change and evolve over time and what we need to do is help clients become more resilient, so that they are more protected and better protected from whatever cyber threats exist.

During 2020, as we saw ransomware impacting our clients, we looked at what underwriting action we were going to take. And now, I want to give you a quick overview of some of that. We really divided it down into five key pillars, and we worked on this in second quarter of 2020, and it was fully deployed in Q3 2020. This is a huge investment that we made, both in terms of money, people, and a huge project to get off the ground.

Firstly, we made a big investment into data analytics. We're working both with our own data, with third-party data, lots of other organizations. We've brought in specialist data scientists that are now part of the cyber team to look at based on our data are clients less or more likely to have a cyber event, what can we tell about them from the data we have, how can that help us drive both client's increase their resilience and also help with our underwriting.

Secondly, we developed a ransomware application. This has been a critical piece of information that we've been using as part of the process. When we underwrite an account, every client tells us about the ransomware exposures and controls and mitigation that they have in place. We've been scanning organizations. This is done with third parties and it's an outside-in view and it's becoming quite common in the marketplace.

We scan clients not only when we insure them, but we also scan them through their life cycle of the policy. If we see new vulnerabilities appear, these are the same kinds of vulnerabilities that bad actors are looking for. And so if we can see them, they can see them. So what we're doing there is notifying our clients about these vulnerabilities and helping them to remediate them, helping them to shut them down. Nine times out of 10, these are reasonably simplistic things to fix, things that should be addressed quite quickly and quite easily. We don't know how many ransomwares we may or may not have helped clients avoid, but we know that we've shut a lot of vulnerabilities down.

These three things are really focused on frequency. We've been targeting frequency very hard. If we can help our clients be more resilient, we will therefore see less claims, and that has been our approach to addressing the ransomware issue.

However, we have also done some limits management. We've looked at our book and we've targeted specific areas where we think we need to look at the limit we have deployed and we've been reducing some limits in certain sections. This will also help with severity.

And then the last thing is, we were talking about the rating environment. Absolutely, the answer to cyber insurance is to address the frequency and focus on frequency. And as I've just explained, we've been making massive efforts with that, but we knew that rates needed to increase. So during 2020, we started to build the rate runway and increase rates. And as Sally said, we're seeing some great rate changes currently, and I'll talk more about those shortly.

The other bullet point I want to make is, we provide great support to underwriters globally. One of the things we did is we created a global dedicated cyber underwriting management team that reports to me. This has been invaluable because as we are taking action, as we're navigating a very fast-changing and volatile market, having a team focused on this and profitability and supporting the team through that process has been absolutely fantastic.

And then, lastly, and more very excitingly, we are making a huge investment into risk management. Every client has their own view of risk. We scan them, they talk about their ransomware application, we look at our data, every client is different, everyone's got their own view of risk, everyone gets their own terms. We treat every client individually. And I think that's really important. And we want to continue to do that, but we want to continue to help with resilience.

And so with that, we are making big investments into our cyber ecosystem. We've been to the exec [ph] during the course of the year and we've had approved significant investments to look at the Beazley cyber ecosystem and think about how can we help make risk management and resilience and support our clients and brokers much better with the cyber threats, the ones that we have now and ones that may exist in the future.

So this is a diagram that shows you our cyber ecosystem and the investments we are making. And what I'd like to do is briefly touch on each of these areas. The first is the data and threat intelligence. I spoke about that. We've been doing some of that already, but we're now working with more providers, more data, more threat intelligence. We're overlaying that. As you will see there, Lodestone, the IT security company, they are now providing us with threat intelligence.

We've established a threat intelligence network that involves people not just from companies that work in cybersecurity, but also we are working closely with people that the ex-government, ex-law enforcement. And we really are trying to make sure we stay on the front foot of the emerging threats for our clients.

Secondly, risk management services. This is absolutely critical. It's one thing to have the threat information, it's another thing to figure out how you can help prevent these things happening. And so what we're doing is we're creating a lot of new risk management services for our clients. We're currently hiring a head of cyber services that will be focused on building out these risk management services that we do even further.

Incident response, we've obviously been doing that since the very early years in 2009. We have a fantastic team that work on that around the globe. We are now launching that further. One example would be, internationally, we established Lodestone in the UK to help us do some incident response. We're looking at how we build out the model further afield. We have it in many countries, but we're making sure we have that response and that unit and that team everywhere where we need them.

And then we are looking at the US team and constantly thinking about how do we evolve, how do we make sure we're on the very front edge. We are looking at different services, different technology, and incident rooms that we can work with our clients on.

And then, most importantly, underwriting and claims. How do we build what we are learning, what we are seeing, the risk management into our underwriting and claims processes going forward so that we continue to manage the frequency, continue to manage the book, and continue to help our clients maintain profitability.

I think it's really important to say there's a lot of things on this page that I could talk about a lot of time. It's a huge project. it's an undertaking that's involving 80 to 100 people across the Company that are coming together to collaborate on this, which is fantastic. And I really appreciate everyone's support with that. But it's not about doing any one of these things well. It's about doing a lot of them well and put in them all together, that's where the magic is in this and that's what we are committed to and that's what we are committed to continue investing in.

So what's the impact of the underwriting and all the action and the risk management that we've been doing, what's it having so far? We wanted to give you an early view. And I would say, it's still very early. We've been looking at accounts to have been found since October, that have been throughout the whole process. And although it's early days, we are seeing some positive signs.

We've seen a 20% ransomware frequency reduction on a policy basis and we've seen a 50% reduction on a per premium basis. And as Sally said, we've seen increase in rates. In the last three months, we've seen the cyber rates doubling in all parts of our cyber books.

We show this graph quite a bit during our results presentations and it's been slightly updated this year with a new line. The bottom charts show the premium growth of the cyber business. And as you can see the premiums are up in 2021. We've actually re-forecast and written slightly more than planned. This is driven predominantly by rates.

This is shown by the pink line at the top. The pink line at the top shows the policy count. And as you can see due to the underwriting actions that we're taking, we've shed more policies than planned due to our continued focus on risk selection. So the overarching message of this is that we have less exposure than planned this year, with significantly more rate.

The other benefit of that is that we are now seeing that our systemic event exposure is reducing. And I want to just to take a minute just to talk about systemic risk in cyber just for a second because again, it's another common question that comes up quite a bit.

Certain covering cyber policies are more systemic in nature, business interruption, dependent business interruption. When we talk about systemic risk in cyber, we are thinking about things that can impact more than one client. When we are thinking about attritional cyber risk, it's something -- attacks that are focused and just really impact one client. And I've given some examples on the slide. A client being targeted for a data breach that's typically one client, one data breach, it's an attritional loss.

Things that are more systemic in nature, for example, cloud outages that can impact lots of clients at once, are really what we are thinking about when we think through systemic risk in Beazley. Managing the systemic risk, it's really no different than any other line of business at Beazley. We manage systemic risk in the same way. We have a group of people that work on the systemic cyber risk that are focused on it and are constantly meeting.

Firstly, we will have a set of scenarios. We spent a lot of time putting together our realistic disaster scenarios that we work. This involves not just the internal expertise we have, but we work with a lot of third parties around the world, a lot of external experts and we are constantly updating them every six months, 12 months and they are constantly under review.

As part of that, we're not just looking at what happened. We spent a lot of time thinking about what could happen, what are the black swans, what could they look like, how would we manage those, what would be the reality of those happening, what's the likelihood and we model a lot of scenarios based on that basis. We have a suite of RDS scenarios that we run. We can run them any time at the push of a button and we're constantly reviewing them on a weekly, monthly basis.

The other thing is diversification is key. The one thing I've learned through the years of coming through the cyber business here at Beazley is that the more diversified book you have, the better you can manage systemic risk. And the thing I'm very proud of and I know the team is very proud of at Beazley is we have a diversified book not just by revenue, but now by geography, by client size, by industry. Managing diversification is absolutely critical.

We set our risk appetite for cyber, the same as we do for any other line of business at Beazley and we manage that risk appetite. And if we think we could go outside of that risk appetite, we purchase additional reinsurance to keep us within that appetite. Exposure to systemic events has been coming down. This is due to two things: number one, as you saw the policy count is down because we've shed more business than planned, but we are already working since 2019 on reducing our exposure to these events by looking at the limits we have exposed, and the types of coverages that cause the main aggregation with our clients, things like business interruption and dependent business interruption.

So for my final slide and in closing, I have given a good overview I think of how we manage our exposure, the work we've been doing, how we are evolving our cyber ecosystem, what we seeing from an underwriting action standpoint, what we seeing from the market and the rates, but what does this mean for us looking forward.

As we continue to get evidence we are profitable and frequency is reducing and that the risk management is really helping our clients with resilience, there could be a rare opportunity for profitable growth. This is actually further supported by the market conditions that we are seeing. However, it's still very early, and this is going to be a continually evolving process. We're going to keep learning as we do this. We are going to keep looking at the threats, looking at the data, looking at the underwriting action, thinking through how we are going to navigate these things.

At Beazley, we remain agile and we want to evolve. We saw market opportunity in 2019, and that was to establish a leading position through the creation of BBR services. We think there is an opportunity now through risk management and resilience to create a seamless kind of opportunity.

And with that, I will pass it back to Adrian.

Adrian Cox {BIO 16257010 <GO>}

Thank you, Paul. Okay. So I hope you found that insightful. On then to the outlook. So I expect growth to continue at the current levels for the rest of the year, but also for that level of opportunity to persist into 2022. We have a particular set of opportunities and a particular set of products at Beazley that are more than just transitory, and that's why we think there is opportunity for continued good growth at the similar levels to this year into next year.

Yields currently on our fixed income is 0.5% and when we think about that all altogether, our combined ratio guidance for the year remains unchanged. The year-to-date natural catastrophe appetite, including the floods and the wildfires that are currently occurring, remain so far within the margin that we hold as there is no need to update our guidance at this stage. And once again, we intend to pay a dividend at the year-end all things being equal and share the strategy at that point.

Talking of strategy, I thought this is an opportune moment to spend a little bit of time outlining our strategy which we have refreshed this year, and also reaffirming some of our attributes. So to start with strategy then, we're a specialty insurer. What does that mean?

Well, most of the products that we underwrite are not written by the majority of the general insurance market as they are by definition specialists, and so require certain specific tools or skills to do well. These products are less commoditized, which allows for the insurer to apply IP and differentiate their offering.

Given that, there can be more margin and better cross-cycle returns than in general insurance. And lastly, demand is growing faster in specialty than in general insurance markets. Why? Because products are generally at an earlier stage in their life cycle and new products are created here to address new and emerging risks which occurs now at an increasing pace as the world continues to evolve faster and faster.

So a successful specialty insurer is in a market that has better cross cycle returns and persistently high levels of growth. And where do we fit into that? Well, our strategy is to employ people who have genuine subject matter expertise and who take pride in continually refining that knowledge and then to deploy them at the point of sale and empower them to use their expertise.

We then find niches were deploying that expertise drive some competitive advantage and I think there are two ways we do this. Firstly, as we out underwrite, out risk select, out claims manage our peers on a risk forward [ph] basis and secondly, our customers, brokers, and insureds value having access to that expertise, people who know what they are talking about, understand our industry and have the authority to make decisions.

In most of the insurance and reinsurance well even in some of the specialty areas those capabilities don't really drive competitive advantage, but in some, they do, and that tends to be in areas where risk is more complex or volatile or changing or new. And our job then is to find those areas where that applies and where there is margin if you do it well to properly reward us for our efforts.

So our product strategy is relatively simple, refine our product set to maximize our competitive advantage by ensuring that the businesses we are currently in are fit for purpose and constantly looking for new ones.

Our footprint strategy is also relatively simple. As a specialist and relatively small, personally, I don't think scale is of itself important. I think our relevance comes from having to say something -- having something to say rather than by size, but given that, it makes no sense for us to have an ambition to have a presence in every geography across the world. Rather, we have a preference to locate whether large pools of demand for the specialist products that we sell. And they are in the large non-life markets in North America and Europe, and in the big wholesale markets for us, London, Singapore, and Miami.

The business that we build in those large mostly retail markets in North America and Europe is sticky, more mid-market and SME, and painstakingly built over decades rather than years. The business that we build in the wholesale markets is more larger risk, more volatile and more actively managed through the market cycle reflecting the fact that opportunities in the wholesale world to wax and wane considerably.

When you combine that then you have a business that can create and maintain differentiated products, where demand growth is higher, that gives us long-term opportunity for compound growth with levels of cross-cycle margin significantly higher than the cost of capital. It's an appealing model I think, but it's hard by very definition if there is a risk you concentrate on are new changing, volatile, complex.

And we have to be good at it to get it right. And not only good, but relentlessly looking for ways to do it better, and that's the challenge that we set ourselves every day. And that's why we invest heavily in improving our underwriting technology, seeking new data, which can generate insight, working with third parties to harness different technologies, building out our risk management services, all to drive doing specialty business well, designing those differentiated products and building barriers to entry. And that's our strategy in a nutshell. It's not new, but I think it's good to articulate it every now and then.

The second topic I thought I would address is what are all the attributes of Beazley as a Company. We've long been associated with a number of them, and I think it seems appropriate now to affirm to the ones that we wish to commit to afresh.

And the first is underwriting discipline. This is particularly important to me. We are an underwriting company, is what we hang our hat on, and as I hope you heard, it's central to our strategy and our competitive advantage. And that means both capitalizing on opportunities, but also knowing when to pull back or to stop when needed. And you will have seen over the last few years that we do reassess our product set and we do stop when what we have doesn't really drive competitive advantage. Engineering, trucking, SME marine, are examples of that over the last couple of years.

Secondly, capital discipline. We've always put great steadiness, returning capital to shareholders when we don't have attractive opportunities to deploy them ourselves and that commitment remains. Thirdly, financial discipline. I do believe in the discipline of regular dividends and the prudential financial management that that drives.

Next, reserve discipline. We commit, as Sally said, to maintaining a consistent and prudent philosophy of setting reserves which should, other things being equal, provide for a consistent flow of reserve releases over time.

Next, diversification. We've long valued the benefits that diversification bring. One of our favorite charts has been that which show rate change across all teams, which is significantly less volatile than each team of itself. That portfolio management philosophy remains.

And lastly, responsible business, which we will discuss I think more at the year-end, but we are building out strategies to address the E, the S, and the G of being a responsible business. I want us to be a Company that embeds these values and those goals at its heart. Our vision is to be and be recognized as the highest performing specialty insurer, and I believe that highest performing includes a commitment to becoming a better business that contributes to those goals.

So with that, I hope you found that useful and I open up to Q&A.

Questions And Answers

Operator

Thank you very much. (Operator Instructions) Our first question today comes from Kamran Hossain from RBC. Kamran, your line is now open.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Good morning, everyone So the first two questions are on cyber because I guess it would be rude not to ask Paul some questions given his presentation. The first one is just about market behavior in cyber. Obviously, you've been in this market for the long haul. There have been some people that have been called into the market more recently and probably have been burnt a little bit in the last year. I am not sure then whether people have exited or the behavior is changing, and maybe all kind of barriers to entry now are a little bit higher than they were a year ago?

The second question on cyber is, I guess, as the risk changes all the time, do you think we will get to a world where I guess given risk management capabilities, we can get some more real-time pricing, or do you think an annual contract is just the thing that we will see in the market for the next few years? So kind of a very big picture question.

And then, the third question, I guess, the growth outlook for next year it sounds really exciting. In terms of the areas of growth for next year, should we expect them to be similar to those that you've seen kind of year-to-date, or are there any other areas that you think we should highlight? Thank you.

A - Adrian Cox {BIO 16257010 <GO>}

All right. Paul, do you want to tackle the first two cyber questions. I will think about how we are going to grow.

A - Paul Bantick {BIO 15979097 <GO>}

Hey. Thanks, Kamran. Yes, you are absolutely right about market behavior. I mean we are definitely seeing a situation where capacity is restricted in the market and that's driven predominantly because of the losses, and some of the ransomware activity, and definitely, as you've seen from the market conditions, and the rate changes we're seeing, the demand is outweighing supply. There have been some entrants in the market. I haven't seen as many in recent times.

In terms of barriers to entry and investment, I think, the word investment is critical. I do think that barriers to entry to be able to this well for clients and to be able to manage clients and help them with their resilience and manage your own frequency and severity I think the investment is colossal. And it's not just a monetary investment, it's the people and IT investment, it's just a huge investment. So I think the barriers to entry are definitely, definitely growing.

In terms of real-time pricing, I think, it could get there one day. I think we're a long way away from it. I think it's early doors. I think we've always thought about that and it's been something that's been in the back of our minds. I think it will become more realistic in the coming years as clients start to increase their resilience and as we can get a better understanding from clients constantly around what do they -- how are they constantly evolving, how are they constantly seeing their controls evolve. But I do see that one day that could be something that potentially the cyber market starts to look at.

A - Adrian Cox {BIO 16257010 <GO>}

Thank you, Paul. So on to growth, I think, what we've been talking for the last 18 months is about the 85-15 split of how we are feeling about our portfolio, with the 15 really being the areas that we think are exposed to this COVID aftershock claims environment, as well as social inflation. I think the underlying assumption still remains, Kamran. So we are looking to grow across most of our book. We still remain quite defensive on things like employment practices, liability, certain parts of our health care book, and certain parts of our E&O/PI book.

But I think overlaying that there is some stuff which is a bit more life in that. We are beginning to open up as an economy. So there will be more evidence generated I think in the second half of this year about what's happening to those COVID aftershocks, is social inflation going to reemerge as the courts reopen. So we will be able to update our assumptions I think as the years go on, which as the year goes on, which will influence what we want to do next year.

Likewise, I think we are continuing to build evidence about how successful our cyber strategy is, and that will influence how much exposure we want to put on the books or not. And of course, we are in a very live natural catastrophe environment, not only in the middle of the windstorm season, but there is other stuff going on as well. And I think that will impact what we think is going to happen to the market, as well as what we think we need to do to our own underwriting strategy.

So the sort of short answer is, our 85-15 remains, but we are in a very live claims environment at the moment, and I think that will influence both what the market does and what our view of risk is. And so that will influence what we do.

Q - Kamran Hossain {BIO 17666412 <GO>}

Okay. Thanks, Adrian.

A - Adrian Cox {BIO 16257010 <GO>}

Thank you, Kamran.

Operator

Our next question comes from Will Hardcastle from UBS. Will, your line is now open.

Q - Will Hardcastle {BIO 16346311 <GO>}

Hi. Good morning, everyone. First question on cyber, second on capital and dividend, if it's okay. So first on cyber, you are seeing these enormous price increases that sounds to be potential opportunities, of course, you are going to weigh the risk off. And you are sort of suggesting that there could be a great opportunity. I guess when will we know if that opportunity truly exists, knowing it's sort of seven, eight months through starting the remedy or the action there?

And then in that context, that level of growth, what should we really see as the maximum level on a Group level that you'd consider to be comfortable to be cyber exposed, perhaps whether it'd be premium exposure or however you look at that would be helpful?

And then on capital and dividend, I guess we've seen a really big earnings beat today to expectations, but still no dividend, the capital even after achieving what feels now higher premium growth expectation for next year is robust. Can you just help us to understand the logic in your thinking perhaps of the no interim at this stage? And what's the greatest risk in your mind that perhaps prevented you from distributing that despite these financial metrics suggesting that you'd have been comfortable to do so?

A - Adrian Cox {BIO 16257010 <GO>}

Okay. Thank you, Will. I'll have a crack at those and please feel free to wade in if I miss anything. So on to cyber and as we've been very careful to say that the data that we have is very early because as you say we're any seven, eight months into something and in insurance terms that's just a blink of an eye right. So having said that, first-party side, the ransomware side, predominantly of our cyber business is very short-tail. So I think we gather more evidence month by month. We'll have a reasonable idea in time for the business plan for next year as to whether we think it's successful or what else we need to do. And so, we should be able to give more guidance towards the end of the year about what we want to do as the evidence builds. And I think because it's so short tail, that's faster than normal I think.

Going back to the little speech I gave about the attributes of Beazley, we do still believe in the benefits of diversification. You definitely can't have too much of a good thing. At the same time, as you say, there may be an opportunity here and we will look to capitalize on that if we think there is one. Nonetheless, we want to make sure that we remain a balanced business. Our rule of thumb is around 15. We may flex that up or down a little bit depending upon how big of an opportunity it is and we may well use our reinsurance partners to build the business with us. But think as a share of the overall, we will flex around a little bit, but we remain committed to a diversified business.

But we might grow it a little bit more gross, use our reinsurance, and likewise, as you sort of intimate Will, there are sort of two ways of measuring this, by premium and by exposure. And because rates are going up so fast, premium may not be an adequate way to do this. And so we'll look at both, but we remain committed to diversification because I think it's important to the consistency of results.

In terms of sort of capital and dividend, we are pleased with where our capital is in the sort of top half of the range. And we did consider whether or not we should pay an interim dividend. I think the underlying driver of why we've decided to postpone is, is because paying a dividend is not just that. It's paying a dividend and explaining what your dividend strategy is going forward. And to us really, that sort of feels like a year-end decision when we can take a look at the whole thing and then set out something new for next year, and that didn't seem to be the sort of thing you want to do halfway through the year. It's a sort of thing that you do when you finish and you have a look back and set out something that's going to last for the foreseeable future. So it's just a timing thing for us really, not much to read into it apart from that.

Q - Will Hardcastle {BIO 16346311 <GO>}

Okay. That's really clear on the dividend. I guess one thing I just wanted to clarify, it's not a new point. You mentioned something about the full-year. Obviously, you stand committed on doing some changes, but just thinking about that a little bit, if that comes, I'm not sure if you've delivered this yet, but will that be the sort of final sort of equivalent, or roughly two-thirds of the year, or will it be covering the whole year, how would you look at that?

A - Adrian Cox {BIO 16257010 <GO>}

Yeah. That's a yes. And so you're right to ask that question because we worded it quite carefully. So the intention, all things being equal, is that the dividend will reflect the full year's earnings rather than just second half. So thank you for asking us.

Operator

Our next question comes from Andrew Ritchie from Autonomous. Andrew, your line is now open.

Q - Andrew Ritchi {BIO 18731996 <GO>}

Hi, there. Thanks. And thanks for the detailed presentation on cyber space, that was very useful and timely. Questions, first of all, I noticed in the triangles, there continues to be recoveries on various accident years on your speciality/CyEx aggregate excess of loss. I mean if you just recap what comfort there is on remaining room on those recoveries because at the minute there is a helpful spread between gross deterioration and net improvement? Should we expect that to continue to basically?

Second question, we are in wind season, what should I think of as your property exposure or property plus reinsurance exposure? Obviously, you give us that through your real estate results annually, but should I think that it has gone up from last year or same because I can't tell to what degree your exposure has grown in those classes? And linked to that, is there any sense can you give us, not you will, of what your sort of remaining cap budget would be for the year?

Sorry. I had two other quick questions. One on cyber, on Lodestone, that's an intriguing business, though I didn't realize you had set up. Is that a business that can generate meaningful fee income I suppose from non-insurance clients? I think I need to check out the website, and it appears to be open to non-insurance clients. So I'm just curious what the sort of strategic thinking behind that business longer term is?

My only other question, Sally, I'm a bit confused by your EPS calculations. I don't get why the average check count is the same year-on-year for the half-year. And also the translation from cents to pence appears to be (inaudible) last year's average exchange rate. Maybe just clarify what's going on there. Thanks.

A - Adrian Cox {BIO 16257010 <GO>}

Okay.

A - Sally Lake {BIO 20925273 <GO>}

I start with. I'll take that one away to look in detail at that. So I probably can't do that live.

A - Adrian Cox {BIO 16257010 <GO>}

The earnings per share one.

A - Sally Lake {BIO 20925273 <GO>}

Yeah.

A - Adrian Cox {BIO 16257010 <GO>}

Okay. I will get back to you on that one, Andrew. If we go through the first three questions then, in terms of reinsurance recoveries available. We may have an echo if that's the case, I do apologize. And yes, we have plenty of reinsurance left available across our specialty lines and CyEx. So you're right to notice the difference in the gross to the net, but nothing is exhaustive and the scenarios that we run don't have us exhausting it either.

In terms of exposure growth, I think there's sort of two things to look at. Yes, our property business and our reinsurance business in aggregate has grown a little bit and I think that has driven up a little bit, 1 in 250, sort of on a pro-rata sort of basis, but there's more to it than that I think. And one of the things we've been talking about the last few years is looking at the near end of the curve as well as the end of the curve. And we've been quite careful to make sure that we are very strict about growing exposures on the near end of the curve. And so it's not all pro-rata.

I would love to be able to share the net cat budget with you, but I'm not allowed. (inaudible) myself to say that's fine, I thought I can say that. And Paul why don't I pass over the Lodestone question to you.

A - Paul Bantick {BIO 15979097 <GO>}

Yeah. Thanks, Andrew. Lodestone, as you rightly point out, is doing fantastically well. Yes, it can and it does do work with non-Beazley clients. It's something that we're seeing a lot of people, particularly in the middle-market clients having a huge amount of value from. So if you take a step back for a second, they kind of do two things, really, when you want to think about Lodestone. They do incident response work. So they're forensics provider and can do incident response work when someone's having some quite of incident, like a data breach or ransomware.

And secondly, they do a lot of proactive risk management services, so helping clients become more resilient, understand their risk before they have some kind of cyber event. We work with them closely on both across our client base and is extremely exciting. We now have cybersecurity firm that can benefit our insureds greatly and as would evolving our cyber strategy and our ecosystem, we're actually -- we've been sitting down with Lodestone every step of the way to think about what does this mean for Lodestone and Beazley and how do we partner on this and what is the opportunity for both organizations. And it's very much done in partnership and very exciting. They have just launched in the UK, and there is hopefully a lot more to come.

A - Adrian Cox {BIO 16257010 <GO>}

Yes, Andrew. I think when we first conceived of Loadstone a few years ago, it was -- we started it because of that concept that you suggested, right. If the world is getting more digitized and that equals more risk and there is an opportunity in insurance, but there's also opportunity in risk management, that could be a business for us to build there. And so we started it quietly, used it to help our clients only, but with optionality to pivot according to where we see the opportunities. And that's exactly what we're doing now, is we're assessing what can we do with Lodestone folks to help our own proposition, but also in and of itself because cyber risk management -- cybersecurity risk management is a very fast-growing opportunity and maybe it's something we can capitalize on that.

Q - Andrew Ritchi {BIO 18731996 <GO>}

And owned by Beazley today?

A - Adrian Cox {BIO 16257010 <GO>}

Sorry.

Q - Andrew Ritchi {BIO 18731996 <GO>}

It's 100% owned by you today to clarify that?

A - Adrian Cox {BIO 16257010 <GO>}

Yes. It is. Well, that and the employees, but yes.

Q - Andrew Ritchi {BIO 18731996 <GO>}

Okay. Thanks.

A - Adrian Cox {BIO 16257010 <GO>}

Pleasure.

Operator

Our next question comes from Ian Pearce from Credit Suisse. Ian, please go ahead.

Q - Ian Pearce {BIO 17168137 <GO>}

Hi. Thanks for taking my questions, all cyber-related, please. So just I was hoping you could touch on sort of what's going on more widely in terms of claims trends in the cyber market. Obviously, you are all flagging some improvement in claims experience. Can you just touch on what the market thinks? I don't think that's been replicated across the market.

Secondly, just in terms of cyber rates, I mean you are sounding a bit more bullish on how long this hardening can continue. So just if you could flag what your expectations might be for sort of cyber rates in 2022 and if you think how long they can continue beyond that potentially as well?

And then, on the loss ratio that you book in cyber, could you just talk a little bit around how you thought about booking the loss ratio at the start of this year for cyber and whether you are reflecting some of that positive claims experience in the cyber loss ratio, because the CyEx loss ratio at the start of this year was still quite high?

And then, finally, just in terms of the investments that we've made, could you just put some numbers around that and how you're treating that from an accounting perspective, whether that's all been expensed?

A - Adrian Cox {BIO 16257010 <GO>}

Okay. I think there four questions there. I'll do the third one.

Q - Ian Pearce {BIO 17168137 <GO>}

Sorry.

A - Adrian Cox {BIO 16257010 <GO>}

No, it's perfect, just making sure that we address them. I'll pass the fourth one about the investments to Sally. I will have a go at the loss ratio and if you want talk about the trends and the rate into next year.

A - Paul Bantick {BIO 15979097 <GO>}

Sure.

A - Adrian Cox {BIO 16257010 <GO>}

Yeah.

A - Paul Bantick {BIO 15979097 <GO>}

Should I go, one and two first. Okay. So, yes, I mean you right Ian. We are seeing right now, as I said, rates doubling. When you look at the wider cyber market and you think about trends, I think, there are several things. Definitely, all the cyber carriers that certainly we see are certainly taken action, everyone's got their own approach and got their own action and their own course that they are taking. But we are definitely seeing a varied set of actions across the market and everyone is starting to really address it, some focused on rate, some focused through other things. And so you're seeing a mixture. It's definitely picking up as we move through the second half of the year.

The rates that were seen for the last month or two, were not the rates that we saw in the first three months of the year. So I think there is certainly a lot more to come in terms of run way. I think you're going to see the rate environment with us for a little while certainly through the rest of the year and into next year. We are in a very fast-changing market. We are in a very, very fast-changing market, and as capacity restricts, it could well be that the rates continue to extend into and through next year. That's one of the reasons why we are keeping our plan very agile and why we plan to reassess later in the year because had we looked at rates three months ago and made assumptions, that have been very different three months ago than they are today, they are on definitely a very steep curve and upward trajectory.

And so I think once we get to the end of the year, we'll think about what is the most likely scenario for 2022 rates, but right now, I certainly see and from talking to brokers and our partners and others, we certainly see the rate environment and rates continuing to increase through next year.

A - Adrian Cox {BIO 16257010 <GO>}

Claims trends.

A - Paul Bantick {BIO 15979097 <GO>}

Claims trends, when we look at the claims trends, obviously, we've got some positive claims trends on frequency. It will be interesting to see. There is also a number of other factors that are starting to happen around the world that are going to impact claims trends. We are seeing certainly different governments start to take action and law enforcements start to take action around some of the cyber threats and will be interesting to see what they do to claim trends. Obviously, we've seen the reduction in frequency.

It's very early to tell on severity, but obviously, the action that we're taking through limit management and the targeted limit management approach, now that we've been doing that for seven, eight months, we will start to see that in the coming months start to really pull through as well because that limit management -- having less aggregate expose to these things will have an impact on the severity. The claims trends, again, it's something that we watch on a monthly basis. It's something that is, as Adrian said, it's a short tail class of business. And so once we get to the end of the year, we'll have another three, four, five months worth of claims trends data, we'll have a much better handle on where the market is at that point in time from a rating standpoint and then we be able to finalize the rate.

A - Adrian Cox {BIO 16257010 <GO>}

I think cyber frequency is down generally or just --

A - Paul Bantick {BIO 15979097 <GO>}

I think cyber frequency was not just -- may have been down slightly recently, but I don't think generally. I think cyber frequency is down slightly. And it can be a bit seasonal, cyber frequency. You see certain hotspots. So July 4 in the US, that holiday weekend, Christmas time, Black Monday, the shopping -- the busy shopping periods, you do see some seasonality for cyber events over the years. But from what we hearing and what we are seeing and from talking to a lot of the experts that we work with, they are not seeing any dramatic drop in frequency, although there are things on the way that might help along with the underwriting actions.

A - Adrian Cox {BIO 16257010 <GO>}

Thank you, Paul. Loss ratios, so we have not taken credit in our loss ratios for the re-underwriting that we've done and from a GAAP perspective, any impacts that that has is likely to be felt at the tail end of next year. And it's not something that we will be booking this year. As you say, it's early from a business line perspective, it's even earlier from a booking and profit perspective. So we will wait a little bit longer before that flows through to our P&L or not. Sally do you want to talk about the investment dollars?

A - Sally Lake {BIO 20925273 <GO>}

So it's not a dissimilar answer actually. So the cost of the ecosystem, as Paul described, is minimal within the first half. I expect it to increase in the second half and then probably increase further in the fullness of next year as well. It will come through our admin costs. I would expect, we may look depending on what we do to look at it if we want to capitalize some of that, but that decision hasn't been made yet. So I can update in the future on that, but in terms of the financials we are seeing today, it's not a significant amount within those.

Q - Ian Pearce {BIO 17168137 <GO>}

Okay. Perfect. Thank you.

A - Adrian Cox {BIO 16257010 <GO>}

Thanks, Ian.

A - Paul Bantick {BIO 15979097 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Freya Kong from Bank of America. Freya, please proceed with your question. Your line is open.

Q - Freya Kong {BIO 20097488 <GO>}

Good morning, guys, and thanks for taking the questions. I've got three questions if that's all right. Firstly, on your dividend strategy, and what you will be giving us at the end of the year, has anything changed in the business for you to step away from your previous progressive dividend policy and what sort of re-basing should we expect?

My second question is on COVID. How are you tracking versus the $50 million of extra exposure that you flagged for 2021? I would think by now at this stage we would have decent visibility for the rest of the year. And if this $340 million that you have booked for reserves, could you give us a sense of the IBNR?

And last question is on net premium growth. So you previously guided to slightly below gross premium growth, but now there is a 10 point difference in the guidance that you arse giving us. Has there been any change in the reinsurance that you expect take on this year? Thanks.

A - Adrian Cox {BIO 16257010 <GO>}

Great stuff. Okay. So has anything changed on our dividend strategy? Yes and no. So we haven't decided what it is next year or going forward yet. So it may be a resumption of what we've been doing before and maybe something different and we haven't thought through that. So I can't really give any guidance as to what that's going to be because we haven't had those discussions yet. I do think it's a good opportunity for us to set a path for the next five to 10 years, want to make sure we take the proper amount of time to think that through and once we have, we will share it. So I'm not being evasive. We just haven't done the work yet.

Moving onto COVID, we haven't used the $50 million yet. So as I said, the sort of behavior in terms of what events are happening and how they are happening, it's relatively in line with what we had expected to happen, and so if that continues as it is, we don't expect to have to use the $50 million of extra that we had flagged. And by the time we reach the end of the year, most of the events that we are concerned about will have either happened or not happened. So we will get clarity one way or another by the end of the year. But as we stand here, we're not planning to use the $50 million.

I'm not able to share with you, unfortunately, how much of that $340 million is in IBNR. There is some, but we currently are not going to give any detail beyond that. And in terms of the difference between net and gross premium, you are right. We had flagged last year some of the growing areas. We were growing in partnership with some reinsurers. And so we were sharing some of that risk on a proportional basis. That is coming through now. I think the net premium growth of 14% is sort of in line with the mid-teens that we were guiding to and which we are still guiding to, and which we are thinking it will persist into next year. Sally, have I missed anything?

A - Sally Lake {BIO 20925273 <GO>}

No. It's fine.

A - Adrian Cox {BIO 16257010 <GO>}

Does that help, Freya?

Q - Freya Kong {BIO 20097488 <GO>}

Yes thanks. Yes. I mean the maximum gross guidance hasn't really changed, but your gross premium guidance has increased. Where -- in which lines are you sharing more with the reinsurers?

A - Adrian Cox {BIO 16257010 <GO>}

So the biggest type of reinsurance we've been buying is proportional reinsurance on our specialty lines and our CyEx books, which are the most capital-intensive that we have and that's why we chose to share that, and also the ones that are growing the fastest.

A - Sally Lake {BIO 20925273 <GO>}

And then you've got the one-off purchases.

A - Paul Bantick {BIO 15979097 <GO>}

And then you've got the loss portfolio transfer that's right in property, which does have a one-off impact. So the difference between gross and net shouldn't be as much at the end of the year. Yeah, you're right. Thank you.

Q - Freya Kong {BIO 20097488 <GO>}

Okay. Perfect. Thanks, guys.

Operator

Our next question comes from Ashik Musaddi from JPMorgan. Ashik, the line is now yours.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. Thank you and good morning, everyone. Just a couple of questions again on cyber and one on the overall as well. On cyber, I mean prices are going up quite a lot, I mean 50%, 100% as you have mentioned. Would you say that most of those price increases that you are seeing is expected to be absorbed by like just increase in the frequency or severity, or would you say that it's just too early to say, and you are being trying to be a bit more conservative with the loss picks that you are putting? I mean this question will last earlier as well, but I'm just trying to get a bit more clarity on how do we think about the price increases and the reserves that you're booking in at the moment. So that's one.

Secondly is I mean clearly you are doing a bit of a portfolio pruning as well, but is it possible to get some views on how do we think about new customers coming in and old customers going out? How do we think about things like whether the new customers coming in are at that 100 -- like double premiums versus same exposure or they are coming with a lower premium, i.e., most of the price increases are with old customers? So that could be second.

And just related to that, I mean, would you say that going forward, you still expect more new customers or would you say that this portfolio pruning will just continue for a year or two, just because you're trying to watch out what's going on?

And the third one is pricing ex-cyber, I mean clearly pricing in second quarter ex-cyber has been more or less stable versus the first quarter, whereas there has been a general noise in the market that going into second half, pricing would most likely start tapering off in specialty lines, reinsurance, et cetera. So I mean it's early days, I agree, but any thoughts on where the pricing is heading towards ex-cyber?

A - Paul Bantick {BIO 15979097 <GO>}

Okay. Right. So let's try and tackle that bit by bit. So yes, we are also seeing significant price increase and we are pushing price increase, and at the same time, we are improving our risk selection and we're seeing some early impact of that. The expectation is if all that plays out as we're hoping it would, that that will bring the margin back, but we have not reflected that in our loss picks or our reserves so far. We're going to wait for further evidence of that.

The portfolio pruning is an interesting way of putting it. So what we've been doing is with all the analytics that Paul was referring to, when we scan our clients and we do our due diligence, the clients are either green-green, or amber, or red, and what we've been doing is, I think, pursuing a different strategy with clients according to which of those buckets they fall into. And we are treating new and existing customers exactly the same because that's the right thing to do, but essentially, we are doing our due diligence to see how well protected they are and how resilient they are.

One of the interesting things is that that itself is also changing because not only are we being more active in what we're looking for, gradually the corporate world is realizing that risk management for network security is an increasingly important thing to do. The clients and companies are behaving now differently to where they were a year ago because they are realizing they need to improve their own risk management. And so our own renewal clients will be different now than they were a year ago because they would have done a lot of that work themselves. And so, part of what we're in now is a transition from a low risk-managed environment to a very higher risk-managed environment, and that's essentially what we're trying to do is to help them through that. And so we're not really pruning necessarily, we're just making sure that the clients we have, new and existing, are appropriately risk managed and that is essentially up to the clients. I would agree of that. And I would add that we are writing new business where we see we're putting new business through the same process where we see new business, as Adrian said, it is green that we think when we do our underwriting due diligence and we run them through the technology and the processes we have, we are writing that new business. But the rates we're seeing on that new business are significantly higher than the rates we saw on new business last year. So we're seeing for the amount of new business we write, it's actually a lot less policies that we need to add to do that because of the rating environment. So we are seeing a lot of new business both in the US and internationally.

A - Adrian Cox {BIO 16257010 <GO>}

And when we look at our rate change ex-cyber, your -- it was a good observation. It's sort of consistent with where it was and it is slightly different from what we hear in the market and that's due to some of the impacts that we were talking about in Q1, right. So, we, like everyone else, have noticed that there is a little bit of tapering on some of the shorter tail lines of business, which continues, but some of the other longer-tail lines of business we've got in specialty lines and CyEx continue to exhibit strong rate changes. And so, overall, that amounts the same sort of number, but the drivers are slightly different. And because I think we do have higher weighting of that business compared to some of our peers, that generates a higher average rate change that we are demonstrating today.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay. And just any visibility on like going forward you would expect it to continue or would you say that for your book as well probably we are getting towards a bit of tapering now?

A - Adrian Cox {BIO 16257010 <GO>}

No, I don't think we have anything new to say on the short tail lines of business. What you're hearing from others is consistent with what we are seeing. I think the longer tail lines of business took longer to turn, so whereas the property market, for example, really started to turn at the end of 2017. It was two years later on some of the long tail classes. So it's slightly behind the market cycle. And our expectation is that it will persist slightly longer because of that. So that's why we're guiding to a similar level of rate change for the second half of the year.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you. Thanks a lot.

Operator

Thank you for your question, Ashik. Our next question comes from Faizan Lakhani from HSBC. Faisal Please go ahead.

Q - Faizan Lakhani {BIO 22154809 <GO>}

Hi. Good morning. Congratulations on very good set of results. I have three questions. First is on reserve releases -- on the reserve margins, sorry. If your margin is at 6.6%, I remember at the full year you mentioned that the 6.3% was depressed due to the (inaudible) and COIVD. So can we assume that the buffer is flat to possibly down relative to full year? Or is it actually a genuine improvement?

And question two is on cyber. Can you just give us some indication on how severity has developed since October and also how cyber is booming relative to 2019? And final question is on capital. Could you just give us a breakdown in terms of how the capital developed from the implications of the change in investment portfolio, rates and volumes/

A - Paul Bantick {BIO 15979097 <GO>}

Okay. I think you want to take questions one and three, Sally.

A - Sally Lake {BIO 20925273 <GO>}

Yeah, sure. So, yes, so just to remind everyone at the year-end we spoke about actually that there was a depression caused by a set of claims within the reserved surplus being COVID in particular, but also the fact that we've had some cats, which we have had again in Q1 to a slightly lesser extent in Texas. And then the other thing that was causing the depression was the fact that the excessive loss we've been speaking about on specialty lines and CyEx was leading to the net position on both the actuarial number and on our balance sheet being very similar, though all of those things still remain and they're not necessarily exactly the same. So that effect still remains in the reserve margin calculation and it will do to some extent whilst we are still recovering on the excessive loss insurance. So hopefully that helped you there.

Q - Faizan Lakhani {BIO 22154809 <GO>}

So will it remain to the same extent this half year?

A - Sally Lake {BIO 20925273 <GO>}

It probably hasn't changed significantly is what I would probably say because if I look at how the gross versus net has moved, as we spoke about earlier, we are still in a similar position. So I would say, it may have moved, but not to anything significant.

A - Adrian Cox {BIO 16257010 <GO>}

And then capital.

A - Sally Lake {BIO 20925273 <GO>}

And then on capital, short answer, kind of no. So we don't give that breakdown. I guess what you're seeing is an overall increase in the ECR of around 5%. So you could kind of work out what if we are growing net premium by 14%, and we're getting 10% offsets from other things both -- and that would include both rate change and claims, but we don't give that breakdown. That's just high level --

Q - Faizan Lakhani {BIO 22154809 <GO>}

Did the investments portfolio have any impact at all in terms of how the capital developed or has that been modest in the grand scheme of things?

A - Sally Lake {BIO 20925273 <GO>}

No, not particularly. The two things that would impact it is if we changed our risk appetite, which we haven't, and secondly, if there is some volatility change in the market which there has been up and down over the last couple of years, but it's not a significant driver of our capital, though it will do in the rounding but our peak capital isn't driven by our investment portfolio because relatively the risk is lower compared to other risks that we take.

A - Adrian Cox {BIO 16257010 <GO>}

So Paul, cyber severity.

A - Paul Bantick {BIO 15979097 <GO>}

Yeah. So cyber severity. It's still fairly early when we're looking at the business, it is down since October, talk about severity. I mean it will take a little bit more time for us to be able to look at that and take a view on that. But with the action we've been taking, both in the limit management, both with program changes where clients -- some larger clients take much larger retentions now than perhaps they did a year ago, we will see I think severity start to pull through in the coming quarters. And we will be able to take a look and take a view on that.

Performance relative to 2019, well, when we show you the 20% reduction that we've seen so far and the 50 basis [ph] on premium, that is very much comparing it to 2019 and 2020 -- early 2020, which is when we saw the most of the ransomware activity. So those numbers are looking at not just how is it down, but how is it down compared to what we saw in 2019, 2020 because that's predominantly where the ransomware threat existed.

Q - Faizan Lakhani {BIO 22154809 <GO>}

And may I ask a couple of follow-up questions if that's okay?

A - Adrian Cox {BIO 16257010 <GO>}

Sure.

Q - Faizan Lakhani {BIO 22154809 <GO>}

In terms of cyber, your frequency is down by 20%. You're keeping your loss pick -- your loss pick isn't allowing it to the improvement in cyber. Can we -- though we eventually assume that the loss pick in CyEx you've sort of broken it down to set (Technical Difficulty) current year down being additional buffer to your results. That would be fair?

A - Adrian Cox {BIO 16257010 <GO>}

You want to answer it?

A - Sally Lake {BIO 20925273 <GO>}

Yes. So I think the question was given that we have amended our loss pick given the positivity that we're seeing in the data, can we imply that there is more reserved margin coming out of that. I would say, if the trend continues, then that would be the outcome, but I would not rush to that conclusion at this stage because I'll say again, as Paul and Adrian have, it's a very early indicator of the data. So I think we need to wait for a year's data at least probably till the year-end to start drawing those conclusions because you are completely correct that if we continue with this trend then that would be an outcome. Hopefully that (Multiple Speakers)

Q - Faizan Lakhani {BIO 22154809 <GO>}

And just in terms of the second half of the year, if rates go up, do you think that will simply just pause the worsening trends, or can we assume improving cyber rates from here would feed into better experience in the second of the year?

A - Adrian Cox {BIO 16257010 <GO>}

So rate action is a backwards looking thing, right. So rates are going up because the claims of the insurance market has paid and so I don't think rates will continue to go up because of what happens in the second half of 2021, rates will continue to go up or not because of what's happened in the first half of 2021 because the insurance market reacts what it has seen and I think the rating environment will persist until the insurance industry in general has reinsured itself that is on top of this problem. And it is a long way from that yet.

Q - Faizan Lakhani {BIO 22154809 <GO>}

Perfect. Thank you very much for answering my questions. Thanks, Faizan.

Operator

Thank you for your questions Faizan. Our next question comes from Ivan Bokhmat from Barclays. Ivan, the floor is yours.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Good morning. I've got a couple of questions both in cyber. The first one would be related to capital intensity of the business. I'm just wondering if given the panel that you've got, the quote right now, if you can help us understand for cyber, what is the -- what cost of business would you compare the capital intensity to? If it would be akin to specialty or akin to property because clearly some of the aspects like the accumulation risk would make cyber quite close or similar let's say to property cat, but I presume that the risk charge under your model and under most rating agency models is far lower? Maybe if you can give some general thoughts on that. Maybe you are aware of any discussions happening broadly of perhaps increasing risk weights in the Lloyd's or Solvency II framework that would be very interesting?

And the second one, I suppose you spoke about the attritional versus systemic risk. And I'm just wondering, could you explain a bit how you can distinguish between your customers? Are you able to offer more narrow policies, limiting that systemic risk to some others outside than just the risk limits? Or typically the policies you offer are quite broad, and therefore, you would still be exposed to, let's say, cloud outages even for the breach response customers? Thank you.

A - Adrian Cox {BIO 16257010 <GO>}

Sally, on the capacity, why don't you have me take a crack?

A - Sally Lake {BIO 20925273 <GO>}

You have a crack. You quite like it.

A - Adrian Cox {BIO 16257010 <GO>}

Okay. Yeah. It's a good observation, right. So it does have attributes or elements of both property and liability in it and if cyber would have been born a different way, it would have been in our property team, as Paul said because it emerged as a regulatory and legal obligation mostly in our specialty lines team. I think, so it has its own place in the internal model, it is modeled separately. I would say if it was like anything, it's probably like D&O in terms of how capital intensive it is. And I think a significant part of that is still the fact that although we've been doing this since 2009, it's still a new business with a lot of uncertainty to it and that generates an extra load, though part of that is because of the volatility that it exhibits, but actually a large chunk of it is because we still load the capital ratios, because it's new and there is uncertainty around that newness.

Attritional versus systemic is an interesting one. We have and what we discovered as we've done more modeling which bits of cover create more systemic issues than others and the cyber coverage has broadened over the years. And as we thought about that more and more, we have realized which bits do. And as Paul I think alluded to earlier, the real thing that joins all businesses together is business interruption and its cousins, dependent business interruption and service interruption. And part of the management that we've been doing these last couple of years is to be much more stringent and careful as to how we give that coverage out because of the fact that we do know it accumulates. Paul, is there anything else you would like to add on top of that/

A - Paul Bantick {BIO 15979097 <GO>}

I think we've been doing that, but we also do a lot of work to understand what these scenarios would look like because they don't I mean the same for large accounts, for example, as they do middle market. It doesn't mean the same for international as it does the US. It doesn't mean the same for different industries. So when we're thinking about the cover we give to clients, we're thinking through those issues and we have a good understanding of when these scenarios happen, who is that going to impact, and therefore, what coverage are we giving them and how much are we give them. It's a combination of all those things put together.

A - Adrian Cox {BIO 16257010 <GO>}

Does that help, Ivan?

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Yeah. Maybe I can follow up. I mean, considering that a lot of your portfolio would be market risks, I'm just wondering, what do you perceive the wording of the contracts in your books different than from broader markets exposures? There is some differentiation which you can help illustrate.

A - Adrian Cox {BIO 16257010 <GO>}

The differential between our cyber wordings and the market cyber wordings, is that what you are after?

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Yeah. As in, if you look at the largest cyber writers, like (Multiple Speakers) who would presumably take more larger clients, and it doesn't have to be minutes of course. But whether you think there is a difference in the wording between you and the largest players, let's say, in the US?

A - Paul Bantick {BIO 15979097 <GO>}

Yeah. I think the biggest difference is around the fact is in our Beazley Breach Response product, which gives us control over the claim. So when you look at the cyber market and the wordings, firstly, agents -- spot on, the main point of differentiation in the wordings is services (Technical Difficulty). Look at our wording, our BBR product is designed -- it's typically used in the middle market because middle market clients are the ones that gravitate to the Beazley Breach Response product because they really crave a lot of those services and all that we give with the policy.

When you line up wordings more generally, the coverages there are all very similar in terms of the actual coverage within the policy. But that said, we also write a lot of cyber that isn't on BBR. We said we are striving for diversified books, we write large accounts where perhaps BBR may not be the best fit. We have a middle-market book and we also have an SME portfolio as well.

So we really work hard to keep the balance of diversification between those. But right now, if you were to compare the policy wordings, I think the services and the risk management services and the way we structure those in the policy is the main difference that you would see.

A - Adrian Cox {BIO 16257010 <GO>}

And that manifests itself in how the claim presents and that's the important thing for us, right. So the value that the client of Beazley Breach Response has if they have an issue, they can call us up and we will handle it for them and take a lot of the stress out of that because it's a very stressful thing to do. And we've very experienced team that can do all that. The advantage it gives to us is that we are controlling how the claim goes. We're doing a lot of it in-house. We are controlling the costs and the result of that is that not only is the claim safely handled, but it's handled by people that we know and trust. And therefore, the costs are contained. And that control over how a breach is handled and how the ensuing claims is handled, which you don't always get an insurance, because oftentimes it's the indemnity policy so the client does it and then we reimburse them. The control that gives us is a significant advantage for us.

A - Paul Bantick {BIO 15979097 <GO>}

The other significant advantage that gives us is speed. We see data far quicker because clients are -- we are their first call. If something is happening, they call us first. So we will see trends, we will see costs, we should see movements far quicker because we have it in-house rather than waiting for third parties to tell us about what they are seeing.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Great. Thank you. By the way, this focused session on cyber is brilliant.

A - Paul Bantick {BIO 15979097 <GO>}

Thank you.

Operator

Our next question comes from (inaudible). Ming, please go ahead.

Q - Unidentified Participant

Hi. Good morning. Thank you for taking my question. Just two questions please. First is, US liability line, there is a comment that you said you are expecting the return of social inflation. I think that's quite in line with market expectation, but could you just give a little bit color in terms of what you have assumed and what actions have you taken in that line?

And my second question is that, you are quite bullish in terms of your growth for full-year 2022, and how much of that is actually embedded with the rates momentum outlook and how much of that will be organic growth? Thank you.

A - Adrian Cox {BIO 16257010 <GO>}

Okay. So to take the first question, we are assuming that the social inflation goes back to the sort of levels that it was and the sort of drivers that it had before the pandemic struck. And so we were talking quite a lot about social inflation and where that was having an impact and the sorts of impacts that that was having back in 2018 and 2019. And our central assumption is that that's what we'll revert to. And we took underwriting action around that back in '17 and '18. And we have superimposed on top of that additional action reflecting the fact that we do think there is a danger of COVID-related claims activity on top of that, and that's what we have done and that those actions remain in place.

When we look at growth next year, it is partly rate and partly organic growth. I think our overall level of rate change is probably slightly down from this year into next year, with slightly more organic growth, noting that overall that the rate environment should be -- could be more positive but we will be able to provide a little bit more guidance on that at the end of the year when we've got more certainty about what that mix looks like, but at the moment, those are just our first pass at it. Did I miss anything?

Q - Unidentified Participant

Thank you.

A - Adrian Cox {BIO 16257010 <GO>}

Thank you, Ming.

Operator

Our next question comes from Andreas van Embden from Peel Hunt, Andreas, please go ahead.

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

Yes. Hello. Thank you very much. I just really had one question. We've seen sort of three years of rate on rate increases across your portfolio and your peers as well and I appreciate we are seeing an acceleration on cyber now. But just want to see how this sort of filters through into your underwriting margins. The rate increases across your whole portfolio, are they well above loss cost trends now? And are you seeing this translate into an improvement in your attritional loss ratio, i.e., your loss ratio excluding the reserve releases and the large losses and the cat losses you incurred during the first half? Thank you.

A - Adrian Cox {BIO 16257010 <GO>}

Okay. I'll have a go then. If I get it wrong, please. So, I think -- so yes, I mean what was Sally saying earlier, she was saying that one of the goals she had, when she took over the role a couple of years ago, was to show more consistent and better prior-year reserve releases. And we've gradually been getting closer to where we used to be as an organization, which I think is evidence of both the re-underwriting that we've been doing and the rates that we've managed to charge. So we are hopeful that the underwriting margin is back in the business and we will start to see that flow through to our financials, which is one of the reasons why I think we are guiding to the low 90%s.

Having said all of that, we live in risky times, right So we are talking about European floods, we are talking about wildfires, we are talking about riots in South Africa, we are talking about cyber changes. The world is a very volatile place and so the game is never finished, right. So we consistently have to react and make sure we're on top of what's new as well as fixing what we know about from the past which is a sort of general hedge. As I said before, that all other things being equal, yes, it should begin to flow back in.

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

And how long do you think it will take for those rate increases to really sustainably take it back to the sort of low 90%s or perhaps even better combined ratios?

A - Adrian Cox {BIO 16257010 <GO>}

Well, we are guiding to low 90%s this year, Andreas. So we're hoping that that will start to go then. When you look at our combined ratios in the past, when we had combined ratios under 90%, those were generally years with significantly lower than average cat activity. So we had a sort of a run rate of 92%ish, low 90%s. And then the bonus, if you will, of a low natural cat-free year.

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

Understood. So the rate increases will bring you back to where you were on average before?

A - Adrian Cox {BIO 16257010 <GO>}

That's what a low 90%s projection would imply, yes, absolutely.

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

Okay. All right. Thank you very much.

A - Adrian Cox {BIO 16257010 <GO>}

Thank you.

Operator

And our final question comes from Nick Johnson from Numis Securities. Nick, please proceed with your question.

Q - Nick Johnson {BIO 1774629 <GO>}

Hi, everybody. Just two questions, please. Firstly, on capital, the required capital growth for next year estimate of 5% is a lot lower than recent years. It's been around about 15% I think. You mentioned the benefit of rates in that calculation. Just wondering, to clarify, does the estimate for next year just plainly change in the percentage of premium ceded? And is it possible that the required capital number for next year could go up once you finalize your cyber growth plan for next year?

And then the second question is on SPAC D&O growth, perhaps you could just talk a bit about the risk management in that category? And sure it feels like quite a risky segment. Thanks.

A - Adrian Cox {BIO 16257010 <GO>}

Right. Why don't you take the first one. While I bring my D&O underwriter on and ask -- while you answer the second one.

A - Sally Lake {BIO 20925273 <GO>}

Yes. Hi, Nick. So yes, you are completely right what that 5% increase allows for is what we're planning to -- currently planning to grow in the business plan, early days on it net of reinsurance which as we've said is similar to what we're looking at this year. So that does allow for the reinsurance -- a growth in every insurance to continue into next year. If definitely -- that is an early estimate of the number and as in every year, that will evolve between now and the end of the year as we continue to evolve the business plan. And then also depending on what happens on cyber and depending -- A, what happens in cyber in terms of rate and exposure growth and what our decisions are within the business, part of which we continue to work through, they will all have effects on the capital and capital requirement They can go up and down, because as I said earlier, one of the reasons the capital is down compared to the overall premium growth is that our exposure is down on cyber in particular. So we have to work through all of that to see where we end up in the year. Again, following on from the point that Paul made earlier, that we've got some encouraging data but there is more to learn between now and when we finalize the business plan, but yeah, it will definitely evolve in the coming months. Over to you Adrian on SPACs? Was that long enough?

A - Adrian Cox {BIO 16257010 <GO>}

Thanks. So that's a great question to finish good morning with. So I guess to start with -- SPACs have been around for a long time. I first had SPACs explained to me when I was running SL back when -- and than must have been five, seven years ago, and they've always been slightly curious instruments, but they've been around for a while and they've really come into vogue as we all know, the last couple of years or so. And they are quite esoteric in terms of the particularities of how the different transactions work and what the liabilities are around those different transactions. And so we designed a policy form so that it was very clear what cover was been provided when because it wasn't always obvious just using a normal D&O policy.

And that's sort of what we're trying to do, right. When things are a bit different, we customize and we bespoke sort of this very clear what is being done when. And there was a chance to do that here I think. We are -- so, although it's been around for a while and although we've managed to produce a policy form, and I think it's a very good one that produces that clarity of what's being covered, they always have been and they remain quite high-risk things. Just like IPOs, high-risk things, and that is reflected in our underwriting due diligence and how much limit we are going to payout and the sort of premiums that we charge. And we are very careful about what SPACs we do, avoiding these celebrity-endorsed ones and so on so forth. We like to do the ones that are proper businesses and so on and so forth. But they are a valid part of our D&O book and we have some history with them, but we're very careful because they are high risk just as we've been very careful with IPOs over the years.

Q - Nick Johnson {BIO 1774629 <GO>}

Thanks. That is reassuring. Thanks very much indeed.

A - Adrian Cox {BIO 16257010 <GO>}

Thanks, Nick.

A - Sally Lake {BIO 20925273 <GO>}

Thanks, Nick.

Operator

We currently have no further questions registered. So I'll now hand back to Adrian, Sally, and Paul to conclude today's call.

A - Adrian Cox {BIO 16257010 <GO>}

Great stuff. Thank you very much indeed. Well, thank you very much for calling in this morning. I hope that was useful. If you have any follow-up questions, please get in touch with Sarah and we'll do our best to answer them. And we look forward to seeing you very soon. Thank you very much.

A - Sally Lake {BIO 20925273 <GO>}

Thanks, everyone. Have a good day.

A - Paul Bantick {BIO 15979097 <GO>}

Good day.