# Y 2018 Earnings Call

## Company Participants

- Adrian Peter Cox, Chief Underwriting Officer & Director
- David Andrew Horton, CEO & Executive Director
- Martin Lindsay Bride, Group Finance Director & Executive Director

## Other Participants

- Andreas de Groot van Embden, Financials Analyst
- Andrew James Ritchie, Partner, Insurance
- Benjamin Cohen, Analyst
- Joanna Tamar Parsons, Equity Research Analyst
- John Anthony Leslie Borgars, Senior Analyst
- Jonathan Peter Phillip Urwin, Director and Equity Research Insurance Analyst
- Kamran Hossain, Analyst
- Nicholas Harcourt Johnson, Analyst
- Paris Hadjiantonis, Research Analyst

## Presentation

### David Andrew Horton {BIO 5697110 <GO>}

Good morning, everybody. Welcome to our results presentation for the year ended 31 December, 2018.

If we have a quick look at the agenda. I'm going to give you an overview of the year, I'm then going to hand over to Martin. This is his last analyst presentation before he retires at the end of May. He's going to run you through the financials. And then I'm now going to hand over to Adrian. Now this is his first presentation as a Chief Underwriting Officer. And he's going to give us an overview of what's happening in the underwriting and talk briefly about the split between specialty lines and cyber and executive risk. And then I will come back for the outlook for 2019. And the crystal ball will be out, what is actually going to happen for the rest of this year.

So if we look at the high level numbers for 2018, we saw some good top line growth. The top line growth, up 12%. That's on the back of rate increases across the average -- across the portfolio of 3%. So we saw some good rate increases across most of our lines in 2018.

The growth actually came across all divisions. All divisions grew to some extent, which was great. And also our geographic footprint. So the U.S. went through the $1 million premium mark, up 20% year-on-year, which is the four years in 5 it's grown by 20%. And we expect that sort of momentum to continue into 2019.

We also grew internationally. We've been investing in our offices within Europe. We obviously did the Canadian acquisition in 2017. So we grew everywhere geographically as well.

Bottom line though impacted by 2 things. Investment, tough year for investments, spreads widening, interest rates rising and equity markets falling. So investment income, roughly down $100 million year-on-year to 0.8% from 2.8%.

And also, we picked up some catastrophe claims in 2018 as we had done in 2017 and more attritional claims, especially in the property portfolio. That had an impact on the prior year reserve releases, which Martin will go through in a minute. Although we did flag of course, at the end of 2017, that the prior reserve releases will be lower because we've used most of our catastrophe reserves against the catastrophes of '17. And the same applies in 2018.

Dividends, in line with our normal plan, are growing just over 5%. So dividend continues to rise and the final dividend at 7.8p.

So what's actually gone on in the business? As I mentioned, great growth in the U.S., which is good. And of course, now we've gone through the $1 billion number, our aim is to see if we can get up to $2 billion of U.S. premiums. This is a relatively small number compared with the size of the specialist insurance market in the U.S. Continue to invest in the States in terms of people. So we recruited within the U.S. last year. And this year, we're looking at opening 2 new offices in Denver and Seattle. So increasing our footprint and ensuring in the core offices we have or the key offices we have. We have multi-products in each of those offices, with the focus mainly on Boston and Houston.

We are focusing outside the U.S. So you can see we recruited 34 underwriters outside the U.S. in Europe, Canada and Singapore, which is great. We have our Brexit plan in place as far as we can. And of course, we're still -- waiting for the final rules of Brexit. We have our Irish insurance company, which can operate through Europe with branches in Spain, Germany and France. And of course, Lloyd's got their Brussels' operation up and running. And we started writing business through Lloyd's Brussels from January 1 this year. As I mentioned, the Canadian acquisition is going really well. Canadian premiums are up about 20% in 2018 over '17 from a relatively low base.

Some people changes that we've eventually announced. So Adrian, as I mentioned, taking over as CUO from Neil, who retired after 28 years with the company at the end of last year; and Tim Turner and Clive, who both joined Beazley in 1998 to start the Marine division. Clive has not been well for a number of years. And therefore, Tim Turner has taken over the lead of the Marine division.

Focusing on a few new strategic initiatives in 2018, 2 related to technology and data. So Beazley Digital is all about how can we do simple business better and easier. So we're going to look at technology, have less touch from underwriting and claims on our simple business. Then we have some initiative called Faster, Smarter Underwriting, which is looking at how do we use data and technology for our large risk business on both underwriting and claims.

Other key initiative is getting closer to the customer. We want to spend more time with our insureds in 2019. We have a good view of what they'd actually like. There is an opportunity to sell more product and to actually understand what they would like for us to think of in the future as customers generate new risks. So we are going to have a key initiative closer to the customer.

Some of you may be aware that we launched a smart tracker. And this was how to write portfolios of business and quote shares of business more cheaply in the Lloyd's market. And in 2018, we launched this, had a $25 million budget. I think we're going to write slightly less than that. It's got good momentum, good broker support. And in 2019, our aim is to write in excess of $60 million. 90% of this business is supported by third-party capital. So Beazley only has a 10% share in it. And our aim is to grow this. And we will have a different stream of income in the future with different capital sources coming in.

Looking at some of the charts. So premium growth, you can see how the premium growth is gaining momentum in 2018. Of course, '14, '15, '16 were not great from a rate environment. You can see how the growth has grown in 2018. We expect that to continue at a similar-ish sort of level into 2019.

Combined ratio impacted by the catastrophes of 2017 and '18. And some of the attritional losses in 2018 in our property division, expenses holding flattish, down a bit this year to 39%. I'm sure Martin will mention that in a second.

Base dividends continue to grow nicely from the 9.3p back in 2014 to 11.7p in 2018. And you can see how the return on equity has been impacted this year by both claims, catastrophe and attritional claims and the lower investment return.

We are very focused, as you all know, on growth in net asset value per share. And what this chart shows is the -- the gray part at the bottom is if we can grow 15% plus the risk-free rate, we hit the top of the gray bar; and at 10% plus risk-free rate, we're at the bottom of the gray bar. And you can see what we've achieved over the past nine years, where the diamond is. So we're just about achieving a 15%, plus a risk-free rate over those nine years. And our belief is as we grow net asset value per share, the share price will respond accordingly to that, which you can see it has done with more volatility over the past year as returns are a bit lower.

I will then hand over to Martin, who will go through the financials.

## Martin Lindsay Bride {BIO 15458196 <GO>}

Thank you very much, Andrew. Good morning, everyone. I'm Martin Bride, the Finance Director of Beazley. So I am going to just highlight 1 or 2 things in the financial KPIs and then talk to you about my usual trio of subjects being investments, reserves and capital.

So on the KPIs, the only 2 things I'd really pull out, improved efficiency of our reassurance purchasing last year. So net written premium growth was actually even stronger than the already very good 12% top line growth.

As far as the per-share metrics are concerned, they were net asset value -- net tangible asset, they were up slightly. But I think we have to be clear that the dollar-sterling exchange rate is really creating that. We carry our capital in dollars because the vast majority of our business is dollar-denominated. And there's been a reasonably significant shift between year-end '17 and year-end '18. But nevertheless, a good position.

So investments. Very happy with how the portfolio responded during the year, not particularly excited about the investment outcome. But very happy with how the portfolio responded. And so very little change. It's a very stable chart over time that you see. Credit to Stuart Simpson and his team. You can see in the detail there, the gray capital growth assets, that are higher-risk assets, some decisions taken during the year to reduce down to our sort of lower end of our possible weight in those asset allocations. And that certainly contributed to the outcome being better than it would've been if we hadn't done that. As I say, we can't really call it a great outcome in absolute terms.

So that is picture of the investment yields. The second half quite strong and particularly boosted in the last 1 or 2 weeks of the year by a slight reversal of the very strong upward trend we'd seen in U.S. rates all the way through 2018. But in spite of that slight reduction backwards, the sort of -- the forward-looking prospects are -- for '19 are encouraging compared to where we've been over the last 5 or even 10 years.

So reserve releases. Beazley does reserve prudently. And we have a consistent approach, reserves built up team by team. And therefore, we do expect releases on average when we settle claims out. So the 2018 picture, slightly different to the usual one in that we do have one of our businesses that's had a reasonably significant reserve increase. But it is only one. The other 4. And in particular the maroon or magenta block from specialty lines, still performing very strongly.

So as we had signaled at the start of the year, reserve releases were below average in 2018 because we came into the year with no margin in the nat cat. Notwithstanding that, we did need to strengthen reserves in our property team in relation to some attritional claims that we were seeing in various portfolios. This will happen occasionally, even though we reserve prudently. But the key is that it is occasionally.

We have a second version of this chart this year, where we've just taken out the effect of the 2017 catastrophes. Our overall reserve for those catastrophes held up. But there was a release from the reinsurance division. And there was some increase in the cat reserves, in the property group they net to approximately 0. And so that's what the picture would have been if you took that out. And you can see there the underlying, I think, it's a $21 million strengthening in property group.

Potentially, more importantly than the reserve releases during the year is the margin because that's really -- to the extent there is a lead indication of what's going to happen next on reserve releases, it's this chart. So this is showing you the margin. We believe, the reserves in our balance sheet have above our internal actuarial estimates that themselves have an element of prudence in. And so you can see we're in the management range. And we are up from the position of last year.

Clearly, we've had another -- as Andrew has described, we've had another relatively active year claims-wise. And so we've not had a huge tailwind as far as reserve strength is concerned. But notwithstanding that, we've taken the action necessary to move the reserve strength up.

Finally, capital. So we ended the year with a 26% surplus capital, measured as a percentage of the Lloyd's Economic Capital requirement, which supports our underwriting at Lloyd's. That's slightly above our target range of 15% to 25%. So we view the position as very strong. We've given the guidance that we think our capital requirement will grow in line with the top line. You can see that the growth year-end '17 to year-end '18, I think, is 9%. Adrian is going to talk to you about high single-digit growth prospects for next year. So that rule of thumb appears to be working.

We did have a one-off effect in 2018 that we are now retaining more risk in our U.S. admitted carrier. And we increased the capital in that carrier to accommodate that extra risk, with a sort of not quite commensurate reduction in Lloyd's capital. There was a -- at the margin, a bit of inefficiency. But that sort of big step-up in the U.S. capital is a one-off from our perspective. And we now would expect both measures to -- broadly to grow in line with their respective premiums.

Final point on the capital front. We did redeem a small amount of subordinated debt, an $18 million instrument late this year -- I'm sorry, late last year. And we have our retail bond due for redemption in September of 2019. So nothing is finalized yet. But certainly, the plans are for there to be some form of debt issuance later on in the year. And we'll be updating you about that nearer the time. So that in terms of delivering capital to support the ongoing growth of the business, there should be an increase, thanks to debt financing. And then hopefully, a return to slightly higher ROEs, which will also help generate capital to support the future growth.

## Adrian Peter Cox {BIO 16257010 <GO>}

Thank you, Martin. Good morning, my name is Adrian Cox. I'm Chief Underwriting Officer.

Start with a review of some of the achievements of last year. Combined ratio, as mentioned, 98%. I'll talk a little bit more about that on the next slide.

Strong growth, I think it's encouraging that that growth came across a number of our divisions. So the opportunities for us are relatively broad-based. The 3 divisions which grew in double digits were specialty lines, PAC and property. Marine and treaty both grew but less than double digits. Notably, I think we were happy to grow our property exposure last year. So although, that account has been in remediation, the underwriters have been working quite hard on that since the middle of 2017. And because of all the hard work they've put in, we were happy to grow our exposure base last year, which I think is good news.

The rate change that we had of 3% was actually higher than planned. I'm going to talk a little bit more about that later on. I think it's worth noting that all the divisions, bar our treaty, beat their rate change plan last year; and all divisions, bar PAC, were rate-positive last year. Our PAC division sort of got dragged down by the softening terrorism market, which had another year of very low claims frequency.

Talking of PAC, that division achieved a 90% combined ratio last year. So the years of reunderwriting of that book and particularly sorting out some of the PA business in Australia, have finally paid off. So well done to them. And as Martin mentioned, our reserve surplus increased a little this year. And we continue to reserve as we always have done.

Pleased with the progress that we and, indeed, the market made on PPL last year. And we didn't quite reach the top end of the targets that Lloyd's set us. But we will get a healthy rebate for them for the efforts that we did. And we're confident that we're going to have a proper go at meeting the increased targets this year. It does look as if the market has finally turned the corner on this issue. And as far as we're concerned, that's a good thing.

So as Martin mentioned, good to see net premiums growing faster than gross. We've been working on the efficiency of our reinsurance programs for a few years now. That's a project that I will also take on in my new role. We can see the makeup of the combined ratio there. The 39% expense ratio is something that Martin will be basking in between now and when he leaves. And the 59%, it's slightly higher than last year. Two things actually lie behind that. First is the strengthening of the property book, as Martin talked about. Most of that was in the 2017 year of account. We have also opened some of the medium-tail business in specialty lines, higher in 2018 than we had in '17 and prior. And the reason that we have done that, it reflects our view that the claims environment now is a little less benign than it was in the immediate years following the global financial crisis. And we have acted accordingly.

This is a slide familiar to most of us, I think. My predecessor believes. And I certainly concur with him, that this does show nicely the benefits of a well-diversified portfolio. The dotted line in the middle there shows that we are once again above the 100%. So in aggregate, we're getting the same sort of pricing levels that we were back in 2008.

A couple of things worth noting, I think. Property, the green -- not the green, the pink line at the top there, is as high as it's been in the last decade, which is interesting. And also interesting is the bottom blue line there, even Marine has turned positive, which doesn't happen very often.

Moving on. Our December rate change was just under 5%, which is an interesting fact, I think. And as a visible sign of some changing market sentiment. And it does feel as if there's some genuine momentum now building to reprice products and areas where margin was -- were being over-squeezed. As always, loss activity is what's driving this. But I certainly think that the Lloyd's business (playing) last year brought a lot of this into the public eye. And overall, we think that, that was no bad thing.

Anecdotally, we've heard that the market lost a lot less business in the last quarter of last year, than the brokers were worrying that it had -- that it was going to. And as evidence to the domestic markets -- domestic carriers are also starting to reunderwrite. And they're reacting to the same issues that we've seen over here, which is why the market lost less business. They're just not doing it as publicly as we have here. I think this is quite encouraging as we look forward to 2019.

Our rate change plan for this year is roughly the same as last year. The indications for January so far is that we will have beaten that so far.

Again, opportunities across most divisions. Our U.S. platform will continue to grow. We'll continue to do as we always have with that. I think the growth hopefully will be slightly more widespread. So beyond specialty lines into some of those other divisions. And as I mentioned earlier, our core product suite is up and running in our international initiatives. Our core product suite being cyber financial lines in medical malpractice. And our hubs in London, Barcelona, Miami, Toronto and Singapore are all doing well.

As Andrew mentioned, we continue to build 5623 with a business plan of about $65 million. Last year, we really tested the concept with all stakeholders, regulatory capital, brokers. And I think it worked. We've brought new third-party capital into the syndicate this year. There was quite a lot of interest in what we're doing in the mission that we're on. And we continue to drive with vigor the concept of reducing the frictional cost of placing and administering business in the London market.

Given the cat activity we had in 2018, we're not expecting normal levels of reserve releases from cat reserves because we don't have them.

And finally, we will split the specialty lines into 2 divisions going forward. And a little bit about that. We decided to split specialty lines into specialty lines and cyber and executive risk for 2 reasons: firstly, that it was getting a bit big; and secondly. And more importantly, we thought that we could generate some real symbiosis by bringing together the U.S. management liability and cyber teams. Management liability in the U.S. D&O primarily. But also (EPL) and some other coverages, are traditionally insurances that have been overseen by the board. Increasingly boards in the U.S. have taken more of an interest in the cyber purchase. And they're tending to purchase them together. Brokers are beginning to organize it themselves the same way. And we thought we could generate some competitive advantage by aligning with that practice.

As I said, we'll be reporting both divisions separately from H1 this year. You can see from those stats that CyEx, or cyber and executive risk, is between 35% and 40% of the old total. It has a lower combined ratio target than the old specialty lines. And it needs a lower combined ratio to generate the same return on equity because it's shorter-tail business.

We should also expect it to have a slightly different reserve release strategy than specialty lines, as (our old) did because it's shorter tail. It also has aggregation risk or catastrophe risk. So its reserve releases, if there are any, will more mirror a shorter-tail business with those sorts of exposure. We have plans to grow both of those in 2019. If anything, the plans for specialty lines new are slightly more growth than CyEx new because some of the real engines of U.S. growth are environmental and miscellaneous medical. For example, they've been growing quite strongly. And the bulk of our international business is within specialty lines.

And with that, I will hand back over to Andrew.

## David Andrew Horton {BIO 5697110 <GO>}

Thanks, Adrian.

So if I just give a summary of the outlook. I think we feel a bit more positive at the beginning of 2019 than we did at the beginning of 2018. If we go back a year ago, our view was, despite the catastrophes of 2017, the industry was going to reload and just have a go in a similar way that they did in 2017. Rates wouldn't respond because of that, because of the extra capacity or the catastrophe reload, rates wouldn't go up that much. And I think that's what we found in 2018.

Having had another year of some catastrophes and margins not being that good, there is definitely more stress in the system. The Lloyd's business planning process has put some stress on some of our competitors, as Adrian mentioned. Some of the larger non-Lloyd's players are also feeling under pressure to reunderwrite and therefore, feel more positive about rates in 2019. So this is going to be the second year of rate increases, not in every single line of business. But across most of our lines of business. And also with higher interest rates, high yields, we feel we can make more money off our investment portfolio in 2019.

On the Brexit, we're as prepared, I think, as we can be for whatever is going to happen over the next month or 2 with Lloyd's Brussels and our insurance company in Ireland. We had one or two executive committee member changes in 2018. And we have the same in 2019. Martin is going to be leaving us at some point in May. I suppose I could start now the four months of congratulating him and thanking him for everything he has done. This can be the first time because I'm sure there are going to be other things like this that are going to happen. I probably won't do it on every investor meeting over the next 2 weeks, Martin. But thank you very much for your contribution over the past 10 years. It's been excellent.

It's great to be appointing Sally, who is in the audience, who is our Group Actuary to the Finance Director when Martin retires. We've also got Dan Jones, who had actually been actually involved in the company to some extent since 2006 as a nonexecutive director and became our Head of Broker Relations in 2011. And Lou Ann Layton, who had historically -- who had been at Marsh for 31 years, joined us in the end of November last year. And that's great. She is steeped in relationships with brokers and clients. So that's fantastic. And Jerry Sullivan, who has been with us more than 10 years, has taken on the Head of the U.S. Management Committee. So he's overseeing distribution, people and systems to see if we can continue the great growth we've had in the U.S. over the past few years.

I mentioned investing in technology. The industry needs to become more efficient. And I think there is the opportunity there with some of the London market initiatives and some of the specific Beazley initiatives to be a lot more efficient and productive than we have historically been.

And also, we continue to grow in terms of people. So we've never stopped recruiting in the 33 years the company's been in existence. And again, with a bit more stress in the system and some of the insurers under some pressure to change and adjust, I think it's going to be a good opportunity in 2019 to recruit.

Back of that, we are now open to questions.

# Questions And Answers

## Q - Andrew James Ritchie {BIO 18731996 <GO>}

It's Andrew Ritchie from Autonomous. Three questions, I think. First of all for Adrian. Could you just clarify on the specialty lines book? I'm talking the book as it is today, the whole book, the CyEx and specialty lines. What -- how much is exposed to what I would describe as a trend risk on claims. So the kind of claims we've been hearing about in the broader market, D&O, M&A, EPL and the general? But how much of the book is exposed to that kind of trend risk? Because you did mention the claims environment. And you've reflected that in your opening (pit). Second question, I guess, for Martin. Placing retro or reinsurance, I guess, has been a little trickier this year compared to last year. Just clarify how that's gone. Is there any major changes in your protections that you've put in place, both retro and reinsurance? And the final question is, why is your expense ratio so good? It never seems to go up. You're growing. I guess you're paying people, I presume. So what -- what is there -- is there some underlying efficiency going on? Or should we expect the expense ratio to sort of creep up a bit?

## A - Adrian Peter Cox {BIO 16257010 <GO>}

First up. Yes. So most of our sold specialty lines of old is exposed to trend risk. I think the key is that it is not all exposed to the same trend risk. So one of the aims, as we built out specialty lines, was to have the same sort of diversification that we have in Beazley, overall. So broadly speaking, any liability book is exposed to trends of business practice or societal changes or law changes or so and so forth. And our job is try to figure out what those exposures are and manage them accordingly. So the things that we see going on, for example in D&O, are completely different trends than what we see going on in health care. And there are some pluses and minuses across the book. Broadly speaking, post-financial crisis, conditions were quite good for us. And the risk management had improved through the noughties. Corporate governance had improved through the noughties. And post. So 2011, 2012, the economy was growing very nicely. And that gave broad-based quite good conditions for us. As always, what happens is the plaintiff bar get reorganized again and find different ways to do things and sue. And that's why we're seeing slight elevations in trends in different pockets of our book. It is by no means across the whole specialty lines because we're diversified to manage that. But the increase in loss pick that we've done reflects the fact that those things are happening in parts of the book.

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

So on your other 2 questions, Andrew. I think on sort of purchasing outwards reinsurance and retro, as a company, we focus on gross underwriting profits. And we have generated incredibly good results for our reinsurers over time. So where we have had claims. And we have had a few claims, we are clearly paying a bit more. But generally, I think we've achieved pretty satisfactory renewals. And there is still plenty of capital in the market. And as I say, we have long-term relationships. We have incredibly good results for our reinsurers, who we work very closely with. And I think we've achieved good outcomes on the rating side as a consequence of that. 39% expense ratio, how long have you got? So we've always said, I think the key thing is if you look at premium growth between 2014 and 2018, it's about 30%. When I've sat here, I've always said it's these periods of slightly higher premium growth, when we can get high double-digit growth, that you should be looking for us to generate some improvement in the expense ratio. Because as you kind of pointed out, our -- we have brokerage, which doesn't tend to go down. And then we employ people. And again, they all expect generally to get paid more. And we try also to be more efficient. So I think we do work incredibly hard internally to make sure that every pound we spend is spent carefully, spent efficiently, every day, every year. And so what you've seen over the last 4 or five years is that very strong expense discipline coming together with the period, where we've been able to grow the top line quite well. And the final part, to the answer of your question, is progressively, I've got a much lower bonus this year because the result wasn't very good. And that's also at the margin tip, the 2018 expense ratio down because we are very clear in this company that, a lot of -- all variable reward is linked to the organizational performance. And when that performance is down, therefore, the bonus pots are down. We think that's a really important principle.

## Q - Andrew James Ritchie {BIO 18731996 <GO>}

Just to clarify on the outwards. So if the arrangements, for example, for the specialty book, I'm talking the whole specialty book, the clash cover, is that still -- I think it was $35 million. And I can't remember what the...

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

Can I pass this across to Adrian? He is the -- definitely the expert on that.

## A - Adrian Peter Cox {BIO 16257010 <GO>}

So a significant chunk of our reinsurance for specialty lines was done at (1/1). That was all fine. Our large clash cover is a (summer placement). But we're not expecting any issues with that.

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

We should say, Andrew, our retro cover is later in the year. So it's in April 1. So we haven't bought retro yet. So we are not aligned to Jan 1 with retro.

## Q - Jonathan Peter Phillip Urwin {BIO 6126952 <GO>}

Jonny Urwin, UBS. Just 2 for me. So firstly, can you give us a bit more color around the 1 Jan renewals? How they went, market conditions in Lloyd's of London in particular? Then secondly, the investment return for 2019, you've got a bit of a tailwind now, which is obviously nice. But I see you're saying you're reinvesting at 3.3%. Is that latest? And what can we expect for this year?

## A - Adrian Peter Cox {BIO 16257010 <GO>}

January renewals, I think they're broadly in line with expectations. I mean outside the reinsurance book, January is not a huge month for us. So it's not a great leading indicator. And as I say, I think we'll end up slightly above the business plan. But the roundups that we have with all the divisions has meant that nothing that has happened in January has impacted our 2019 plan at all, particularly.

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

I think as far as investment returns are concerned, I think the guidance I'd give on the core portfolio, the 85%, is we expect to receive 2; to 3-year treasuries, plus 70, 80 basis points uplift for credit risk. Then as far as the 15% capital growth assets are concerned, well, I think that could -- obviously, there's a much wider range there as to what we can expect. So that would be my benchmark, Jonny. So that's -- today, that's probably about (310) on the core portfolio because rates have eased back a bit.

## Q - Kamran Hossain {BIO 17666412 <GO>}

Kamran Hossain from RBC. Two questions. One just on the reserve releases in specialty. You called out cyber for 2015 and '16 reserves as developing positively. I guess, when we think about reserve releases in cyber, is -- could you maybe give an idea of the quantum of that reserve release and whether, if there are no cyber catastrophe events, whether you see these as being sustainable? That's the first question. And the second question on the combined ratio. I guess we've always talked about a 90 combined ratio being a decent starting point in the medium term. Given the lower reserve releases next year, what's that number we should start off with in our models?

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

Right, okay. I'll maybe give that second one to Sally. But the -- so the -- as far as the cyber loss ratios and the CyEx reserve releases are concerned, I think the -- as a proportion of premium, CyEx's business will have lower technical provisions than the new SL business because it's got the short tail and the long tail. So therefore, as a proportion of premiums, the reserve releases, you should expect it to be a slightly low percentage of premium than from the new SL. It will also be more volatile, because as Adrian's alluded to, there is an aggregation risk in that portfolio. And we haven't really seen that crystallized into a claim incident yet. So there have been some quite strong reserve releases. I mean you can work out what the quantum of them is because we -- in '15 and '16 in the triangles, we're only releasing on the shorter-tail specialty lines business. So all of that loss ratio movement essentially is in there? And we're also giving you premium figures. We write between $250 million and $300 million of cyber premiums now. So that's cyber. Combined ratio. So the below average reserve releases on the short-tail businesses, I think, my view would be that the short-tail business is probably -- in good years, we're making a reserve release of 10% of NEP. And I would say 3% to 4% of that is coming from the short-tail businesses typically if you look at recent history. So this -- I would guide for 6% to 7% of any P reserve release. And therefore, sort of something around the 93 mark is probably mechanically what comes from that. We are now in a higher investment yield world. And as I've said to a number of you in one-to-one meetings, 3% investment yields and 90% combined ratio, these 2 are pretty big ROEs. So we may need to revisit at some point if we're going to stick with 3%-plus investment yield, what the long-term combined ratio is going to be. But...

## Q - Kamran Hossain {BIO 17666412 <GO>}

I'm happy with 3 and 90.

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

Andreas van Embden, Peel Hunt. Just 2 questions. Have you become more comfortable with what the peak risk is on your cyber book? Do you have a number you might share, either today or maybe at the half year stage in terms of what type of aggregate risk you're taking on your balance sheet? The same question is, again on that cyber book. There is the margin in there still, if I read correctly your release. How big is that margin? How does it drift off and run off the balance sheet? And thirdly, the 5.6% of your margin, are you going to rebuild that in a normal cat yield, would that be rebuilding gradually back to the middle of the range? Or you're happy where it is?

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

Right. Shall I start? Then maybe Adrian, I don't know whether you could add in a few things on cyber risk. So the peak risk on cyber, I mean I -- we view it as lower than our nat cat risk. I personally -- model error is already large on nat cat risk. Model error is multiples bigger because we haven't yet really seen our first event, Andreas. So we're not sure it's helpful to publish specific numbers. I know one or two of our competitors have. Maybe Adrian can say a bit more about how we monitor that. As far as cyber is concerned, I mean when we business plan, we categorize our products higher than 20% ROEs, where we're looking to grow less than 10%, where we're looking to alleviate profit. As far as I am aware, cyber is still in that first category. Underneath that, there's an assumption of how big these systemic events are and how much they cost. And they haven't happened yet. So clearly, our historic cyber book has been very profitable because it -- we were pricing it to be a relatively high-margin product and assuming there were going to be some aggregation risk claims that haven't been yet. But I believe -- as I say, Adrian, perhaps will say a few things about how he sees the adequacy of cyber pricing going forward.

## A - Adrian Peter Cox {BIO 16257010 <GO>}

Surely. So we've been talking about cyber aggregation risk for a long time. And we spend quite a lot of time investigating what our cyber exposures are and what our systemic risk is. As Martin said, there are many fewer data points than there are some of the other aggregation risk we have. But that doesn't mean that we can't try to figure out what the possible areas of accumulation are. What that's impacted by are 3 things, really, I think: What is possible to do? Who we're selling cyber to? And what we're selling them, right? And those 3 things have evolved very much over the last 10 years. And that impacts the sort of aggregation risk that we have and the quantum of that risk. So you go back 9 or 10 years. And our client base was a lot more focused on health care industries and financial services. And that drove what sort of aggregation risk we had and they mostly bought breach response cover. And the coverage that is bought now is a lot different from that. Our client base is a lot broader. And what is possible has changed. And we have to figure out what our accumulation does in response to that. And we spend a lot of time thinking about what particular bottlenecks or points of aggregation are, what is it possible to do them. And therefore, the impact that it may have on our portfolio. And whilst we can't model them based upon past events, what we can figure out are those areas of aggregation accumulation, which sort of fits with the same sort of principles that we have in other parts of the old specialty lines because that's how we started thinking about D&O 14 years ago. And other liability books. So it's possible to do that. As Martin said, the risk -- the error risk is quite high. And that's because we don't have those data points. Referred to in the annual report, are some further disclosures about how we think about cyber and some relativities between that and the natural catastrophe risk. And we do have slightly less of that. And partly because of that model risk. But I do believe, you can do quite a lot of thinking and work around what is possible and how they make impact your client base.

## Q - Benjamin Cohen {BIO 21227414 <GO>}

Ben Cohen, at Investec. Could I ask 2 things? Firstly, on specialty lines, on the sort of the noncyber business. What is the likelihood that you can sort of match the claims' inflation that you're allowing for in the year ahead, presuming you need to see pricing to move up if you're going to sort of offset some of the sort of trend risk? And is there a scenario in which you need to shrink parts of those books if the market doesn't respond? And the second question was, looking ahead to the debt raise that you're likely to do in the second half of the year, would you see that enabling you to grow more, build a bigger buffer in terms of the capital position or potentially return more capital to shareholders?

## A - Adrian Peter Cox {BIO 16257010 <GO>}

Shall I do the SL trend first?

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

Yes.

## A - Adrian Peter Cox {BIO 16257010 <GO>}

As I said a few minutes ago, the trends -- the products that the products are exposed to in specialty lines are very different and diverse. And they are up a bit in some. And they're relatively flat in others. And we have to make sure that we are comfortable with the pricing and the margin in that pricing according to what we think is happening to that trend. And one of the jobs we try to do is to figure out what we think those are because they're quite forward-looking. I do think that the price changes we're seeing do -- reflects the changes that they have been going on. And so we are, by no means, getting the same level of rate change across the whole of specialty lines because they're exposed to different things. And we had different levels of loss activity across those different portfolios. And one of the useful things about specialty lines is that we've built that diversity of products and client base so that we're not exposed to the same thing. Will we and have we shrink things if we don't think there's enough margin left and we can't get that -- the price to match the rate change? Absolutely. And despite the strong growth we've had in specialty lines over the past few years, we absolutely have strong focus groups, quite dramatically in some cases, where we don't see the sufficient price. Fortunately, what we have also been able to do is to find areas that we can grow where there is that margin. And we do see a sustainable growth profile for us.

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

I should think as far as the debt raise is concerned, Ben. So mechanically, we'll be clearly above our buffer at the end of the first year because when you raise debt, you have to do it in big lumps. The buffer at 15% to 25%, I think, is fine. I was saying to Andrew yesterday, I'm slightly worried. I've never been down towards the bottom of that buffer because I've been lucky to have these fantastic ROEs while I've been CFO. And the first time we do actually go there, people will worry. And they shouldn't. I think 15% to 25% buffer is more than enough. And we certainly wouldn't be raising debt to return equity. So I think any return of equity would be a function of the levels of ROE we make and the growth prospects of the business.

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

And I think it's a fair comment, when we've returned equity, Ben, it's been when the outlook has been lower growth and the ROEs have been high. And at the moment, the outlook is pretty good growth. And therefore, we need the debt to grow over the next number for years rather than just the one year.

## Q - Paris Hadjiantonis {BIO 19703051 <GO>}

It's Paris Hadjiantonis from CrÃ©dit Suisse. Firstly on -- a question again about my model, I guess. If I just look at your rate increases, 3%. I know you're guiding for lower reserve releases going forwards. But wouldn't the attrition loss ratio fall year-on-year? Or is there a reason why I shouldn't be having my attritional loss falling? So maybe, I don't know, higher loss peaks for 2019, will it be something you have discussed for specialty lines to an extent? Then secondly, I'm coming back to your comment, Martin, 90% combined ratios and 3% investment returns might lead to a high ROE. But you're growing out 10% more or less. Maybe the guidance is 5% to 10%. Why would you want to bring ROEs -- sorry, why would you want to bring your combined ratios up? Do you want more growth?

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

Can I start? So absolutely not. I mean if we can make 90% ROE and 3% investment return, we will definitely do it. And as in our business planning process, we grow the things that make more than 20. We try and remediate the things that are making less than 10. So it doesn't -- generally, the outcome is a very stable combined ratio. So there's not a whole load of business. It's only going to make a 92% combined ratio, that Adrian is sitting there saying, "Okay. We're not going to do that because it's 92%. And we do 90%." It's -- so no, FINAL

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I don't think there's any thought of changing our target business and products and pricing in order to raise our combined ratio. As far as the rates are concerned, I mean mechanically, you're absolutely right. But I think that's going to emerge at reserve release at some point, assuming -- so we are not altering our opening loss picks. As Adrian said, our 2018 opening loss picks are slightly higher in some areas than 2017. And I believe our plans for this year are to open at broadly similar levels in 2019. So assuming that we have normalized claims' activity, you're absolutely right. If we've sort of had two years of 3% or 4% rate increase, the final loss ratio on that business should be lower than the 2016, '17 loss ratios. And I guess you'll see that coming through in reserve releases in year 2 and 3 in short-tail businesses and in sort of years 4 to 6 in the medium-tail business.

## Q - Joanna Tamar Parsons {BIO 1558226 <GO>}

Joanna Parsons from Cannacord. I'm coming back to cyber again. There has been, obviously, a lot of talk about potential growth in the cyber insurance post-GDPR. You, yourselves, have talked about using cyber as a platform for your European growth or part of the platform for your growth. Could you give us a bit of a feel for what you've actually been seeing in that market, the sort of growth you've been seeing, whether the European demand has been as you anticipated, better, worse? And what you're seeing on pricing and competition. Because again, we see a lot of talk about pricing pressure there. And how is that reflecting on your book? Then finally on that, the joint venture that you have with Munich Re, how that's going? And they seem be recruiting a few people. So are they looking to step out and do it themselves without your help going forward?

## A - Adrian Peter Cox {BIO 16257010 <GO>}

Oh, we haven't noticed that. All right. Okay. So the growth in international cyber was much higher than the growth in the U.S. It is off a much, much smaller base than that. Nonetheless, at maturity, the analogy we'd like to use is of D&O. So the U.S. D&O market grew much earlier than the international D&O market. But ultimately, the international D&O market is bigger than the U.S. market. And fundamentally, that's what we expect to happen to cyber in the fullness of time. And nothing that has happened this last year has invalidated that assumption, I don't think. GDPR did provide a bit of a boost. My own personal belief is that what provides the biggest boost to demand are big loss events because people react to what's new and present. But I think GDPR did have some impact. It definitely had impact on the supply side too. So the insurance industry is a lot more prepared to sell cyber in bulk internationally than it grew organically in the U.S. And I think there is a reasonable amount of competition, both in the U.S. and internationally in cyber. I think we still do it well. We still have a very good product out there. And demand is growing as fast, if not faster, than supply. We do see price competition in cyber. I think, equally though, we see the product continuing to evolve and change. And part of that is because of competition. But part of that is because what companies need to ensure is changing as what is possible to do to them. It's changing. And that partly reflects the rate change that you see in cyber. I think it will continue to stay competitive. I think it will continue to grow. And the market will respond to loss events as and when they happen. Oh. And Munich Re, yes. So our joint venture with Munich Re is doing very well. The whole vector concept has really appealed to the client base that we're after. The sales cycle for these things is very long because they are buying very, very large towers. But I think it's positioned us very nicely in that space. And we're comfortable with where we are. We've seen Munich Re gear themselves up for this a bit more. And that's a very distinct thing that they're doing. It's away from our joint venture. And we're fine with that.

## Q - Nicholas Harcourt Johnson {BIO 1774629 <GO>}

Nick Johnson from Numis. Just a quick question on nat cats. Obviously, very active year for the last couple of years. Should we, do you think, be building in a larger nat cat budget into forecasts? I'd just be interested in your thoughts on the nat cat environment. Obviously, an active year in '18. But in total cost terms, it was average in billions of dollars over a long period of time.

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

No we're not, at the moment, we're not changing the nat cat budget. So we're holding the same budget in 2019 as we had in 2018, which was up a bit on 2017. So we actually wanted to wait and see. Because you're right, it's not as active a year. And yet the impact on the industry is quite high. So we're holding the budget flat into this year.

## A - Adrian Peter Cox {BIO 16257010 <GO>}

Well our nat cat budget reflects our view of the risk award of writing nat cap. So it will go up and down according to how we see those numbers.

## Q - Andrew James Ritchie {BIO 18731996 <GO>}

Sorry. I just had a quick follow-up question on PAC, which had a very strong result. It looks like it was particularly driven by a very strong prior year, particularly on the 2017 year. Is that -- should we think as 90 as the kind of combined going forward for that division? Or was it kind of -- is this one-off release of excessive conservatism when you were trying to reunderwrite the book?

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

Without sort of setting the target to the guy who runs that division who's sitting in the audience, I think 90 seems like a reasonable target for that division, Andrew, going forward. I mean it has a mixture of businesses in there. Terrorism, which until. And hopefully there won't be, there is another terrorism, that runs at a very low loss ratio. Then contingency, which is more -- doesn't vary as much. Political can be quite volatile. Then the growing A&H business in the U.S., which I think is doing incredibly well. So I think the PAC division is going to settle down to quite a profitable division because we have got rid of the Australian business, which wasn't performing well.

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

Australia is completely run-off.

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

Australia has completely gone, yes. And we were still living with some of the run-off. But ideally, it's going to be -- if it deteriorates further, it's going to be small numbers to the division, while the U.S. business looks good and is growing. And we've been working at that for a number of years. We've got a good team in place. And it's grown quite a lot in 2018 into 2019 from a relatively small base.

## Q - Andrew James Ritchie {BIO 18731996 <GO>}

That's great. One other follow-up. Are you concerned that now you're splitting out cyber, okay, I appreciate it's not stand-alone cyber, it's with the management liability there as well. I mean you're going to make much clearer the profitability of that business. I appreciate it's volatile. And it's got characteristics. Does that concern you at all from a competitive and your competitor intelligence point of view and from what your competitors can see?

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

No. I don't think we're concerned about that. And you guys have been pushing us to do it for the last 10 years. So it's great to have a question saying you're now concerned we've done it.

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

We have the management liability in there. I mean they're going to be interesting lines, because they act completely differently from each other. The management liability being a much longer tail than the cyber business.

## Q - Andrew James Ritchie {BIO 18731996 <GO>}

But that's all together? Is that the rationale...

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

Yes.

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

I think maybe John in the corner has got a question. And then we probably need to wrap up because it's 11:00 and we have some other meetings.

## Q - John Anthony Leslie Borgars {BIO 15015364 <GO>}

John Borgars from Equity Development. The property business in the United States was aiming to get higher -- lower claims ratio by going to small and medium-sized businesses. But the effect of that currently is swamped. Well the reported property result are swamped by the cat losses. Can you tell us what the underlying performance of the medium-sized property business is doing?

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

Without going into specific detail, John, the medium-sized book has performed well. So where we've had losses in the property division, it's in the large-risk book. So the medium-sized book, which is still catastrophe-exposed, has performed pretty well through the catastrophes of '17 and '18. We obviously don't disclose at that level of detail. But it has.

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

Great. Okay. Thank you very much, everyone. We'll stop there. Thank you for coming.