Q4 2017 Earnings Call

Company Participants

- Inga Kristine Beale, Chief Executive Officer & Executive Director
- John Parry, Chief Financial Officer & Executive Director
- Jon Hancock, Director-Performance Management & Executive Director
- Nicola Hartley, Head-Treasury & Investment Management

Other Participants

- Andreas van Embden, Analyst
- Ben Cohen, Analyst

MANAGEMENT DISCUSSION SECTION

Nicola Hartley {BIO 3815569 <GO>}

Good morning, everybody, and welcome to Lloyd's 2017 Financial Results Presentation and Live Webcast. We are joined today by Inga Beale, Lloyd's Chief Executive Officer; John Parry, Chief Financial Officer; and Jon Hancock, Performance Management Director.

So, Inga Beale will start the presentation today by taking you through Lloyd's strategic and financial highlights. John Parry will cover the components of the results in more depth. And Inga will conclude by providing insight into Lloyd's plans and focus for 2018. And Jon Hancock is here for the Q&A session.

So, at the end of the presentation, the audience are invited to ask questions. And for those listening remotely to the live webcast, please use the Submit a Question icon. We ask that you provide your name and organization before asking your question. And please note that the presentation and Q&A session is being recorded and will be made available on lloyds.com for audio playback.

I'd now like to invite Inga to begin the presentation.

Inga Kristine Beale

Thank you, Nicola, and hello, everybody. Welcome to those who've joined us in the Lloyd's building today and welcome to all of you who've joined us on the phone. So, I'm going to give you just a little introduction to the high-level numbers, and then run through some of the priorities that we had for the Lloyd's market for 2017, and then I'll hand over to John Parry who'll go through the details.

Now, if you turn to the slide 3, which has all of the numbers on, you'll see that the Lloyd's market experienced an exceptionally difficult year last year. This was driven by both challenging market conditions, so affecting that sort of underlying business, but also a significant impact from natural catastrophes that occurred mainly in the second half of the year.

So, this meant, for the first time in six years, Lloyd's is reporting a loss. And you'll see here the aggregated 2017 loss for the market is £2 billion, a complete reversal of the prior year, which was a profit of £2.1 billion.

Now, we know that the natural catastrophe, it was one of the, well, record year at least for the past decade. And I think what struck everyone was of course we have had a relatively benign period or loss period anyway for a few years. And we saw major claims more than double in 2017. So, major claims were £4.5 billion, and we'll come on to that in detail in a bit more later. But that was more than double the previous year's total of £2.1 billion. So, you can see the impact of large claims on the result.

But we all know that this is what we're here for, this is what insurance is all about, and Lloyd's, I believe, has really proved its value and its strength. We showed how quickly we responded to some of these natural disasters, how quickly we were actually getting money out there, where it was needed most to put people's lives back together.

And we paid out, overall last year, paid out £18.3 billion in gross claims. But we also saw that the market recapitalized and the market was well able to meet all of these commitments and without really any significant impact on Lloyd's total resources, which remain strong at £27.6 billion.

Now, we know that we have still excellent ratings from the rating agencies where we got excellent from A.M. Best, strong from Standard & Poor's, and we remain at AA-, very strong, from Fitch. And, of course, we all know that this is partly to do with the Central Fund that sits at the heart of what Lloyd's delivers, but that was not touched last year, so each of the syndicates is firm, able to meet its own liabilities.

Now, in terms of underwriting and, of course, underwriting result is what we focus on a lot in the Lloyd's market. So, if we think about that combined ratio and the impact that's having, that meant a full year underwriting loss of £3.4 billion. Although we did see an increase in the investment returns to counteract that, which meant the return was up to 2.7%, so up to £1.8 billion. So, that was some good news on the other side of the balance sheet.

You will see there an increase in gross written premiums and there were two factors there. There are some factor - one of the factors is the actual growth either from new syndicates entering to new business being introduced to the Lloyd's market or growth in some of the existing syndicates. But also, about half of that growth was down to FX impact, and John Parry will go into that in a bit more detail.

But some of the success for Lloyd's, in the growth area, are looking at new products. Lloyd's is known for its innovation and cyber insurance continues to grow. We've got more syndicates being able to offer cyber insurance this year than we did last year. And particularly also, we're seeing a growth in demand from the sharing economy. So, Lloyd's is responding very well to what's happening out there in the business world. And we provide insurance for ride-sharing firms and firms like Airbnb and the like. So, we have seen or we are seeing, actually continuing to see new innovation in product, which is absolutely excellent.

So, it was a difficult year. We shouldn't shy away from that. But we have I think weathered that storm incredibly well, and I would now like to just touch on some of the other things that were going on last year.

Moving on to slide 4, market conditions. It is all looked at by Jon Hancock and his team with his Performance Management hat on and we've certainly had our work cut out. We did introduce very much a risk-based approach to market oversight last year. This means that a stronger focus will be put on those syndicates and businesses that are underperforming, and those that are performing well over a tried-and-tested period will have less oversight. So, that means we can focus on a real risk-based approach, so where we think there is most risk for the Lloyd's market.

Importantly though, we believe that for the successful businesses and those that are profitable and very well run, it enables them to really focus on doing more profitable business, so not being bogged down and hampered with unnecessary oversight. We also rolled out a new account management approach, which is changing the relationship that the corporation has with all the managing agents and syndicates in the market and particularly understanding their strategy and how they want to use Lloyd's going forward.

Brexit, you can't go very far these days or I certainly can't go very far without being asked about Brexit and our plans. We announced and we're ahead of many others because we're a market and we need to provide that certainty for all our market participants. We announced ahead of most others that we would be setting up a subsidiary in Brussels. That will be up and running for 1st of January 2019. And we, as I said, want to do that because we've got so many businesses that operate within the Lloyd's market, we need to give them that certainty and particularly, of course, all of our EU 27-based customers. And we've been on quite a few roadshows around the rest of the EU telling them about our plans.

Moving on to Solvency II, the Solvency II environment we're in these days and the capital. Despite the losses, the market-wide and the central solvency coverage remained above our risk appetite levels. So, that was not of concern to us, and, as I said, there was no impact on the Central Fund by any of the syndicates last year.

Moving on to modernization, some of you may have picked up the news yesterday that we announced that we will be mandating electronic placement in the market. It will be done on a phased-gradual approach, but it's an absolutely essential part of what we need to do to take Lloyd's forward and, indeed, the London market, because this modernization effort is for the entire London wholesale insurance market.

So, we know that the electronic placing system, the one where we talk about mainly is PPL, and we are going to be expecting syndicates to deliver against adoption targets. Because while the technology is now up and running, it's the adoption that we need to drive. And we've got a phased approach to that and we're hoping or planning to have at least 30% of the Lloyd's market being placed electronically by the end of this year.

But we also have some other elements to the modernization, which is about capturing data. So, however the data comes in, whatever format the broker submits the data to the underwriter on, we capture that digitally with using technology. And that data then can feed directly into underwriter system, so no wikiing (00:09:35), improving efficiency, taking out an unnecessary duplicate, triplicate wikiing (00:09:43) that goes on particularly when you've got a subscription risk and importantly then feeding in with no opportunity for errors into the carrier data.

And we've also been working on things such as simplifying the coverholders, so we rely a lot on MGAs in the Lloyd's market where we delegate underwriting authority. We've been streamlining that approach whether it's coordinating centralized audits, whether it's coordinating and having a central compliance oversight function for coverholders. And we've already reduced the number or the amount of activity that goes on across the market, which the coverholders are really appreciating. And that's really all about making Lloyd's easier to do business with and attracting more business, more profitable business.

The last thing I just wanted to touch on is the operating model that we worked on within the corporation. That was a big focus for last year. We know that expense pressure is out there for everybody, and we wanted to do our fair share of reducing expenses, but importantly, also, making sure that the corporation is fit for the future in this rapidly changing world. So, we restructured, we reorganized, focused very much on the market and their needs.

We did let 10% of people go in the UK for – that was some – that did produce some savings, but we also looked at very many other aspects. And one of the aspects particularly, just a nice example, was a procurement – centralized procurement function, which we did for the corporation. That already delivered £1 million in 2017 of savings and is now due to deliver another $8 million in potential savings over the next few years.

So, we looked at all of the aspects of what the corporation does to think about how can we streamline that and make sure the corporation is fit for the future and particularly how we can use data much more and technology, and we've introduced artificial intelligence in some areas. So, there's a lot going in the corporation as well.

But before I go on to talk about 2018 and where we might or where we are taking our priorities for this year, I'll now hand over to our Chief Financial Officer, John Parry, who'll take you through the financials in more detail. Thank you.

John Parry {BIO 18896198 <GO>}

Thank you, Inga. Good morning, everyone. John Parry, the CFO for Lloyd's. Just going to walk you through the financials we reported today for the 2017 calendar year. So, slide 6 is the overall income statement for the market. It's, as Inga said, it's a loss of £2 billion for the full year with a combined ratio of 114%. Within that, there was a strong investment return of £1.8 billion, achieving an annual yield of 2.7%. There is foreign exchange movements in each of these lines, and we particularly pulled out there the impact on our gross written premiums, which is approximately half of the growth year-on-year between 2016 and 2017.

The other line clearly that has moved significantly in 2017 is our incurred claims, which have risen to just over £18 billion. And that's sort of a sign of the size and scale of the Lloyd's market and its global position particularly in the U.S. and the impact of those natural catastrophes on the market, an exemptive response of the market in both paying those claims as I'll come to responding to injecting the new capital to support the opportunities for next year.

Slide 7 is a waterfall doing the movement from the 2016 results to these numbers for 2017. In the blue bars, you have the movement on the underwriting result, and you can see, both on attritional and major claims, there's been a reduction in the result. The first one is the sign of the intense pressure on pricing, the excess capital in the industry, and the challenging market conditions. Then you have the large increase in major claims, as Inga said, taking us to about £4.5 billion in 2017, well above our long-term average and more than double the level of 2016.

We have seen a significant surplus on prior year reserves, but less than the very large number of over £1 billion in 2016. Number for 2017 still over £700 million, reflecting the prudent and well-capitalized reserves on balance sheet for Lloyd's. Then you have the improvement in the other item, which is investment return increasing to £1.8 billion.

The other large movement is the reversal of the large gain we had on foreign exchange in 2016. The market writes maybe two-thirds of its business in U.S. dollars, the U.S. is our largest market, but a lot of our business is denominated in U.S. dollars. We hold more dollars than we have liabilities and, in 2016, that triggered a large foreign exchange gain following the weakening of sterling after the EU referendum result. Much less movement in 2017, that's on a movement from 2016 to 2017. And that gives us our overall reported loss of £2 billion for the year.

On the next slide 8, just going to go through that movement in our reported gross written premiums, it's now stand at over £33 billion. As I've said, approximately half of that is through foreign exchange. Remember, more than half of our business would have been written in the first half of the year, particularly (00:15:38) in 2016 prior to the EU referendum result when sterling was trading rather stronger against the U.S. dollar.

We have seen a reduction in pricing on our renewal business. It came in at just under a 2% reduction across the whole account. That was less than what's anticipated in the business plans for syndicates. Syndicates have continued to write within those approved business plans by Lloyd's.

The change during the year, we did see some stabilization after the storms and a small uptick in pricing in the fourth quarter, and that has continued with the 1st of January renewals.

Four new syndicates joined the Lloyd's platform in 2017, and there are also a couple of one-off items contributing to the reported growth. Firstly, reinstatement premium income, Lloyd's writes an awful lot of reinsurance business, and when there are large claims on that, that triggers reinstatement premiums from our cedents. And there's also that small impact of the Ogden rate change on UK liability motor and particularly motor reinsurance business. That announcement by the Ministry of Justice in the early part of 2017, that is some adjustment in pricing to sort of match that increase risk of the earlier announcement from the Ministry of Justice to take account of very low risk portfolios.

So, existing syndicates increased by 5%. Now, insurance we typically track GDP or inflation and that would have been about 2% for our key markets particularly the U.S. The balance has come from some measured profitable growth across the better-performing lines particularly sort of U.S. property and buying the business over time, but also the new products and the innovation that plays with Lloyd's strength, you see that particularly in cyber, warranty, and indemnity business.

Just looking at the components of the combined ratio, comparing our claims and expenses as a ratio of our net earned premiums. The 2017 bar shows an increase in the accident year excluding major claims to just over 98%. Expenses across both acquisition costs and admin expenses stayed reasonably flat, but there has been an increase in the attritional loss ratio year-on-year. And that is that sign of that slow-but-steady decline in pricing over a number of years, which has led us and the market to really tackle the underperforming lines of business.

Then you have the increase in major claims. We'll come to that in a moment principally the U.S. windstorms' Harvey, Irma, and Maria. Then a reduction in the combined ratio through releases on claims reserve setup for business written and earned prior to 2017. So, as I said, that's a release of approximately £700 million across the market. What we actually saw in earlier years is actual experience are coming much better than expected. For 2017, actual experience was more or less tracked projections. But a number of syndicates do reserve prudently and select a cautious initial loss estimate, which were then recognized over time. This, I think, is a sort of more sustainable or expected level for reserve releases, a point that we have flagged in the past when we really had a super abundant release from reserves caused by very good actual experience. No concerns regarding the methodology and oversight of reserves both at managing agent level running the syndicates and also here essentially at Lloyd's.

Of course one of the stories is the impact of natural catastrophes. You can see that 2017 saw a big increase on the previous few years to £4.5 billion. I think an important point to note is, this is not a truly extreme experience. These are not the events that we set capital for. You can see that in 2005 and 2011, the market experienced similar levels of major claims activity, but, at any one year, this is the principal reason why we have a reported loss for 2017.

Those three windstorms, Harvey, Irma and Maria, wreaking devastation across the Caribbean and the United States, incurred claims to the Lloyd's market approximately $4.8 billion or £3.6 billion. That is absolutely in line with the initial loss estimates that we put out in October 2017. And it's pleasing to note that, as we track the sort of development of paid and notified claims experience against previous windstorms or large catastrophes, they're tracking well. So, the moment we have no concerns regarding those loss estimates put up by syndicates, recognizing of course there's still a very wide range in the potential industry losses from these storms. Into the fourth quarter, there were also two instance of wildfires in California, which incurred claims of approximately $700 million or £500 million giving a total for the year of £4.5 billion.

Slide 11 shows the Lloyd's markets experience across some pretty high level classes of business; six direct classes, property, casualty, marine, et cetera, and our reinsurance book, and in the annual report, we go into more detail breaking that out between property, casualty, and more specialist lines of business.

There you can see the impact of the major catastrophes particularly on reinsurance and property business. The increase in the accident year ratio, that's the sort of third bar, the lightest blue, 121% and 131%, but it also, because it's across the book, you can see the impact of the pricing pressures in the industry and, in fact, to the Lloyd's market, and we can see why there's an intense focus on all aspects of the combined ratio whether expenses or claims.

We compare the aggregate Lloyd's performance against a series of competitors, approximately 13 companies. And as you can see there, in 2017, for the first time for a number of years, Lloyd's has underperformed when comparing its combined ratio to that group of competitors. Lloyd's largest market is the U.S. We do write a lot of reinsurance business that is catastrophe exposed, and that is the principal reason why we have a higher combined ratio for 2017 than that group of competitors.

Just turning to investment return. As I mentioned earlier, it's a return of £1.8 billion or a 2.7% yield. That's across the whole market whether the assets held at syndicate level, within members' funds at Lloyd's, or the Central Fund. And we saw positive returns on the majority of assets, which are fixed interest or cash. You can see about 86% of our assets held in high-quality investment-grade bonds, government bonds, and cash and cash equivalents with 14% in equity and other risk assets. Actually, those assets are a small proportion of the total, but they had a very good year in 2017, contributing double-digit investment returns, particularly on developed market equities. The increase in that, from 12% to 14%, is more recognized in that mark-to-market increase rather than change in the strategic asset disposition by syndicates.

The Central Fund stands as the last link in our chain of security and is therefore able to take a long-term horizon to its investment disposition with 60% allocated to a core portfolio of high-quality fixed interest, government, and investment grade bonds, with 40% allocated to growth assets across a series of outsourced managers managing developed market equity, emerging market hedge funds and the like. And it's those growth assets that gave us an excellent return in 2017 supported by a positive return on those core assets; an overall return to the Central Fund of 5%.

Turning to the balance sheet and you can see, at 2017, net resources remained over £27.5 billion in total. Again, we've got a slight foreign exchange impact here. The market holds assets in the currency in which it writes business and also its capital to match its exposures. A sensible risk management because so much of our business is written in U.S. dollars, and you've got that translation from the previous rate of $1.24 down to $1.35 that would have some foreign exchange impact. The market and the Central Fund seeks to preserve its solvency coverage at the expense of some P&L volatility.

There has been an increase in the reinsurance asset following the storms up to nearly £17 billion. The Lloyd's market buys reinsurance from very well-rated counterparties. Over 90% of that asset is with A-rated reinsurers or collateralized, so very secure position in terms of our reinsurance asset.

Central assets increased further by 4% to just under £3 billion, and that's a sign again, as Inga mentioned, there's been no hits to the Central Fund from any of the events in 2017. But there's been no new member hitting the Central Fund since 2007. A tribute to the way that the market is capitalized for risk. We do have a full distribution model in that if you have surplus assets members, our capital providers may take the capital out and, equally, when there are losses, they inject it. And we had an incredibly smooth coming-into-line exercise at the end of the year to capitalize for the storms that occurred in the third quarter, so leading us to actually have a net surplus at member level as at the year-end.

And that means, on our solvency coverage, we are in the same position at December 2017 as we were at December 2016. We have two measures of solvency for Lloyd's, firstly, at a market-wide level, so taking all of the potential claims and exposures of the Lloyd's market. We have a risk appetite of 125%, and we exceed that comfortably at 144%.

We do hold some assets that are ineligible for solvency because of the tiering test under Solvency II where you have a mixture of Tier 1 assets and Tier 2 assets. The preponderance of our Tier 2 assets at market-wide level are letters of credit provided by well-capitalized, well-rated banks. There's a limit on how much we can count towards solvency for that and we already announced some transitional provisions to the market to reduce that ineligibility.

For the Central Fund, the ultimate payer of claims behind all syndicates, our risk appetite is 200% and we stand at 215%. And that's with a successful refinancing of our subordinated debt obligations. In January 2017 we issued a new Tier 2 bond and, in fact, that slightly exceeded the allowance that we can count again on that sort of tiering test, but it did enable us to redeem the Tier 1 debt in June 2017. Lloyd's gearing is very low and our debt profile now goes out to 2024 and 2027.

Just closing on the longer term, Lloyd's is a market that takes risk from its policyholders and, in any one year, there must be the chance of a loss being reported, particularly when there's severe natural catastrophes. But over the longer term, capital efficiency of the market is shown there, that over a 5-year return is an average of 7% and over a 10-year period over 9%. Thank you.

And to close, I'll now hand back to Inga Beale.

Inga Kristine Beale

Thank you, John. So, an incredibly tough year last year for the Lloyd's market, but I am absolutely confident that we go in to 2018 in a strong and secured position. We've got some excellent capital strength out there and we really are in robust financial shape, and we continue to pay all valid claims, which we have done for now 330 years this year.

We know that pricing remains under pressure in some regions of the world and also for some product lines. But therefore, it's important for us that we will continue our focus on market oversight and retaining as much discipline in the market as we can. We know that we've made great strides towards modernizing the market in 2017, but there is more to do. But that's all about really making sure that Lloyd's is easy, accessible, efficient, and that we continue to take cost out of the market.

We announced fairly recently our gender pay gap. Not anything to be proud of at 27.7%, but it means that we need to take some actions. So, we've got sort of decades of women not being in senior positions in the workforce here. So, it's not as though we can do something overnight, but we know that we got to put in place plans to change this over the medium- to long-term, and that's exactly what we're doing. So, you will hear more about that as we go forward.

So, our priorities for 2018. We know that that market oversight has to be there. It's got to be there. It's at the heart of what the Performance Management division do. We want to continue to focus on making it more and more risk-based. We have introduced a new approach with our account managers, but we also talked about the portfolio reviews we were doing, and I remember sharing, probably with many of you who are joining us today, about how we were looking at the worst performing portfolios in the market and then the worst performing syndicates within those portfolios. And it seems as though there was more work to do in that regard because we know that some of the underlying business, perhaps some of the non-cat-effective business, still isn't hitting the profitability targets that the market would certainly like to see.

The second priority, operations and services, this is where that modernization is sitting, and we will continue to drive adoption of all the technology solutions we're putting in place. We are also though introducing a new workstream as part of this. This is going to be focused very much on claims. We prioritized at the beginning of this London market target operating model work. We knew that we couldn't do everything for the market. So, although we designed the entire blueprint, we knew we couldn't do everything or we would start to fail, we wouldn't deliver on anything.

So, we honed down the focus streams to specific workstreams and claims didn't make the first cut. But now claims is going to be at the center of what we're driving this year. And this is really going to be about affecting the policyholder's life, showing full transparency to them once we've built the solution to where their claim is in the process and looking at how we can make sure that those funds get to those policyholders just when they need it most even more quickly and efficiently than we're doing at the moment.

The customers and distribution, that's another important part. We know that there are challenges out there in terms of new types of distribution, people are looking at using technology and data much more, and we don't want to be left behind. So, we've launched and made the announcement about setting up an Innovation Lab. This will be a physical lab here in London, but it will be looking at the entire global arena. And we will be setting up - we'll be working with a partner on that rather than doing it ourselves, and it will be for the benefit of the Lloyd's market participants. And we haven't determined what would be looked at there yet. There may be new things we want to invest in. There may be just projects we want to be involved in without investment, all sorts of things; nothing is going to be excluded. But obviously, we want to have a very vibrant environment in that Innovation Lab and make sure that it's - we make quick decisions. And we allow failures because we know that, to be successful in doing anything new and starting out new things, that to allow some failure is essential and we will allow that. We want to have a very rapid environment where we quickly make decisions on whether to push something forward. But if it's not going to work, we quickly make a decision to stop doing something. So, that'll be a new cultural addition to the Lloyd's market and I think really supporting the whole product innovations that Lloyd's has been so good at for centuries, and it'll give that added edge to all types of innovation and embracing technology.

And the customers and distribution, our Brexit project will be a critical part of that. I touched on it earlier. We will have the Brussels subsidiary up and running for January 2019, so before the UK actually Brexits. We're still working on solving the issue of contract continuity for existing policies and old policies that we may still have to service, and I know that's a sector-wide concern of regulators. And ideally, we would get some sort of European-wide regulatory solution for that, but there's no certainty around that. So, obviously, we have to look at other solutions for how we could with the servicing of existing and past contracts.

We don't have any immediate plans to expand our licensed network further. That was a big part of the work that we've been doing over the last five or so years. And while we did open successfully after about 20 years of lobbying in India, we did open in India. We don't have a proactive approach to seeking new licensees at the moment. The two of the major growth markets of the future, China and India, we now have onshore capability and we're going to really consolidate and build on the progress we've made to-date.

We mustn't forget talent. We will be focusing, again, on talent, and making sure that we attract new talent and, importantly, retain that good talent in the market. And a lot of what we do centrally in the corporation is indeed provide talent programs for the entire market whether its leadership development or whether it's leading and running a graduate in taking an apprenticeship program for the market. So, there's still a lot to be done on talent.

And obviously, capital will always be there, an important part of what we do at the center, providing efficient and flexible capital and maintaining those financial strength ratings.

And brand, we're the keepers of the Lloyd's brand, and while we have many participants in the market who go out and then use their own brand, we know that Lloyd's is one of the strongest brands globally in insurance. And it's our role to protect the reputation of Lloyd's particularly the trust that customers put in at Lloyd's brand that, as I said, this year has been around 330 years.

So, thank you very much for listening. We are now here to answer any questions. And John and I are joined by Jon Hancock who manages all the performance management area. Thank you.

Q&A

A - Inga Kristine Beale

So, let's start by taking some questions from people in the room.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi. Thanks very much. Ben Cohen with Investec. I had a couple of questions. Firstly, you mentioned in the annual report about determining a new layer of protection for the Central Fund. I just wonder if you could update in terms of where you are on that thinking. I think there was some press report to you looking at alternative capital, different structures, what that might be for, what that might be looking to achieve.

My second question was in terms of some of the classes now on an attritional loss ratio basis are quite heavily loss-making before any sort of investment income, aviation, motor arguably, could you be more specific in terms of really what action you're taking in some of these areas to make sure that you're not sort of entering into kind of a long-term issue around profitability? Thank you.

A - Inga Kristine Beale

Okay. Thanks. So, we'll have – Jon Hancock will answer the underwriting performance one. But first, John Parry, I suggest you respond to the capital one. Just to let you know, in terms of the ILS structure that launched in London, the London market group was a key proponent of that and pushed that a lot. And whilst we've seen limited activity, I do know we're proud that one of the Lloyd's players is one of the first to use that new ILS structure here. And we're hoping to see more activity in that space.

Over to you, John.

A - John Parry {BIO 18896198 <GO>}

Thank you. So, Lloyd's is committed to having a diversity of capital provision both from its members and also in the Central Fund. To-date, the Central Fund accrues capital through a levy on the premiums written by the market, which are at a all-time low of 35 basis points, investment return on the fund, and then we have subordinated debt issues. A pool of capital that we haven't used is alternative capital or insurance-linked securities. So, I did a non-deal roadshow to introduce Lloyd's, talk about our chain of security and get some feedback to see whether there is an option for us to supplement central assets through something that we could do centrally on behalf of the market or for ourselves.

Clearly, we are in a position of financial strength. We exceed our risk appetite for the Central Fund of 200%. So, it was exploratory talks, get some feedback to see whether that was something feasible we can take forward this year to further supplement central assets.

A - Inga Kristine Beale

Jon?

A - Jon Hancock {BIO 18712327 <GO>}

Okay. Yeah. It's obviously quite a broad question, Ben, so I'll answer. And I'm sure there'll some follow-up from the room. So, to deal specifically with the – it's an underlying performance, and that's the language that we've certainly been using throughout last year. And we called out as many of the syndicates already had, that there is a performance gap and we focused on that underlying performances as well as looking at the whole performance. But really to address the issue that you called out, let's make sure that we are understanding the business that we're writing today in the future, not building up a problem. So, that's being – on our minds, it's the approach that we've taken across the market and the syndicates individually.

I guess the first thing to call out that we do there is that's the approach we've taken into the plan process. So, when we did the planning through the second half of last year for the 2018 and beyond plans, we did it on the basis that the underlying performance, so including the attritional loss ratios, is not good enough and not where it needs to be, and we called out that that needs to improve. So, that's the approach that we took into the plan.

So, every plan that was approved and every plan that was presented had that in mind and had different remediation plans, different target plans in there. We went in with a mindset and a very public and a strong mindset that all the plans had to be realistic and sustainable, not just a plan that looks on the right numbers. So, we'd looked very, very closely at bridges from one year to the next and one ratio to the next.

We gave very strong messages about no growth in unprofitable lines and no growth in unprofitable syndicates actually. And any growth that we've approved in plans as being through the better performing portfolios, through the better performing syndicates, and where they're not in that category, whether are loss-making or marginal, they're flat or shrinking.

Important to note isn't it that we don't set the price for the customer. The markets do that themselves and so they should. But what we have seen is a gradual and fairly continual improvement in price. We measure a risk-adjusted price by taking into account price and cover. John's already alluded to it, yeah. At the half year last year, we were about 2.5%, minus 2.5% of risk-adjusted rate of 2.5%. That was lower than the plan we went into in the year. Q3, that improved to a minus 1.2%; Q4, that improved to a positive 1.5%, and in January this year, it had improved to a positive 3%. So, I think those are about showing good discipline in the market. It was happening before hurricane events anyway, which did change sort of the drivers for sure. So, I think they're all good indications. And obviously, there's huge variation. That's a very, very aggregated market view and there's some huge variations in prices there.

Probably the final thing to talk about is one of the latest things Inga talked about is those product portfolio remediation, the work we did through 2017 through identifying the poorer performing portfolios saw about £500 million of business removed from the market and combined ratio in those segments improved by about 3 percentage points. That's an ongoing initiative. We went to the market in December last year with what the portfolio review classes are for this year. And we've honed the approach again this year. We've now – we are now targeting the absolute worst performing lines of business at a portfolio and syndicate level in the most material portfolios, to Inga's points, that's what we'd say is a risk-based approach. Let's focus our time and effort where we can make real big impact.

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

Andreas van Embden, Peel Hunt. Just following on on that, could we maybe zoom in on the casualty book, please, because it's underwriting at a loss both in an accident year and calendar year? The reserve releases have been quite low for the second consecutive year, and I think you mentioned as well in your annual report that price increases are below claims inflation. So, I just wondered, within that book, which are the casualty lines are you really concerned about right now and what is the level of margin above best estimate in reserves currently? And do you think there's enough there to be able to continue positive reserve releases in 2018 and 2019? Thanks.

A - Inga Kristine Beale

Okay. Thanks. So, Jon can touch on the underwriting little bit, but just first of all on the reserve piece, I'll ask John Parry to comment.

A - John Parry {BIO 18896198 <GO>}

Yes. I mean, so we have, in previous years, written to the market regarding the sort of initial reserving for certain casualty lines. It's in aggregate an area where we think we are at around the best estimate. We have seen surpluses in the shorter tail classes and also in some of the sort of earlier years of writing casualty. So, no surprise that the market has responded to that and actually put reserves in and around the 100% mark.

We've seen actual experience kind of matching projections for 2017. So, the level of surplus that we see in the market, we think is there again at 2017, but our research will continue with that because these are very high level numbers at this stage. We will receive more granular data over time to sort of complete that analysis.

A - Jon Hancock {BIO 18712327 <GO>}

Okay. And on the performance of the classes, I think there's two things going on here. One is there's some really good growth in cyber, which is brand new to the market premium generally as well as some U.S. D&O business, which is new opportunity. Some of the syndicates writing business that they'd not previously been written and they brought teams (00:45:30) going through that. So, there's a balance going on here of focusing on the better business.

In terms of the two that are concerned, I think it's probably worth saying that the attritionals have deteriorated a little bit over the last year. They were too high to start with, and that's the focus we've been taking. Over last year, we spent a lot of time on the casualty treaty book per se and looking at the quality of the underwriting, the levels of reserving, and we got some good outcomes from that and some good insight we got from that. So, that's work that's very, very well underway and is being actioned across the market.

The other two for this year, in terms of the portfolio reviews that we've targeted, one is EL generally, so employees' liability generally across the world for its underlying under performance and for the trends that we're seeing. And the other area is the professional indemnity book, the non-U.S. professional indemnity book. The U.S. book performs much, much better, but that's where we're zoned in on those – two of those portfolio review classes that we've flagged that we're doing actual work on. So, over the course of 12 months, we'd have reviewed the majority of that book, and obviously it comes with actions.

A - Nicola Hartley {BIO 3815569 <GO>}

Any more questions from the room? Okay. Let's move over to take some questions from our webcast audience.

A question from Kamran Hossain of RBC Capital Markets. And the question is 2017, so the lowest return on capital since 2001 at Lloyd's. To what extent was 2017 result conservative both in terms of loss picks on the cat losses plus lower reserve releases and therefore no need to window dress results in a bad year. Are price increases year-to-date enough?

A - Inga Kristine Beale

John?

A - John Parry {BIO 18896198 <GO>}

If I'm to take...

A - Inga Kristine Beale

And then I'll let Jon Hancock account (00:47:28) the prices.

A - John Parry {BIO 18896198 <GO>}

Yeah. If I can take the first point regarding the reported numbers, I think at this stage of what we can see, I think it's no concern regarding where they've been set and to say, on the hurricane claims estimates, they've been robust compared to previous experience. And for a number of syndicates they're into their outward reinsurance programs, which would absorb any deterioration in their gross result would probably be passed on to reinsurers, so that gives some comfort.

In terms of sort of delving into that, the different drivers for management's in looking at the year, whether or no there's some major claims around, I think that's too early to tell where we are. We know there's been a slow but steady decline in pricing across the number of lines that Lloyd's writes for a number of year. So, having an increase in the attritional loss ratio from 16% to 17% is as expected. Whether it's one or two points different, compared to where it could have been at this stage, we wouldn't be able to tell.

A - Jon Hancock {BIO 18712327 <GO>}

So, are the price increases enough I think was the question for me. So, we've answered some of that hopefully by showing the progression that we've had over the last few quarters. But my wider answer to the question is, it depends and you probably expect me to say that in many ways. I think it depends on how sustainable are those price increases. You can imagine within the price increases for loss-affected lines versus non-loss affected lines and some geography challenges as well.

There is some risk that is perfectly, adequately priced across the market and some risk that is underpriced. So long as the underwriters are making the right choices on those, then the price will be enough. I think it's also important to remember that we sit here in March and the world doesn't rest on the 1st of January. 1st of January is an important renewal and it's an important renewal for Lloyd's. There are some key renewal times of April and U.S. domestic especially in June and July as well.

So, I think if those rates stick and if underwriters are taking the right action in the right portfolios and really understanding the price adequacy in that underlying result, I think the market is in better shape than it was, but it needs to continue to show. This can't be a one-off small adjustment generally but it's got to be more targeted than that. There's not a one answer or one-size-fits-all here.

A - Nicola Hartley {BIO 3815569 <GO>}

Now, we have two questions from Steve Evans of Artemis. The first is, is Lloyd's getting involved in the B3i initiative. And the second is what would be a rough target for the expense ratio of the market by 2020 and beyond?

A - Inga Kristine Beale

Okay. I'll just take that B3i question. We are involved to a certain extent although we're not one of the founding firms. We're very aware of it and some of the Lloyd's businesses themselves are involved in the B3i project. But it does not form parts of the London Market Target Operating Model work, however, we can't avoid but to be involved and be aware of it, and we're monitoring it. And should it be successful, we certainly want to make or the market would want to make the most of that success.

Now, in terms of expense reductions in the medium term and a lot of this will come from the TOM that we do, but it will require firms themselves to change their business models. So, while centrally we design and provide systems and technology, unless the relevant changes are done within the firms themselves to make sure that this central system speak directly to the firm's own systems, they won't necessarily have the benefits that will come from this. So, I imagine that it will take some time for all of those financial benefits to run through the entire market expense base because they have to invest in technology, they have to change their own business models, and that takes time. So, that's where you'll see the major saving come out. And, of course, then, we've got the acquisition costs that are actually showing an increase, a small increase anyway, in 2017. That does continue to keep our attention. And we're aware that change of business mix impacts some of that because we've got quite a big book of binder business, coverholder business, delegated authority business that contributes to that higher acquisition cost ratio, and all of these aspects we'll be looking at, not necessarily as part of the London Market Target Operating Model work, the TOM work, but we'll be looking at, more broadly, what can Lloyd's do, if anything, to address some of those distribution costs.

A - Nicola Hartley {BIO 3815569 <GO>}

Can we take another question from the live webcast? No? No more questions. Okay. Well, I think that brings us to conclude today's presentation. Thank you very much for joining us this morning.