Q2 2015 Earnings Call

Company Participants

- John Reizenstein, Chief Financial Officer & Executive Director
- Neil David Manser, Director-Investor Relations & Corporate Strategy
- Paul Robert Geddes, Chief Executive Officer & Executive Director

Other Participants

- Alan G. Devlin, Analyst
- Andreas E. Van Embden, Analyst
- Andrew J. Crean, Analyst
- Andy Hughes, Analyst
- Ashik Musaddi, Analyst
- Deepinder Bhatia, Founding Partner
- Dhruv Gahlaut, Analyst
- Fahad U. Changazi, Analyst
- Gordon Aitken, Analyst
- James A. Shuck, Analyst
- Jon M. Hocking, Analyst
- Oliver G. Steel, Analyst

MANAGEMENT DISCUSSION SECTION

Paul Robert Geddes {BIO 2474781 <GO>}

Cheers. Well, good morning, ladies and gentlemen. Welcome to our – oh, we got more? Where you have gone? Fine. Welcome again to our First Half Results Presentation. I thank the Goldman's for having us back here. We're now going to alternate between here and Canary Wharf, so at least half of you are happy at any one time. Thanks for the feedback last time.

I'm joined by our CFO, John Reizenstein and seated in the front are my Executive Committee, colleagues who, certainly, if you haven't had a chance to meet, you can meet afterwards over coffee. I'm going to begin with a brief overview of the key highlights, then come back later to talk about our strategy, and the outlook for the rest of the year.

Turning to page 3, today is much more than a strong set of results. Over the last five years, we've transformed this business and now have a more focused strong franchise with improved competitiveness across the board.

Ongoing operating profit up 42% to £336 million and a combined ratio of 89.4%. This does include a couple of unexpected tailwinds, namely good weather and higher-than-expected prior-year reserve releases. Whilst delivering this, we also improved customer metrics with retention and Net Promoter Score both up during the period. We completed the sale of our International division back in May and returned the net proceeds in July. We are now fully focused on the UK market.

In this market, we are now more competitive. And this can be seen in another quarter of stability across our Motor and Home brand policy count. This improved competitiveness hasn't come around by chance; it's actually a result of a multiyear improvement program. We've also cut costs again, further improving our efficiency, and we will continue to focus on this going forward.

Whilst delivering all of this, we've been investing behind the trends that are established themselves in our industry; for example, telematics in Motor, eTrading and Direct Line for Commercial, and digital solutions on claims. We're also pushing industry boundaries, for example by building the next-generation of customer systems as we speak. Taken together, we're moving ahead with our mission to make insurance much easier and better value for our customers.

Let me hand over to John for the results.

John Reizenstein {BIO 6786139 <GO>}

Thanks, Paul, and good morning, everybody. We'll start with the financial highlights on slide 5. And before going into that, let's just remind you that the ongoing numbers now exclude the International Division, which can be classified as discontinued.

So as Paul said, a strong set of results in the first half, albeit helped by some tailwinds. Gross written premiums were up slightly versus the prior year. I'll come back to that in a moment. Underwriting profit for the period increased by £95 million to £153 million, as we benefited from those tailwinds, i.e., good weather in Home and higher-than-expected prior-year reserve releases across the board.

Installment and other income was pretty flat at £73 million. Investment return was up 5.5% to £110 million as we saw further gains on the property portfolio, the investment income yield being stable at 2.4%, which brought us to that operating profit of £336 million, 42% ahead of last year.

COR for the first half was 89.4% and around 92% if adjusted for a normal level of weather claims. This is well ahead of the 94% to 96% guidance, and that's due to higher prior-year reserve releases. Adjusting for that, we would have been within the original guidance of 94% to 96% and we'll come back to that.

Return on tangible equity was 21.2%, well ahead of our 15% long-term target, but again benefiting from the factors I've mentioned. And we've seen some performance in every segment with most of the increase in Home obviously due to the weather.

Our strategic priorities continue to drive an increase in our overall competitiveness, with positive quarterly trends in premiums and policy account. In Motor, premiums were up 2.7% in the first half following more favorable market conditions in the second quarter. As you can see if you take a look at the bottom, mostly GWP was being flat in Q1 followed by growth of 5.4% in Q2.

In Home, markets have remained competitive, but we've held our own brand policy account stable over the last few quarters. We'll come back to Motor and Home giving pricing in a moment.

In terms of the remaining segments, Rescue maintained good momentum over the period with 5.1% GWP growth in the first half. Total IFPs were up 1.5% since the start of the year, with Green Flag Direct up 4.9%. It is, however, worth noting that we've observed increased competitor activity in the Rescue market over the last few weeks.

Other Personal Lines GWP was up 9% mainly as a result of rate changes in the travel book. And in commercial, headline premiums were down 2.3% versus prior year. Within that, we continue to see strong growth in Direct and eTrade, with eTrade up 15% and Direct Line for business up around 3%. However, this was more than offset by competitive conditions in the regional business where we remain disciplined.

Let's look at the current year underwriting result, and it's been another period of current-year attritional loss ratios and improvement, with our ratio down 1.9 percentage points to 69.1%. This reflects the benefits from investment in technical pricing and claims and our updated approach to booking current-year margin on Motor.

The red bar on the left shows that at this point last year, we had incurred £64 million of Home weather claims, whereas the figure this year is zero. In a normal half, we'd expect around £40 million of costs for major weather in Home.

In the first half, we've recognized significant prior-year releases of £215 million, equivalent to 14.9% of earned premium. You remember that at the full-year, we said prior-year reserve releases will be lower in 2015 than 2014. They are slightly low for Motor in the first half, but higher than we expected in Motor and higher across the business.

Overall, looking forward, we don't expect to see the same level of releases in the second half as in the first half, and therefore total prior-year releases for 2015 are expected to be below the level reported last year.

We go into cost. We're making good progress on reducing our cost base, with a 7.6% reduction in the first half. And we've seen expense ratio improvement of 0.4 percentage points to 23.6%, as the cost efficiencies more than offset the reduction in net earned premiums. As we said at Q1, it will be difficult to maintain the same level of reduction in the second half as comparators become more challenging due to the good progress we made in the last part of last year.

Let's start with the segments with Motor on slide 9. And indeed, obviously, in IFP, as I mentioned, we've seen encouraging trends. Policy counts remained fairly flat over the last year while GWP is up 2.7% in the first half. Net earned premiums have reduced by 7.1%, and about half of that is due to the impact of increased reinsurance cover.

The current year loss ratio for the first half was 85.6%, a 1.6 percentage point improvement on prior year. This reflects the change in our approach to current year reserving, which I'll come onto in a moment. Prior-year releases were down a bit, but still higher than expected at £1.5 million. We continue to benefit from positive development from accident years 2013 and prior, in particular from large bodily injury. Looking ahead, as I said, we don't expect to see such large releases in the second half of the year. We'll come back to pricing claims and reserving in more detail in the next few slides.

Motor COR was 91.4%, which is 2.2 percentage points better than prior year, largely due to the current-year loss ratio improvement. Installments and other income was stable, and Motor benefited from an increase in investment returns, giving it a total profit of £181 million, up 10% versus the prior year.

Before going on to the current year and reserving, I thought it would be useful on slide 10 to give you a picture of what claims trends we're seeing. Overall, the Motor claims picture is mixed versus our expectations this year. We've seen stable trends in most perils, but there are two areas where they've been worse than expectations as shown in the table.

Large BI represents around 15% of gross claims costs, and in 2015 we continued to see elevated frequency of claims within £100,000 and £1 million just as we had in 2014. We believe this is down to a number of factors.

As you know, large BI is inherently volatile. In addition to this, the market as a whole has seen an increase in the number of killed and seriously injured, certainly based on the DoT killed and seriously injured stats for 2014 over 2013.

When we analyze the trends in more detail by subset, we have identified some emerging trends; for example, higher frequency in drivers aged 75 and over. The data is also affected by our processes where we continue to make improvements. We believe this has contributed to an acceleration of the recognition of such claims in the incurred and likely therefore to have exaggerated the effect on frequency. We have not taken account of that in our reserving. Our reserving does not give any credit to such an acceleration. So that's potential upside. But in any event, the combination of these factors together explains the uptick and we continue to monitor it very closely.

Moving on to damage claims, here we have seen good frequency but an increase in severity driven by such things as the cost of parts, paint, labor used, cars and credit higher. Taking all of these together, claims inflation is currently running a little higher than expected and ahead of the long-term 3% to 5% range we've previously indicated.

As you can see from the pricing numbers at the bottom of the table, our risk-adjusted prices were up 6% in Q2 against same period last year, which is consistent with what we're seeing in claims inflation. The combination of our actions and more favorable market conditions meant that in the second quarter, we were able to hold policy count pretty flat while GWP was up 5.4% versus the prior year.

Let's look at the Motor current year loss ratio. We've split out the moving parts here to show that the – within the improvement of 1.6% for the current year loss ratio. First of all, we had a benefit from a refinement in our approach to determining the level of risk margin for the current year booking, and that's resulted in a £40 million or 2.5% improvement in profitability for the first half-year and 2.5% on the loss ratio as well. The positive movement was partially offset by our pricing having to catch up with claims trends, which as I mentioned proved a bit worse than expected; that's the red bit. As I said, we think that Q2 pricing data shows we're now in a good position.

So we covered most of the current year, and let's look at prior year. So here on slide 12, we have the usual chart showing the accident year development on a gross basis. The majority of prior years have continued to develop favorably, a combination of our prudent approach to reserving and improvement in pricing and claims.

You'll recall we discussed large BI volatility for 2014 accident year. We've taken a prudent approach to this, which explains the uptick here. To remind you, we've now brought our reinsurance cover down to £1 million, but that didn't fully cover the 2014 accident year. But on a net basis, the increase in loss ratio for 2014 is 2 percentage points taking that into account. We are very confident about the level of reserving we have on 2014, and in fact, the latest July data point for large bodily injury is a little bit encouraging for 2014 and also for 2015. Overall, Motor prior-year releases were higher than expected at £145.5 million or 23.8% in net earned premiums and we don't expect releases to be as large in the second half.

Let's move on to Home. We've had a great set of results as we focus in improving our pricing and propositions and had the favorable impact of a good first half in terms of weather events. So, making – delivering an excellent profit of £104 million.

Start with IFPs, these were down 4% over the year. Within that, our own brands have been pretty stable and actually flat over the last nine months. Good result considering market conditions and reflects the actions we're taking on pricing and propositions.

Partners' policy count continued to reduce and was down around 7% since last June, reflecting the changes in customer journeys across bank channels. While I'm on the subject of partners, at this stage, we have no update regarding the Nationwide contract, which is still in the process of being retendered. As we've said before, Nationwide accounts for about 22% of Home GWP but makes a much lower contribution to Home profit. Total Home GWP was down 4.5% versus the prior year with own brands down 3% and partners down 5.7%.

Moving to the current year attritional loss ratio, this improved by 2.1 percentage points to 47.5%, reflecting improved risk selection and good underlying claims trend. Prior-year releases were up a bit in the first half to £38.2 million, reflecting underlying favorable claims development, and as with last year, we're not expecting so much in the second half. All this gave us a reported loss ratio of 38.4%, 18.2 percentage points better than the prior year.

Home COR improved by 17 percentage points to 80.8%, and within that, the expense ratio was slightly better while the commission ratio share was higher as we share the benefit of the good weather – good results with our partners. Operating profit was up £69.6 million to £104 million.

On slide 14, is our new data. We've extended the Motor-type analysis to Home to show what's been happening over recent quarters in pricing and risk mix. This is for own brands. The improved risk mix is largely due to a higher retention and technical pricing developments. The Home market remains highly competitive. The increased competition in Home, we believe, is driven by a number of factors including channel changes and low reinsurance rate.

Our underlying claims picture in Home, as I mentioned and disregarding the good weather, has been good, and this together with our initiatives in pricing meant we were able to reduce our own brand risk-adjusted prices by around 2%. We believe that our ability to protect the value in Home is the result of our higher retention rates, strong propositions, and continued investment in pricing and claims.

Now, we move on to Rescue and Other Personal Lines. And starting with Rescue, which makes up the bulk of it, it's been another good first half for our rescue business, which grew policy count and premiums. IFPs were up 1.8% versus June last year, and GWP was up 5% with a number of positive trends driving this performance.

We saw growth in Direct following a successful new marketing campaign. We also saw continued improvement in linked sales with new business customers purchasing cover at a higher average premium. Rescue COR of 79.6% was up slightly versus the prior year. That's due to changes in pricing in the bank channel, in turn off the back of favorable performance in the prior year.

Now, the rest of Other Personal Lines, which is mainly Pet and Travel. So, excluding Rescue, other personalized GWP was up 9.3% primarily due to re-pricing on the travel book. Including Rescue, overall GWP grew by 7.5% in the first half. Overall segment COR remained broadly stable at 91%, and profit was 2.3% to £26.4 million.

Finally, a good set of results in Commercial, which has maintained a sub-100 COR in the first half. IFP dropped 4.8% over the year, mainly driven by growth in Direct Line for business and eTrade. Overall GWP was down 2.3% year-on-year, reflecting competition in the regional business, where we have remained disciplined. In eTrade and Direct, we continue to grow GWP with eTrade up 15% and Direct Line for business up around 3%.

The current year loss ratio improved by 1.8 percentage points with reductions across all channels. Within that, benign weather in the first half of 2015 compared with the prior year was partially offset by an increase in fire claims in 2015.

Prior-year releases increased to £32.6 million, and again, we wouldn't expect as much in the second half. That gave us a COR of 98.8% within which we've seen an improvement in expense ratio as well as a number of efficiency programs and a reduction in commission ratio reflecting the growth of our direct business. Operating profit for the period was £24 million.

Going back to group with investments on slide 17. Headline AUM stood at around £7.3 billion at the end June. However, this includes the cash proceeds from the sale of international. Following special dividend paid on the 24th of July, AUM is £6.9 billion, which is reflected in a chart on the top right of the slide.

The income yield was up 10 basis points to 2.4% as we continue to move towards our target asset allocations. This generated investment income of £83 million, which are down slightly versus same period due to the lower average AUM.

The overall return was 3.1%, 30 basis points higher than the same period last year, with total gains for the period increasing £26.8 million. This was the result of fair value increases on the investment property portfolio and high gains on disposal of fixed income debt securities. Looking ahead, we don't expect that these such high gains in the second half or indeed in future years.

We've updated the outlook for investment income yield, taking into account current asset allocations and targets and current yield curves. As a result, we now expect slightly lower growth in yields than we originally thought, with an estimate of 2.6% by the end of 2016. You can find the usual waterfall in the appendix.

So page 18 shows how we get from the headline ongoing operating profit of £335.8 million down to profit after tax. I'll mention a few lines. Run-off profit was £38 million, up versus same period last year, reflecting the favorable prior-year releases, particularly from large bodily injury. Going forward, we expect run-off to continue to generate profit albeit not at the level we've seen in the first half.

Restructuring and other one-off costs reflects the cost associated with the exit of one location, which we announced earlier this year, and costs relating to IT migration. So, guiding to a total spend of around £50 million this year. And as I've said before, over the next three years, we expect profits from the runoff business will broadly offset the restructuring costs.

The results of international reported as discontinued, the incremental contribution includes the recycling of the AFS gains in international through their profit and loss. Together with gain on disposals, this gives us total contribution net of tax of £181.2 million. The effective tax rate for the continuing business was 21.7%, slightly above the UK standard tax rate of 20.25%. And taking all that into account, profit after tax was up to £428 million versus £176 million in the same period last year.

Moving on to capital, the position at the end of June remains very strong and you'll see that the risk-based capital cover is actually above the top of our risk outside range. This would ordinarily lead us to consider a return of capital. But as we told you at the year-end, we wouldn't do this at the half-year pending the transition to Solvency II.

In respect to Solvency II, we are making good progress, and I've submitted our pre-application to the regulator. We should complete the full application this year and aim, subject to PRA approval, to be working from our internal model from 1st of July 2016. Meanwhile, we'll operate from January 1, 2016 under the standard formula approach, which is, of course, more onerous than the internal model approach. As part of the Solvency II transition, we will be recalibrating our risk appetite range, and we'll update you on that at the full year.

Let's look at book value and TNAV. Overall, TNAV was down 1.1% to 151.4% per share over the six-month period once you adjust for the international dividend as shown at the bottom of the slide. This reflects strong earnings, offset by dividends paid and reduction in the balance of unrealized gains. The balance at the end of June was £44 million net of tax.

A few words on dividends, we recently paid the special interim dividend of £0.275 per share in line with our decision to return substantially all the net proceeds from the sale of international business. Alongside this, we also completed 11 for 12 share consolidation in order to maintain comparability of per-share data.

Today, we're announcing interim dividend of £0.046 per share, which represents 5% growth on the previous year and is in line with our policy to aim to increase the dividend annually in real terms.

Before I hand back to Paul, I'd just like to summarize some of the financial trends on slide 21. It's been another good period of progress across our key metrics. The current year attrition loss ratio improved again. We have reduced the total cost base again. We've maintained – slightly enhanced the investment income yield. And we've increased the regular dividend again and paid out the international special while capital remains strong. With that I'll hand back to Paul.

Paul Robert Geddes {BIO 2474781 <GO>}

Thank you, John.

So today, I'd like to tell you about the excellent progress that we've been making in the first half against our strategic priorities before closing with the outlook for the full-year 2015.

Before I do, let's turn to slide 23 and remind ourselves of our four, strong, profitable businesses that have delivered these results and the leading franchises that support them. Our results are evidence of the excellent progress we're making on our strategic priorities. And here on slide 24 is a reminder of the strategy I set out at the start of the year that drives our initiatives.

And we're believers that the digital revolution that's profoundly changing all customer industries will profoundly change insurance too. And we want to harness this revolution for the benefit of our customers. Our mission is, therefore, to make insurance much easier and better value for our customers, something that really energizes us at DLG.

We plan to do this by being great retailers, and at the same time great manufacturers and rediscovering our ability to lead and disrupt the market. When we're done, this should've built sufficient advantage to be a business that can produce good returns and also growth. As I've also said at the full year, the acid test for the strategy is that it drives the right actions, and we share with you our busy 2015 agenda.

Six months in, I'm delighted with the progress we've already made and the benefits that we're seeing, so let me give you my half-year report card. Starting with great retailer on slide 26, where we continue to improve our customer's experience through targeted initiatives and investment. The first half of 2015, we've continued to differentiate our brands and refresh our propositions. Last year, we launched a new positioning for Direct Line with fresh, edgy marketing and market-leading service propositions.

We're really pleased with the results. Customers have really wrapped well with a kick up in our already strong brand measures and a further strengthening in our retention rates. In this half-year, we've removed amendment fees from all Direct Line products as well as introducing more propositions and ads in the campaign. I'm going to show you one of those in a moment.

We recently refreshed our Churchill brands, making the most of our iconic hero with the strap line, depend on the dog, supported by new TV advertising.

And what's charming and amusing is the ad's also explained the rationale, products, and service reasons why customers should choose Churchill over the other brands on price comparison websites. Through multiple pricing initiatives, we also significantly improved the price competitiveness of Churchill.

Investment in our brands has led to an impressive growth in our brand preference stores, with Direct Line up 27% and Churchill up 18% year-on-year. Let's have a quick ad break.

[Video Presentation] (25:59-27:00)

Good. If you – all right, if you couldn't quite hear that, it's available on YouTube.

So a few more retailing highlights to mention. Our investment in digital infrastructure continues at pace. We recently rolled out a new quote and buy journey for our Home customers as we did in Motor last year. Our focus on improving customer experience is delivering best results in key customer metrics such as Net Promoter Scores.

I'm particularly proud our high retention rates have increased yet again, with Motor up 0.6 percentage points and Home up 2.6 percentage points versus the prior year.

In Commercial, our improved technology and capability have enabled us to develop more new products with the launch of professional indemnity for Direct Line's business customers.

For our core products, we aim to also be a smart and efficient manufacturer, leveraging our scale to deliver a flexible range of products, claims and customer experiences at a lower cost. As I set out at the start of the year, we have plenty more in the tank in terms of pricing and claims initiatives. A successful deployment will help us compete in the competitive markets in which we operate.

Being a smart manufacturer, we relentlessly seek to reduce our costs with short-, medium-, and long-term initiatives, many of which will also improve the customer experience. The first half of 2015, we've reduced our total cost base again with the 7.6% improvement versus the first half of last year. Our new claims propositions have helped us drive down claims inflation and improve efficiency. For example, Motor customers can now upload images of their damage and track their vehicle repairs by an online portal. This not only makes it easy to claim for our customers, it also improves the efficiency for our claims handlers.

Direct Line's seven-day repair proposition is going very well. We now have repaired around 25,000 vehicles under this proposition.

We continue to invest on our pricing capabilities to broaden our footprint and improve our competitiveness. Whilst I can't give away too much detail on specific initiatives, I can share one example. In commercial, we've been increasingly leveraging up our Personal lines pricing capabilities following a number of improvements in Commercial Van technical pricing. We've seen a significant growth in NIG in the first half of currently rolling out price changes on to Direct Lines for business van as well.

Our final pillar is about how we're building our strong market positions by investing in market trends, which we believe will drive future growth. We continued to grow our telematics offering in the first half with a 48% increase in telematics policies, which are now just shy of 60,000. And to-date, we've gathered over a quarter of a billion miles of data and have been working with the flow to analyze this data and gain unique pricing insights. In Commercial, we've been recognized for our leading capabilities in e-trading and Direct, both of which have been growing. We were recently voted number one for e-trading in a broker survey. We also won Best Landlord Provider for the second year running.

As our customers evolve, we need to evolve our product range. Commercial is planning to launch a new cyber product for regional brokers. Reassuringly, it will be fully reinsured. Our Green Flag Direct offer continues to perform well with new marketing campaigns and changes to the pricing structure, helping it to deliver 4.9% growth in policies this year.

In my introduction, I referenced many years of investment across the business. I would like to spend a minute to reflect on the journey we've been on and highlight a few of the many milestones that we've achieved.

As you can see from this very busy slide, the pace of change in this business has been relentless, and the combination of all these milestones has put us in a much stronger competitive position. Taking Motor as an example, we completely overhauled our claims processes, rolled out a new claim system to be able to have a market-leading claims function and claims performance.

We've been bringing all our pricing data together, which enable us to sharpen our technical pricing capabilities. We've recently refreshed our brands, rolling out new websites and refreshed our propositions.

We've come a long way in our journey to reduce costs, having exited a number of sites and remained focused on improving operational efficacy right across the business. The result of all of these is that Motor business has now been regaining its competitive edge.

We're now rolling out initiatives across other areas of the business, and we don't intend to stop here. As you've seen, we have plenty more in the tank, and I'm excited as we continue our journey and we're busy working on the next generation of digital initiatives.

Finally, a brief summary of where we are and the outlook for 2015 on slide 30. The UK Motor and Home markets remain highly competitive. We've also seen a step up in Rescue competitor activity recently. The pricing pressure we saw in the motor market in early 2015 was less intense in Q2; taking the first half, in total, market prices have increased, but we believe not by as much as market claims inflation.

In Home, the picture is mixed as we've seen further new business price deflation across the market with an acceleration in the second quarter. Against this backdrop, the group will continue its disciplined approach to managing the tradeoff between margin and volumes.

We've made good progress on costs, and this remains a focus for us going forward as we seek to reduce our total cost base again in 2015. We are updating our 2015 COR target to 92% to 94% primarily due to the higher-than-expected prior-year reserve releases. This still assumes normal annual weather costs still to come of £80 million in Home.

Disregarding the high prior releases, the underlying trends in the first half are more in line with the previous 94% to 96% COR target. Lastly, we are well ahead of our 15% ROTE target in this half year, although again, much of this is due to a higher prior-year releases and benign weather.

As I said at the start, I am really pleased with the benefits of our investments starting to come true; we're not going to stop there. We'll continue to invest and innovate to help us target sustainable returns in these competitive markets. Thank you.

Q&A

A - Paul Robert Geddes {BIO 2474781 <GO>}

Now, we've – for people on the phone, a slight technical hitch, which means that if you have questions, could you email them to Neil Manser, whose email address – hate to broadcast this, hope it doesn't go viral – is neil.manser@directlinegroup.co.uk, and Neil will be your agent in the room. So here's the email and people in the room don't need to do that. You can email Neil as normal.

Okay. So, who's going to kick us off? We'll start in the front.

Q - James A. Shuck {BIO 3680082 <GO>}

Thanks. It's James Shuck from UBS. I'd just like to return to Motor regaining its competitive edge. I mean clearly you've done a lot there and you have fantastic claims applications, and efficiencies got so much better. But the in-force policies have come down quite significantly over the last few years. They're still not returning to growth.

So my question is, I mean, when are we actually going to see real signs of this competitive edge returning? Is 2016 going to be a year of growth for you? Because as you point out, the claims inflation in the market is now, well, currently running – I mean, if you're 3% to 5% and you're slightly above that, so 6%, and the market – you're presumably yielding slightly better than the market, then rates need to start moving well in excess of that. So are you anticipating a cycle turning? Is that the time where you press the growth button? That's my first point.

And my second one is just on the – it's actually on the reinsurance purchasing because you mentioned greater reinsurance purchasing, but then slide 38, which shows your retentions and your deductibles, I can't actually detect any changes between 2014 and 2015.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Okay. 35:08 I mean the last point is a very simple one. It's just that we've got a full year of 100% placement for the full treaty year. So that's the change on the motor reinsurance. We get 100% coverage. We had about 50% I think, effectively because of the treaty year and we didn't close that fully. So fuller cover.

I think on Motor – listen, we take the fact that we've had flat policies and growing GWP in a market like this as a kind of staging post, and one which we didn't want to not remark upon. So internally, it feels like, actually, quite a lot of progress. So we've been a business that has been shrinking, and now we're in a position to say that we have a stable position and a stable franchise.

And of course, actually, to win in the new business market, there's many policies, when you have a big book like ours, in itself daily trading very hard. So we're pleased with our interim step. Clearly our ambition longer-term is growth. But if we suddenly go and chase growth at the wrong time in a cycle, we're going to abandon some of the principles that I think have stood us well over the last couple of years.

So growth is an outcome of our competitiveness. So as I stand today, I'm pleased with our competitiveness on pricing, but we get better every month. Our claims, all the benchmark I think says we have greater claims. Our brands are meaning more to our customers. Our costs are still high, and I still think we need to improve on our costs.

So I think there is definitely more to come, but I'm not going to suddenly start predicting or forecasting growth because I think that would lose us focus on – again, on the value, which is our guiding, our kind of North Star, as our 15% ROTE, and that's really what we want to pursue. But as I say in the medium term, I'd like for us to be able to live with that and growth. And Q2, we did have some growth in Motor, so – which we think is going to be – we're in different place in Motor than we were a couple of years ago.

Q - James A. Shuck {BIO 3680082 <GO>}

And the outlook for the industry and sort of 2015 given the claims experience.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Well, my lawyers are looking at me to – and I'm very good at this. Thank you, Humphrey. We make no forward-looking pricing statements at all. I mean I think your observation about claims inflation in the market is pretty worth just reacting to. So we think, and you can see in the back of the pack, we think we lead the market still on bodily injury frequency, and that's both claims and risk selection. And our own benchmark, which sadly we can't share, says that on small bodily injury severity, we're very good and forward, we're very good. So we think compare well to the market on that.

Large BI, I'm sure someone's going to ask John the question a bit more about 2014. There's a few moving parts within large BI. We may have been a bit unlucky at the market. We may have been. We won't know. But we think there's some industry factors as well behind that. And I think on accidental damage, again, we're pleased with our frequency, but the severity, again, some of those are market-wide factors. We think everyone is facing higher new car prices and credit-higher costs and paints and parts and labor.

So I think in aggregate, we think we are still doing as well better than the market. It's hard to know on the large BI. I guess we'll hear more about that in the result season.

Anything else? Okay. Yeah.

Q - Jon M. Hocking {BIO 2163183 <GO>}

Jon Hocking for Morgan Stanley. I've got three questions, please. On the change in reserving approach for Motor, are there any plans to replicate that for Home and Commercial and ROPL in terms of having a consistent policy?

And the second question, what you're seeing in the sort of 2014 large BI line, has that changed any way your view about PPO formation and reserving?

And then finally, just on the internal model, versus standard formula under Solvency II, once you move on to the internal model, where do you see the big areas of opportunities? Is it mainly reserving or is there anything on the investment side? Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Thanks, Jon. I mean on margin policy, that's a Motor-only thing, so we're not planning to apply that in the other segments, not at this point anyway. On the impact of the 2014 accident year bodily injury increase, what does it say about PPO? The fact is that on PPO propensity, we've not seen it's been very, very stable. So if the overall frequency goes up, yes, we'll have some more PPOs. But there's no change in propensity.

In terms of the model, I think what we've done in the past is shown you on the older – in the old model – so, the ICA-type model, what the relationship is between the different risks, and the reserving and investment, what amount of the capital they take and how we allocate it. And I'm sure we'll do the same under Solvency II. I don't think it's going to be dramatically different because the Solvency II internal model is a kind of enhancement of the existing internal capital model. And the standard formula will be different because standard formula is much less precise in terms of a UK general insurer and has a particular way of doing things like investments. But I think under the transition from the old risk-based capital to the kind of new Solvency II there probably isn't any major change in proportionality. But we'll show you that when the time comes.

Q - Jon M. Hocking {BIO 2163183 <GO>}

Is it possible you have a dip appearing on this before you get it back again when you move to the...

A - Paul Robert Geddes {BIO 2474781 <GO>}

Dip in?

Q - Jon M. Hocking {BIO 2163183 <GO>}

If your RBC is allowing you to take into account some of these...

A - Paul Robert Geddes {BIO 2474781 <GO>}

, you mean?

Q - Jon M. Hocking {BIO 2163183 <GO>}

Yes.

A - Paul Robert Geddes {BIO 2474781 <GO>}

I think we're not at all pessimistic about the standard formula, but clearly the opportunity is in the internal model. So the standard formula is likely to be not far away from where we are today. I mean, obviously, that is yet to be determined, but it's not really far away. The real opportunity – we haven't looked through that. There is an opportunity on Solvency II clearly yet to be finalized and subject to approval. And we haven't been approved yet. But assuming that goes well, there is an opportunity. We've always been a little bit optimistic about that and what it could bring. But it's too early to call it.

Yeah?

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Dhruv Gahlaut from HSBC. Just three questions. Firstly, could you just talk a bit more about the reserve margin given you've had a big reserve release this time? Also, you've changed the basis in terms of the initial pick on the loss ratio in the Motor segment. How does that play?

Secondly, could you also state what your retention numbers are in absolute terms, in terms of both Home and Motor segments, where they are?

And thirdly, are you expecting any changes in terms of the claim trends following the MedCo reform, what has come in in April this year?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. So I'll let John talk about the reserve margin. Listen, MedCo – really, the proof of it will be in the strength of the accreditation process, so, basically, able to kind of come in. If the accreditation progress is vigorous, we think there could be some upside. But as in all of these things, that will go to the consumer pretty quickly as previous reforms have done: still doesn't make it, not worth doing. We think it's a positive initiative. Small claims track would be another positive initiative if we can get the government to adopt it, which we haven't yet.

John, do the reserving. I'll get the retention numbers.

A - John Reizenstein {BIO 6786139 <GO>}

Sure. I mean, starting point is that it would have been nice to have introduced this reserving change at a time when everything was going swimmingly in all possible respects. And in 2014 what hasn't gone swimmingly. But the two things aren't connected. We plan to do the change to the current year reserving margin, which is not massive, but we plan to do that anyway and it doesn't relate to claim trends for any particular period. The reason we're doing it is because we know that our actuarial best estimate is itself pretty conservative, and we were layering on an extra layer of conservative. And what's more, we were doing it in a rather automatic way.

And so we decided to – and it could vary from period to period because we'll look at it as we do our review. But we decided not automatically to book that extra margin in the current year. So that's kind of statement about the current year. And on balance, we'd expect that to continue, although clearly, we look at it each time.

And we do from time to time make one-off payroll-specific margins, if we see something that we don't like as well, that could happen. But this is a statement about our kind of regular margin that we were doing.

In terms of the prior years, we continue to have a strong ABE, which sees reserve releases and a very strong margin. So our overall reserve position remains just as strong as it was the last time we talked, but we have made that change for the current year.

A - Paul Robert Geddes {BIO 2474781 <GO>}

On our retention rates, I'll round it off a little bit, but Motor's over 80% and Home's 85% in the second quarter.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Thanks.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Right. Keep moving backwards and then we'll – come again.

Q - Andrew J. Crean {BIO 16513202 <GO>}

Good morning. It's Andrew Crean just for Autonomous. I've three questions. Following up on Solvency II, we've all been waiting for you to resolve Solvency II and then potentially look at your capital position. Now, you're saying that there's a sort of stepping-off point in – with the standard formula in January, and then in July, you get the internal model. How would you deal with any potential capital return? Would you look after the full-year figures through to the internal model, or would that have to wait until this time next year?

Then the second question on nationwide, could you be a little bit more specific on if it's 23%, your Home premiums, what is your profit, and are you in that calculation thinking about cost overruns elsewhere if you lose that volume?

And then thirdly, on this sort of perennial issue of trying to predict your Motor reserving release, it will be enormously helpful if you could give the – I mean, you released 24% of premium. If you could give us, when you set up a current year, what level of margin against best estimate are you really looking at? Is it 10%, 12%, which is what Admiral will do, or is it more or less? I mean, how does it reflect against the 7% reserve conservatism that you go into market with?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Well, I'll let John think about how he'll answer that question. I'll just cover briefly on nationwide. So it's a lot less than 22% of profit. It does make contribution to fixed costs, which is what that – basically, the profit that's left. So we would have to, and again, this is not a certainty. If in the event that we lost it, we would have to absolutely make sure that we took the variable costs out when have attritions. So we think that's a way of doing that quite smoothly. And then it would just add an amount – I won't say the amount, but an amount to our central cost challenge effectively we need to cut out. There are other moving parts in terms of the rest of our partnership business that may help offset some of that as well. So we'll...

Q - Andrew J. Crean {BIO 16513202 <GO>}

If you do this, could you give us this figure? Because it might be important.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah, we will. Yeah, we would.

A - John Reizenstein {BIO 6786139 <GO>}

Yeah. I think on Solvency II, I didn't think there's any new news. I think we've mentioned 1st of July. We'd mentioned standard formula before, as I think we have to go through for a few months – hopefully for a few months. And what we've said is – I'm going to stick to the script, I'm afraid, which is that the first time, we'll look at what we should do with our – whether we should have any return of capital beyond or will it be dividend will be at the year-end. That's the first time we'll look at it.

And when we look at it, we'll look within a state of knowledge. And if we know lots about Solvency II and internal model and we've had good news on [PRA] and all that, then we'll be in a better position to do something. But if there's still lots of clouds and we don't know where it's going to end up, we might have to delay it. But it's moved from time point to time point, and we'll keep you in the picture. And I think our track record is we've been fairly – more than fairly open about our capital position and been very clear about – that's something which we will distribute, and we have done.

On the reserving, all I'd say is we do give – we may not give quite the same information as other companies, but we do give some information. Firstly, we do give core guidance. We update it, as we've done today. We give you a view on trend on prior year, where we're going with that. We talk a lot about current year. And I appreciate we – I'd love to be able to give you more, but that's kind of – that's the package, if you like, where we are today. And we've had that discussion before, and I'm sure we'll reflect on it. But at the moment, that's the package.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Okay, keep it in the back. Anyone on the – good.

Q - Gordon Aitken {BIO 3846728 <GO>}

Thanks. It's Gordon Aitken from RBC. Your costs are down 8% in the half, and I noticed the staff costs are up slightly. Just wondering why this is, and have we reached a point, say, where staff numbers can't be cut any further? And just on your penultimate slide, Paul, you've had all those things going on, those initiatives you've done. I noticed 34 sites out of 19 in 2010. Another 5 sites exited the next year. Just could you remind us where we are now and where this can get to in terms of number of sites? And just a final point is on the insurance premium tax increase. I mean, in your plans, are you expecting more people to shop around?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Okay. So on IPT, we will collect the tax, and I can't make any future statements on pricing. That's all I can really say on that. So we'll see if the market will be efficient, and our pricing strategy and our pricing stance. But I can't really say any more on that.

On sites, listen, I'm not going to make future site announcements here. We've managed our process of reducing our sites very effectively. Our staff engagement is high. We've treated those affected. We have no immediate plans for any other, but it's something which we keep under consideration. We've got very, very good sites in good strategic places. We've continued to invest in our sites. We buy some of our sites, but there's currently no news on sites. But your costs observation and the underlying – John, do you want to cover?

A - John Reizenstein {BIO 6786139 <GO>}

Yeah. There is actually underlying improvement in staff cost. You just can't see it. The underlying improves about between 3% and 4% year-on-year. There's been a bumpiness on the – that comes into the reported statements, and that's due to allocation to claims and allocation to IT project, but essentially underlying is in the right direction.

A - Paul Robert Geddes {BIO 2474781 <GO>}

And we continue, as I've said before, short-, medium- and long-term actions to challenge ourselves and our efficiency. As we've said, probably longer-term, self-service we do see as an opportunity for costs to change in the sector, and us in particular. We actually have a number of longer-term levers, but we have short-term levers. We still can engender more of a cost culture. We can still reduce bureaucracy. We can still reduce committees. We can still reduce – yadda, yadda, yadda. And we're not done on that. It's a continued focus. But I am proud of our engagement scores at the same thing running – improving across this picture as well. So we're managing those two things that I've said before. It's very important you don't let one go at the expense of the other.

Yes?

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

Andreas van Embden, Peel Hunt. On your new business sales, could you comment how much those are through press and websites? You mentioned you're doing more there. And is this only the threshold brand or is this across the board?

And my second question is you mentioned one of your slides that you're in to beat claims inflation. Assuming this is mainly on the Motor side, does this mean that you're looking to improve your margins over time or just trying to keep them stable? Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Let me give you one-half answer, and John can finish off the margins over time. So on PCW, about two-thirds of the market is sold through PCWs on motor, and that's stable, actually. So PCW haven't grown their share of motor in the first half, which is a bit of a feature. And that's partly, we think, the fact that I think we and Direct Line and Aviva are doing quite a good job of giving customers benefits from going Direct. And the Direct propositions, I think, are kind of fighting back, but giving customers reasons to shop Direct. Against that, we're about 45% of our business is written on price comparison websites.

Home PCWs are growing, largely from the bank channel. They're just crossing about 50% line, and we are about 30% of our business, I think. About 30% our business is on PCWs.

Churchill, we play of own brand, Privilege and Churchill, and we – a number of our partner brands are on as well, I think it's at Sainsbury's. We slightly changed tack to make Churchill a bit more competitive versus Privilege, and that's had the benefit – Churchill has some benefits which the customers are opting more positively for the brand. They tend to buy more things, be stickier, and so have some positive characteristics, and we've been able to afford the competitiveness through a lot of the pricing that we've done, particularly on price comparison website, our pricing algorithms there. So it's quite nice to see the rise of Churchill versus Privilege on that.

So, beating claims inflation – yes, we try and do that, and we have various trackers to make sure that we do our – I've actually probably talked about most of them, how we do. So we do benchmark quite significantly, and we show only some of the latest data. While I can't be precise on this, large BI.

A - John Reizenstein {BIO 6786139 <GO>}

And you're talking about claims inflation beating market claims inflation, whereas I think Andreas is talking about our pricing beating our claims inflation. And obviously, in the first half this year, we didn't manage to do that. That's why we have that little red bit in the current-year waterfall, which we'll learn through for a few more periods, by the way. But – so that's another challenge, obviously. I think in terms of competitive – ultimately, that's about competitiveness. And probably we will continue to try and use the lever of claims and pricing to achieve competitiveness. But probably, the more powerful lever now is – for us it's going to be costs, as Paul was saying earlier.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Okay. Let's keep going. We'll switch through, switch sides.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. Andy Hughes, Macquarie. A couple of questions, first on the household side and then on Motor. So, nationwide is 22% of premiums and a lot less of the profits. Does that mean RBS is a lot more profitable than nationwide? Must be. And so nationwide is kind of arm's length, is there kind of risk there for repricing at some point in the future?

And second question on the Motor stuff, so to take you back to slide 11 which shows the movement in the kind of current year 2014 H1 to H1 2015, obviously, it's based on the H1 2014 at H1 2014. So if you did that today with H1 2014, it would look a lot worse. So you'd see 0.5%, I presume to be a lot higher. What's the number now? I think it's a general question coming back on the reserve margin. Obviously, you've increased the reinsurance. So even if your reserve margin is the same, your actual amount, pound sterling, is reduced. If you're releasing £200 million from the Motor book, how much are you putting in? I mean, it's obvious to me they're substantially lower in the 2015 year, but I've got no way of knowing what that number is. Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Let me do Home initially. So we've said over time that partners obviously share in the profitability of that. They bring a lot to the party and get a lot of the profitability. So our own brands are more profitable than our partnership business, so I hadn't made any comment about relative profitability, and you wouldn't expect me to with our various partners. But my comment is more about own brands versus – so that's why the split is half. Partnership is half our Home business, but not half our Home profitability.

I would just remind you that we did renegotiate the RBS contract at a time when we were exiting the bank, so I wouldn't call it kind of – I think we did do it on an arm's length basis, and I think it was done on commercial terms. But obviously, you wouldn't expect us to share the detail on profitability. All of that's confidential with each partner. John?

A - John Reizenstein {BIO 6786139 <GO>}

Yeah. I mean two points. First of all, you're right. I mean, these numbers on page 11 are our reported numbers. And if you looked at the developed number, it'll be worse than 2014 on that page. And then, the waterfall would look worse.

I mean, we have booked 2014 higher than 2015. So, 2014, we have more certainty about that it's a bad year than we do about 2015. 2015 is still a premium year for the large bodily injury. And as I mentioned, both 2015 and 2014 are showing a couple of points of encouragement in the very last data point we just had for July.

So, 2015, we'll see what happens. We're obviously watching it. 2014, we know, is a bad year although there is some scope potentially for it to be a bit better than we've booked. So accept that, but that's where we are.

On the margin point, I think we aren't adding automatically new margin to the book of margin. But the overall reserving strength, taking into account the strength in the ABE as well, remains very strong. So yes, over the very long term, all other things being equal, by not adding that margin, it will go down as a percentage of things kind of flat in terms of the book. Then, overall, over quite a long period, it will go down.

But we talked about the 7% margin at the IPO. We've talked about the reserved conservatism within the ABE, which you can add to that 7%, although I haven't said what that is. And we've also said that the 7% is higher – we've said this at year-end, and it still is

– than it was then. So the overall incentive is very, very strong. But yeah, over the very, very long term, by not putting that extra bit in, it will go down over time.

Q - Andy Hughes {BIO 15036395 <GO>}

Could I just ask a quick question? Because on slide 10, you showed the large claims' severity and frequency at H1 2015 having increased rather than gone down. So, I mean, I don't know. You said 2014 is what it is. But it sounds like...

A - Paul Robert Geddes {BIO 2474781 <GO>}

Now, that's against our expectations, right?

Q - Andy Hughes {BIO 15036395 <GO>}

Right.

A - Paul Robert Geddes {BIO 2474781 <GO>}

It's not against the prior year. It's against our expectations.

Q - Andy Hughes {BIO 15036395 <GO>}

So H1 2015 was better than the large claims in previous periods?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Well, it doesn't matter in terms of the very largest anymore because they're all reinsured. And the – at £100,000 to £1 million, it's still elevated. We've said that before, and therefore higher than our expectation. So we've said it's elevated. We haven't booked it as high as 2014 because we don't know for certain. It's yet to be fully developed. And that's where we are. If you like, there's a bit more risk on 2015 than there is on 2014, but we're comfortable with the total position.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Good, yes. Deepinder, front. And then we'll go to Neil and then – sorry. Anyone with questions you want to get into our discussion? No, very well. We'll stick with the process.

Q - Deepinder Bhatia {BIO 2187897 <GO>}

Deepinder Bhatia from Bayard Asset Management. This is slightly a longer-range question to do with driverless cars. So, clearly, we're not going to see millions and millions of driverless cars on the roads anytime soon, but the glide path is beginning to emerge in some way. And I'm just curious to know what research Direct Line has done internally to study the issue and how you think this might play out. What are the kinds of scenarios by which it might play out, and then what opportunities and risks do you see to the business model, not just for yourself, but perhaps for the insurance industry as a whole? Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

It's a great question and one of my favorites, and it's something which is increasingly getting attention. And there's a real buzz now about driverless cars.

I think I share your an analysis, which is for the percentage of the car park which won't have steering wheels I think will be quite low for quite a long time. But that sounds a bit sort of head-in-the-sand about it, because what I think will happen is technology will continue to reduce the frequency and potentially severity of accidents. Frequency of accidents has been continually coming down with new technology; severity has been offsetting it. So I think there's some deflationary pressures.

And I think the clear and present topic, I think, is somewhat the technology which could – which is being developed in semiautonomous cars could come more quickly to the mainstream cars, and semiautonomous brake, I think, is a good example of that, which if you buy a car today, it will likely have semiautonomous braking.

Our strategy is a few-fold. One is that we want to be the insurer of choice for lower-risk cars like that, so we want to be proactive in assessing the risk of new stuff and offering the best prices on it. So we want to have an expertise in assessing this technology, and very, very quickly, pricing it and then reacting whether we've got the pricing right or wrong. So that's one of the things which we're working on.

Secondly, we do think that it's important to continue to talk to motor manufacturers. And we have a current relationship with Citroën, and we want to have more conversations with them because they're also working at what the future looks like.

I do think the currency which we can talk to them with is our expertise in telematics, which I think is a potentially monetizeable feature of the cars which are equipped with these boxes. We are developing, I think, maybe UK exclusivity with The Floow. I think The Floow is developing a global reputation in this area, and we, through The Floow, through our quarter-billion miles of data, are developing some very strong insights about what data matters and what it can do, and we're learning about what customer expectations are, how we use the data and what discounts we offer. So we are people that, I think, manufacturers would want to talk to, and we want to talk to them. So that's our kind of three-pronged approach.

So long-term, I think this could get – no steering wheels in any cars, quite a long – science fiction, if it ever happens. But I think some shorter-term opportunities.

That was our break, right? Okay.

Q - Alan G. Devlin {BIO 5936254 <GO>}

Thanks. Alan Devlin from Barclays. A couple of questions, first of all just from a large BI, coming back to that, do you think that's a step-up, a one-off step-up within frequency or is it going to be a trend and continuing? You alluded to the fact that there may be an acceleration in the recognition of incurred. I wonder if you could elaborate on that.

And then secondly, you talked about being a disruptor, particularly in telematics where you're expecting to double the amount of telematics policies this year. I wonder if you could just let us know your view on the early learnings from that so far. Thanks.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. I mean, telematics is a profound – profoundly important thing, and everything we hope to find from the data we have found, and it's deeply predictive. If you're effectively sitting next to a driver, know when, how, and where they drive, it's better than knowing their profession and their age, right? So, certainly enriching on top of that data which we already know. The issue is the cost of access in that data is quite high, and the customer also expects a discount to pay for it.

So those economics have kind of started to work for young drivers. I wouldn't be doing the amount of young drivers that we're doing without it. But we'll – to go mainstream, it probably takes the technology costs to come down, which is either building those into the cars or some form of cheap plug-in device or cracking it on smartphones, which it hasn't been cracked to-date, the issue about it being always on the quality of the data. We kind of are, therefore, device-agnostic, and we're interested in the data. But for this to become a mainstream thing, it requires a step-change in the costs. The large BI trend?

A - John Reizenstein {BIO 6786139 <GO>}

Yeah. I mean that's the £64 million question. I mean, this is what we're very focused on. But I think we're going have to be patient because this is slow developing. That's why we're getting news releases from 2013 and 2012 and 2011 and so on. If it is process change, which kind of will be good news, I mean, it will be sometime probably before we're prepared to fully recognize them. At the moment, we haven't recognized it at all. We're just assuming it's bad news. Now, as bad news, we're kind of assuming 2014 – we book and we price on long-term trends – trendy view on large-volume inflation because it's so volatile. And it takes a lot to shift us off that trend. So, 2015, on that basis, is a one-off. But it is a little bit early to tell, and because it's an at elevated level in 2015, we have to be a little more cautious on that. I'd love to know the answer, but we aren't quite there yet.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yes – actually, before we come up for seconds, why not give everyone chance for their first? Then we'll do phones, then we'll come back to you.

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

Hi, guys. Fahad Changazi from Nomura. Could I just follow up on Andrew's question rather – I'll probably just ask the same question. As I wasn't clear about in terms of how you phrased the answer regarding capital return, so if we don't have certainty on Solvency

II in December, will you delay returning capital for the year or just be very conservative in terms of what you'll return at full-year?

A - John Reizenstein {BIO 6786139 <GO>}

I don't think I've got very much to add. I mean, we're trying to – we're looking forward to the decision we'll be making – being made by the board. We've had lots more feedback from the PRA both about our application for internal model and about standard formula because you have to apply for the standard formula as well. And I certainly we do not have a crystal ball, and we will – I think our track record says we will be as generous in a way it's warranted given our policy not to hoard capital.

We've got to go through a process of determining the risk appetite range around our capital. We know what it's today, 125 to 150. But Solvency is a different thing. The internal may start at a low level but it's more volatile. We've got a lot of work to do to get that point. We will definitely know much more in six months' time. Whether we know quite enough, I just can't predict. I'd love that to be the case. I'll do my best.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Okay. We'll come back to you. So does anyone – got a first question? Yeah.

Q - Oliver G. Steel {BIO 6068696 <GO>}

Oliver Steel, Deutsche Bank. Why have you lowered your investment return guidance? Is that simply a matter of forward rates or is it something else?

A - John Reizenstein {BIO 6786139 <GO>}

Yeah. It's a little bit of forward rate there. The rate picture is a little bit – a few moving parts there. So these short-term rates, i.e., for 12 months and below, have gone up as people think that's now more likely to happen than sooner, and we assume it's the end of the year.

But actually, the yield curve – the forward yield curve from medium-length maturities has actually softened a bit, which makes reinvestment a little bit more pressured in terms of rate. But actually, the other driver is simply the progress we made with our new investment classes. So, some are going better than others. So infrastructure is going fine, but private placements is a little bit slow. And so, it also reflects our kind of current view on how fast we'll get these things done.

Q - Oliver G. Steel {BIO 6068696 <GO>}

So just a follow-up on that, I mean, if we then look at, say, 2017, are you still aiming for the same sort of investment mix as you originally were?

A - John Reizenstein {BIO 6786139 <GO>}

Yeah. The mix is clear. It's just the pace of getting there that's a bit slower. And we haven't made any changes to mix since last time. But we constantly look at new things, and we might have some new things to say later in the year.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Okay. Can we just go to Neil for the one more in the room.

A - John Reizenstein {BIO 6786139 <GO>}

Bits from outside the room.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Sorry. The young man upfront.

A - Neil David Manser {BIO 5571223 <GO>}

So, I've got a question from Greig, KBW.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Oh, good.

A - Neil David Manser {BIO 5571223 <GO>}

So it's a question on telematics. So can you talk about what's going on in the market for telematics, and secondly, profitability for telematics?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. So I kind of think I've slightly answered this. So we're certainly seeing that the loss ratio improvement is meriting the cost of the discount. We're saying that we are renewing the drivers that we want to renew better. We're saying that there are some startup costs, so we're not kind of there yet. There's some quite high one-off costs, or the boxes are kind of a bit subscale.

But all of that saying is we've got a – we think we got an economic model that works beyond drivers, taking all that into account. And I wouldn't want to be without it because who's to say, if we didn't have it, what the profit impact would be. But I think it's going to take some change in technology costs.

Yeah, market. I think people are trying different things still. So, some people persisting with apps. We think apps long term could be interesting, but there's some technology – iOS interfaces which we need to work on. And, again, the flow, our partner are doing some interesting stuff in the States with apps.

Other people trying different sorts of plug-in devices. We plug ours into the OBD port. Others will be plugging into the cigarette lighter. Both have merits. One is more easily accessible, but it can be dislodged. And we quite like ours because they also get some engine diagnostics. We're also piloting using this engine diagnostics on Green Flag, and we've a policy with customers giving them feedback on what's happening to that car. So if the warning light comes on, we call them or they can call us, and we can diagnose it. So I quite like an access to the OBD port. Does that meet his needs, do you think, Neil? Excellent.

Can we – sorry, just again the first one and then we'll see if we've got...

Q - Ashik Musaddi {BIO 15847584 <GO>}

Just one quick question. Ashik Musaddi from JPMorgan. Can you give us some update on the regulatory front apart from Solvency II? Was there any big pending issues at the moment or are you envisaging any new issues that are coming on your way be it price comparison website or FCA-related viewers? Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Sure. I mean, I think the PRA is busy with Solvency II and obviously stress tests and where we think we will place on that. The FCA have quite an extensive agenda, and some of those studies are going towards the end of consultation. PCWs, we have an appetite for some enhancement to how prices are displayed for people who want to pay monthly so that people get those stacked. So that's the current conversation. Another conversation is about disclosure of claims ratios, and we're trying to work again at the ABI level with the regulator on how we do that in a way that's helpful to customers.

And it was also flagged in the budget. The ABI again is trying to work to a standardized approach on how we put renewal premiums on to renewal letters. So if you can see the previous years, it's not as easy as it looks because you have to decide if they change their policy, do you restate the premium. And there's also some technology challenges for most insurers, I think.

So there are kind of a range of issues in the later part of the implementation where it's all about the detail of implementation. We're working closely at the ABI level with the FCA. But as I said, I think new studies, I think – there was a big hiatus of stuff, and that's kind of largely working its way through.

Right. We'll do final one. If we cannot meet your needs, we can do so over coffee. We'll have one more, okay?

Thank you. Just a couple of things really. The first one is on the – I can't get you to make a forward-looking statement on pricing but maybe I can get you to look at a retrospective one. So if the large claims increased significantly in 2014, do you think this contributes to the price increases we're seeing now? So if this goes away or moderates, does that mean that price increases stopped and turned negative? Or do you think there's another driver behind what we've seen in terms of price increases that we've had recently?

The second bit was I just want to kind of clarify John's comment a bit where he talked about – all I wrote down was 2015 is a bit more risky. So maybe we could kind of investigate that a bit more in terms of kind of what do you mean it's going to be more volatile in terms of the book loss ratio, or – thank you.

So, large BI on a gross basis, is only about 15% of total claims costs. So that's just what we've disclosed in the chart, which is hopefully useful. I guess observation just on to-date – I won't talk about the future – is the market is priced probably 1.5% over the last year cumulatively, 2.9% in the quarter. We think our claims inflation has been over our 3% to 5% target. Now as I said, you could probably debit off – maybe we've been unluckier than some on large BI. Maybe we've done a process change. But then again, we also know we've probably beaten the market on small BI, which is a bigger peril.

So, I don't know, we'll know more with you in the next few weeks, hopefully as people disclose. But I think there is – again, no forward-looking statements but I think people are pricing – we think claims inflation has been there for a while. We've been talking about it for a while and pricing is only now even just starting to kind of catch up with that. I make no forward-looking pricing statements. Prices can go down as well as up. Am I right? I'm afraid, have I said enough? Good.

A - John Reizenstein {BIO 6786139 <GO>}

Yes. What I meant to say, [Ali], was we booked 2014 higher than 2015 because we have more certainty that it's a bad year. That's what I meant. We could – the chance of being wrong are a little bit higher on 2015, probably, than 2014. But as I've mentioned the last piece of data is quite encouraging for both.

A - Paul Robert Geddes {BIO 2474781 <GO>}

But pretty certain on that 2014 is not going to get much worse because we've booked rather conservatively, as we said.

A - John Reizenstein {BIO 6786139 <GO>}

Just going to previous question. There is one other for regulating, which is Ogden. This is a long saga, but there is a public consultation out for – or actually, there's an expert group looking out what the rate should be and they're expected to report back in – I think it's September or October. We don't know what they're going to say and we don't know what will then happen either. So it's possible they come out with the rate that the government will accept or it could get – kick the can. It could get hit down the road again, but that's another thing that's going on.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Terrific. Thank you. Neil, no other last?

Okay. Thank you, everybody, for your questions. We look forward to see you next time. We have Goldman Sachs coffee and biscuits, which I'm sure are excellent. So please, join us for those. Thank you very much.
