FINAL

Bloomberg Transcript

Y 2019 Earnings Call

Company Participants

- Adam Westwood, Chief Financial Officer
- Geoff Carter, Chief Executive Officer
- James Ockenden, Chief Actuary
- Trevor Webb, Claims Director

Other Participants

- Andreas van Embden, Analyst
- Ben Cohen, Analyst
- Ming Xu, Analyst
- Nick Johnson, Analyst
- Trevor Moss, Analyst

Presentation

Operator

Welcome to the Sabre Insurance (Technical Difficulty) your host today, Geoff Carter from Sabre Insurance to begin. Geoff, please go ahead.

Geoff Carter {BIO 20756770 <GO>}

Thank you. Good morning everyone and welcome to our Annual Results Presentation session. Clearly, this is not our usual approach as we're all phone based and we're all in different places. So please bear with us if we have any IT challenges, but hopefully not. We're obviously very aware presenting these results in a difficult and challenging period for many people and at a time of the fast moving change.

We are going to discuss our thoughts on COVID-19 in some depth, but don't want this to be the sole focus of this session. Though you're aware people have access to the slides, if you haven't they are on the sabreplc.co.uk website. And me sitting in the room by myself, reading out the slides to you could become fairly dull, fairly quickly. So we're going to pick out the highlights in the slides and then allow plenty of time for questions at the end if that's okay.

I will try and remember to say when I turn pages on the slides. If you go to Slide 2 and whose is presenting, same faces, same old faces here, myself, Adam, Trevor and James. At least, I assume they are out there and I'm pretty certain they're not dressed like that if they're dialing-in from home.

To move on to the agenda, we're going to talk through the 2019 highlights, the financial results, the market context, a brief reminder of our strategic approach and then a summary and our outlook, sort of pre and post the COVID-19 impacts. And then as we said at the end, we'll have a Q&A session.

So perhaps, if you move forward to Slide 5. As a headline, we're very pleased with the results for last and we're confident we can trade well this year as well. We start tightly to our strategy and principles, both of which we will recap later. We delivered robust results, I think in a very turbulent market. Underwrite -- even underwriting performance -- year-on-year premium delta, the premium gap closed slightly in the later months of the year. So we ended up slightly better in terms of premium than we expected. And that's despite having pushed through rate increases in excess of 10% during the year. Maybe tight focus on covering the ongoing significant claims inflation and also other cost inflation, that we will speak about later.

After much discussion as a Board, we are declaring the final ordinary dividend today of 8.1p. We are deffering the special dividend declaration pending greater clarity on the COVID-19 impacts, and we fully considered, at great length, the recent PRA and the IP [ph] communications. The Board may propose an interim -- additional interim dividend later this year to return excess capital. It's probably noting our thoughts on capital haven't changed at all. We view anything over 160% of our capital range to being surplus during our requirements and far better return to our shareholders who can invest it more creatively. So no change to our principles here. Our coverage -- our SCR coverage was 214% at the end of the year, with this slightly reduced ordinary dividend, a 180% post the interim dividend.

You can see the key numbers on the right hand side, very good loss ratio. Expense ratio exactly we expect and combined ratio also pretty much exactly what we expected at slightly below our long-term target of 75%. We move on to operational highlights. We're seeking to be boringly consistent in our focus on the things that really matter. We're looking to track and cover the long, long claims and cost inflation. We want to optimize our profit within our COR corridor, broadly that 75% to 80%. We'll talk about them in a few slides time how we do that. We're looking to understand the possible changes during the whiplash reforms. And I think as everyone on the call knows, we are prudent and conservative in our outlook on how much benefit they might deliver.

We're continuing to rollout innovative new rating factors, and they're continuing to do that despite the fact we're all working from home at the moment. Increasingly, we are integrating machine learning into the claims and the underwriting process. And clearly at the moment, we are responding to the COVID-19 operational challenges, but we return to many of these points later in this session. Few of the more interesting things we've done, Insure2Drive, our direct van product, is now rolled out to almost all price comparison websites.

We've agreed a new distribution agreement with Saga, to launch mid-2020. Clearly, everyone work from home gives us some challenges around the time scales on that, but we intend to get that way as soon as we can. We've appointed Goldman Sachs to help us manage our investment still within very conservative guidelines, our views have not changed that our investments are there to fuel on the underwriting profit, not to be a key driver of our profit. Fully high levels of staff retention, over 90% of the colleagues recommend Sabre as a place to work, which is fantastic.

As I think, we've not spoke about much in previous years is we do look to reward our colleagues who are supporting our success. We have a range of share schemes, bonus schemes. And we also pay an annual bonus, I think net of tax this year that was GBP1,250 for all staff. Importantly, we continue to try and expand our underwriting footprint, so we can offer our prices to more and more customers. At the moment, we're up to about 98.5% quotability.

So at that point, I'm going to pause and hopefully Adam is out there somewhere and can talk about the financial results.

Adam Westwood {BIO 20481660 <GO>}

I am. Thanks Geoff. I do hope everyone can hear me and is well.

Let's move straight on to a summary of our 2019 result which is on Slide 9 of the pack. Top-line premium came in at GBP197 million for the year. So below 2018, but as just said a little ahead of our expectation, given the level of price increases that we put through during 2019. Net earned premiums, down of course, but it does benefit from the earned through premium written in 2018, and being a net earned premium also benefits from a small decrease in our reinsurance rates from July 1, 2019 renewal.

The combined operating ratio remains pretty healthy at 73.4%, albeit adversely impacted relative to 2018, both by claims costs and slightly increased fixed cost base set against a reduced premium. We'll talk in a few slides about how we think about writing premium at different levels through the cycle. Our investment return continues to reflect the market value movements on our gilt-based portfolio. And the gains in 2019 reflect market-wide movements in gilt-yields. And I'll talk a little bit more about investments as well in a couple of slides time.

Profit after tax is, as you would expect function all of these metrics with earnings per share being proportionate to profit. We declaring, as Geoff said, a total dividend of 12.8p for the year, which is approximately 17% of our adjusted profit after tax. And as such represents our ordinary dividend as per our dividend policy. As Geoff mentioned, we are deferring payments of any special element of the dividend at this point. We've discussed the dividend with our regulator in the context of recent communications from EIOPA and the PRA.

We consider the dividends to be prudent and full within our own risk appetite. The distribution of capital we are making, demonstrates our confidence in the robustness of our business and the strength of our balance sheet, while recognizing the challenges and uncertainties presented by the unprecedented environments in which we currently operating. Our solvency position remains very strong at 214% prior to the announced dividend and 180% after the capital required to fund the dividend is subtracted.

So if you move on to the next slide, there is a breakdown of our underwriting performance, that's Slide 10. As ever, we should look at our expense and loss ratio separately. Our loss ratio has continued to benefit from strong prior year releases, with the financial year loss ratio of 51.5%. That's net of a prior year benefit of 11.3%, which is a little higher than in 2018.

During 2019, the group sought to optimize profit by writing business towards the top end of its preferred combined operating ratio corridor, which is between 70% to 80%. That along with the historically high levels of short-tail claims inflation resulted in a higher current accident year loss ratio than in 2018. First glance, our expense ratio appears to have improved year-on-year. However, we are keen to point out that this did benefit from a one-off reduction in an accrual held against industry levies, which reduced our overall expenses by around GBP3.3 million.

Without the benefit of that, our expense ratio would have ticked up a little year-on-year to around 24%, which is driven by an increase in underlying levy cost, an increase in our staff costs, both of which were effectively fixed against a lower top-line. Together these contributed around 1.5% to the increase in combined ratio this year. The increase in staff costs, the result of the combination of inflationary increase in salaries and through share scheme costs at our commitment around an excess of resource in our claims team in anticipation of future growth. The increase in industry-wide levy across is -- as I say, industry-wide. And as ever, we've implementing rate increases to cover the costs going forward. This all remains well under control and we continue to cover the increase in cost of claims and underlying buying expenses within our prices.

If we move on to the next slide on investments and our conservative approach to risk. Our investment portfolio during 2019 will be familiar, being almost entirely invested in gilts. And in January 2020 we appointed Goldman Sachs to assist with our asset management, with a mandate to maintain low capital, low risk portfolio still predominantly gilt-backed and to markedly increase our yield over the long-term.

We've chosen to step carefully into a revised portfolio and currently have invested 5% of our assets into highly rated corporate bonds. We've got no direct exposure to the equity markets, and a well placed to write out the current market turbulence. I should add, that we have also chosen to increase our cash reserves since year end, in order to make sure we maintain sufficient liquidity and can easily meet the cash requirement of our dividend.

So if you move on to the next slide on capital generation. We have continued to generate significant capital during 2019, and we've carefully considered the level of dividend will pay against the current market conditions. We're confident in our business model and continue to consider the best use of our excess capital to be to return it to shareholders in a prudent and orderly manner.

Our dividend policy remains to pay out 70% of our profit after tax and to consider an additional special dividends to distribute any capital we considered to be surplus to our requirements. We are announcing a total dividend of 12.8p in respect to 2019, which means at year end ordinary dividend of 8.1p due to be paid in May. We will continue -- we'll keep our level of surplus capital under review as events develop, and hope to return to our preferred SCR range as soon as it makes sense to do so.

The solvency capital ratio having subtracted the cash required to fund the dividend, remains a very healthy 180%. I would add that we've seen no significant adverse impact on our solvency as a result of the current economic and market conditions.

Moving on to my last slide, approach to capital management, Slide 13. It's really a reminder of the -- our overall approach to capital management, and it will be familiar to people that have been in these presentations before. As I said, in normal circumstances, we prefer to operate within a capital range of 140% to 160%. And generally manages through the distribution of surplus capital via dividends.

As by convention this is measured as being the period end position less the cash required to fund any year-end dividend payment. And as the dividend is not paid until some time after the period end, the actual level of capital held over the last two years has actually being considerably higher, as it demonstrated by the chart at the bottom of the slide.

And on that note, I will hand back to Geoff who is hopefully still there to talk through the market context.

Geoff Carter {BIO 20756770 <GO>}

Thank you, Adam. Funny, you say that, my own phone dropped out. I hope you (inaudible) for the last two minutes. Okay. So we all -- as usual, I'm going to go into some detail on our view of the current market position, and we'll try and maintain our position as given the most (inaudible) for the annual results presentations. If we move on to the claims inflation side, importantly, we don't see claims inflation tied enough. Our view is virtually the same as we had last year. And if anything, we think the long-term trend might be slightly upward. The fact is we've got -- very similar, our overall inflation is 7.5% to 12.5%. The bent metal costs still at 10%, theft over 25%, while PI frequency is flat, and severity is still inflating.

I guess, importantly, the mix of business underwritten maybe a factor in different insurers having different views. On the claims inflation number our best guess is that, if you start writing any high-theft risk policies, that might be worth 1% to 1.5% on claims inflation. So we could see happy to maybe at a level of around 6.5% compared to our quote [ph]. Importantly, over the medium term, we really don't consider claims inflation a problem, providing its identified quickly and we can increase prices appropriately.

We're going to the next slide, Slide 16, to break out the bent metal claims, in a bit more detail. This isn't just about the parts and the cost of repairs, it's also about the migration to credit repair models, which as I'm sure most people on the call now are significantly more expensive than fixing the car ourselves through our own network. We're looking to capture our own and third-party vehicles to mitigate these industry driven increases.

We thought it might be interesting just to breakout on the next few slides some of the drivers of the bent metal cost inflation. I think as people know, we outsource our first notification of loss and management repairs to the innovation group. The innovation group facilitate repairs across a whole range of other insurers and partners. Our best guess is this gives us the same buying power as and insurer with about 4 million motor policies, which takes away any concerns we may have that our smaller scale, those has exposed to a disproportionate claims inflation.

This analysis is across all the repairs, not just the Sabre portfolio. So if you flick on to the first one, which is a Ford Fiesta, the key information here is a manufacturer of list price increases over the last six years. So if you take an example here, the front bumper on the Ford Fiesta has increased by 7% between 2018 and 2019. Probably slightly simplistically front-end damage could be fault claims and rear-end damage non-fault claims.

If you flip to the second slide, you can see a very similar thing shown Vauxhall Corsa. If we take the headlamp cost, increasing by 23% year-on-year. So, not quite worked out why a left headlamp is more expensive than the right headlamp. No doubt, Trevor going to explain to us later if people are interested. And finally, Volkswagen Polo, very similar message across all these cars. And the key message here for us, is that parts are getting significantly more expensive even for fairly normal much of super-tech or very advanced -- very advanced vehicles. So I'd -- this looks to us very clear evidence of one of the drivers of ongoing claims inflation.

If you flick on to Slide 21, look at the premium inflation position. This is our view of what will happen on premium. We believe right, gently increase in late 2019, but then there was a sharp acceleration as we came into Q1. But always a bit cautious here to say, it could be a premium increase or it could be people moving away from the types of risks, that we tend to underwrite. It's probably too early to say what impact COVID-19 have on this in the medium term. Our belief is any impacts on COVID-19 should be fairly short time, and we'll talk about this in much more detail in a minute. Importantly, any of the short-term impacts are not changing the fundamental drivers of claims inflation.

If you go to next slide, Slide 22. Last year you may recall, we presented a seesaw, which showed the market pretty finely balanced between the drivers for price increases and decreases. That's not how we see it this year. We believe it's very heavily weighted towards the need for price increases. You can see on the left hand side, the premium inflation factors. So that's the underlying claims inflation. That will inevitably lead to some competitive margin squeeze. The whiplash reforms, we will talk about in a second. The lawyer response (inaudible) legal reforms, we think will be fairly assertive.

The FCA pricing review will have an impact. As will the industry luggage around the MIB, which perhaps doesn't get much exposure, and the Insurance. We'll talk about all these now -- bit more detail in a minute.

On the other side, the only deflation -- long-term deflation factor, we see the whiplash reforms. It seems unlikely to me that will happen this year, given the current operational challenges. So that still feels a little way-off. And at best, we view that as fairly modest. To dive into few of those in more detail, the FCA pricing review, it was back to June -- I suspect now somewhat later before we see the remedies. I have no specific insight into where these will go. We do know the FCA has been listening to the industry, they are aware of the equal impact between new business and renewals.

To reiterate, we don't utilize inertia pricing or propensity modeling, all our prices are calculated purely from risk factors. The market claims premium inflation, I think we've touched on, we don't see claims inflation tailing enough, and we will continue to seek to fully cover claims other cost inflation, as we go through this year.

On Slide 24, the MIB levy is one that perhaps doesn't get spoken about terribly much. This levy is almost certain to increase due to the Ogden cost impacting the MIB's normal claims. In addition, some of the recent Supreme Court judgments have met the MIB responsible for accidents occuring on private land involving uninsured vehicles. Our best view is, have increased this year to about 17% to 20% on the previous levels and probably, more to come later.

In our case, we spend about 3.5 million here at the moment on the MIB. On the FSCS, there's been quite a lot of insurance company failures in '19, not by people regulated by the PRA, I don't think in any cases. We're aware that non-UK regulators are having an increased focus on solvency levels. Whilst the failures of some of these insurers is reasonably good news for us in terms of opportunities, there is a risk of an increase in the FSCS levy to compensate customers.

We move on to insurance costs, I think these are well flagged in previous competitors presentations, very significant market price increases at the end of the year. Some mid-single digit, see in excess of 30%, driven mainly by the Ogden impact. It's fair to say that the size of the portfolio and your claims experience will drive the level of that increase. Our renewal is not till mid-year. We certainly wouldn't expect to be at the high end of those increases, but we are increasing prices now to ensure there is no risk in a funding gap, if we get a reinsurance price increase.

The whiplash reforms, we put into a (inaudible), which we're not going to sell through now. But we're very happy to take any questions, so at the end of the session or afterwards. Our view hasn't changed but the outcome from this could be mildly positive or mildly inflationary. And it's going to be some time before those impacts can be accurately assessed.

So let move forward, if it's okay, to Slide 28. Very briefly on Ogden, not a big impact on our results. We are concerned about Ogden (inaudible) indicating a different discount rate of minus 1.75%. That would require a very significant price increases in that market, if that were to come through.

On Slide 29, I think we're really keen to start to talk about cost inflation rather than claims inflation. So these are just sort of small summary of things we see coming. So from reinsurance cost increase in levy's and the underlying claims inflation, our view is that cost inflation will be in excess of 10%, this year. Many of those industry factors are not specific to us. Okay. Now to change focus slightly, a brief reminder of our strategy, although I'm sure it's becoming quite well known.

So on Slide 31, our strategy hasn't really changed at all. We want to maintain a very wide underwriting footprint, which as we've discussed, broadly in excess of 98%. And we want to continue to be very defensive on our non-standard positioning as well. We want to maintain our market lead in underwriting performance, that really means writing in mid-70s to 80% ratio range. Strong cash returns, as I mentioned earlier, our approach to capital hasn't changed. We want to maintain the capital range of 140% to 160% and return excess capital to shareholders, as we -- and when we can. And we still believe we're going to get attractive growth across the cycle. We'll talk about our view on timing on that in a minute.

I think it might be useful this year to provide a bit more context to our pricing approach, which is on Slide 32. Any point in the cycle, we're looking to optimize our long-term pound profit by balancing volume and margin within this target corridor. If such a thing was stable, market conditions exist, we view 75% as our bulls eye. At that point, the optimal point between volume and margin. In weak market conditions, which is where we were for much of 2019, we're very comfortable to be right in the 80%, to right hand side of this graph. As market conditions improve, we seek to take enhanced margin ahead of premium growth. So we're looking to move back from the right hand side towards the bulls eye. In our view that is always the most profitable approach to take, not to chase volume.

We only we would expect to end up on the left hand side of this graph in the low-70s, in periods we've had to increase rate as volume has outstripped our operational capacity to take it, all where we've seen exceptional reserve releases coming through from prior periods. So stable conditions, 75%, soft market conditions, very comfortable and towards the right hand side of this graph.

We as a company, tend to be pretty prudent. I think in our approach to life, we tend to say we are very quick to react to possible bad news and cautious responding to what could be positive news. Our view is the risk taking business prudent is being prudent is key. Our view is exactly the same as the last year. If it turns out, we're being too prudent on any assumptions, they do demonstrate that over time and allow us to reduce our rates. If we're right, they're still paying to come to the market. We've already taken our pricing action on that, will allow us to grow at that point.

If we try and sum it up, if we are too prudent, then we may give up some volume, that will deliver (inaudible) combined ratio result at some point. And we can then also reduce our prices and grow. If we're overly optimistic and -- you can significantly undermine the combined ratio and it can take years to recover from that position. Okay. Perhaps on to, one of the more fast-moving bits of the presentation, which is the summary and outlook. And this is all considerably more confusing than it was just a few weeks ago.

I'll summarize what we think we are today, what we were pre the COVID impacts. Very focused on our long-term strategy, prioritize loan growth and profitability and remaining centered on the mid-70s combined target. Signs of market price increases coming through the end of this year and into this year, to cover off claims inflation, but not to close the jaws in our view, between the gap that we'll have opened up for many competitors between claims and premium inflation.

We're very comfortable with the pricing we achieved on the renewal business in '19. If market conditions had persisted, we'd been seeking to move lower in our combined corridor back towards the bully eye, we just described, ahead the more material volume growth as the market price have continued.

Go to Slide 36, and haven't really mentioned COVID-19 impacts, and I think we do now need to talk about our views on that. First of all, I do want to reemphasize, we fully appreciate difficult time for many individuals and companies. So just to give some context or approach here, we intend to continue, since all of our colleagues on their full service. We do not believe we're going to need to take any advantage of the government support currently available. We're looking to proactively support our smaller suppliers and local stakeholders in the (inaudible) area through this period and that includes (inaudible) offering colleagues paid levy to support NHS or other voluntary activities. We're trying to maintain flexibility in our approach to customer issues, as we know customer circumstances could be changing fairly rapidly through reasons outside their control. But generally, trying to do the right thing without undermining the ongoing foundations of the business.

So how might COVID impact our result? In the short term, there is going to be a significant reduction in claims frequency. At the moment around 60% down to these initial weeks. However, we do think as a potential subsequent significant increase in claims costs, that could come through, things like (inaudible), a lot of parts are made in China, there is about a two-month lead time to get parts into the UK.

Body shops may have a limited capacity, immediately post the lockdown period. And there is going to be claims types, trends emerging. So we are concerned here that we might see increases in theft, in vandalism, potentially joyriding. And the risk of wider economic influence is also having an impact here. So for example, customers becoming financially stressed and leading to cancel their policies. We also view, as we go forward a risk or a significant increase in personal injury claims, again, financially stressed people -- customers. That whiplash reform was not happening in the immediate future and claims management companies looking potentially take advantage of that situation, could lead to an increase in exaggerated or unfortunately forging of claims.

On the next slide, we re-purposed our scales here little bit, just to show our view on how this might impact. So on the cost reduction side, clear reduction in claims frequency on the right hand side, probably worth about 0.5% on our combined ratio for each week, this goes on. Balance in that is parts availability, body shop capacity, potentially a significant increase in miles driven, post the social distancing, increase in stress -- financial stress, increased less [ph] of the earning claims. And sadly, potentially poor management and claims management firms.

Our view is these are short-term impacts, they don't impact the underlying claims inflation drivers. We'll talk a bit more about the outlook in a second, in terms of premium. Pick up on the other direct influences on our business. I'd like to really pause and thank all our staff for this huge effort, a very successful effort they've put in to be work from home, they're working highly efficiently, we haven't missed a day. We have no backlog building up, we have no fund [ph] delays coming through.

Our IT team has put in an fantastic effort to put in place a radically different BCP plan, and we do not have all of our staff working from home completely effectively. We're going to look to prioritize essential work that claims has required. We're taking a sympathetic view towards some of these data [ph] changes. For example, being a taxi drivers become into delivery, is we are fully supportive of the ABI principles that was set out in mid-March, about how we help customers through this period.

Taking things as a whole, we've done some extensive scenario modeling, the example we put in the RNS [ph], is a 50% drop in premium, is not designed to be a planning assumption, it was to show an extreme position and even in a very extreme position we would still be capital generative and profitable going forward. As we sit here today, people are continuing to buy policies. We haven't seen a massive step up in cancellation of policies. What I do believe is we're going to see lower volumes in the market for the next few weeks. Some research came out yesterday on car sales being down by 20% or 25% year-to-date and I think 40% odd in March.

We're seeing the volume of quotes to aggregators being around 20% lower at this stage. What might that do? We may see some competitors starts over discount because of the short -- relatively short benefits and lower claims frequency. And we may see potentially some competitors start to chase that lower volume through discounts.

Our priory is we need to stick to our underwriting discipline and continue to ride at the combined operating ratio, and if we need to let the top-line move around a little bit. Our investment case in these market conditions is probably just we're touching on. We've got a very consistent and stress tested strategy, that has delivered very consistent profitability in a fairly narrow band across all parts of the cycle. Whereas, I think most of you have no debt. And right now, an 80% combined saving, that generate significant capital and leaves us confident we can continue to pay an attractive dividend. The vast majority of our earnings generated from underwriting profits and we have very little dependence on investment income to drive profitability.

On Slide 41, we've restated our dividend decision, but I think Adam has given a good explanation in his section, I won't touch on that, again now. On the outlook slide, if we put in two slides, the outlook we would have given about a month ago which would broadly have been a central base case of margin enhancement this year, before potentially modest top line growth. On track to deliver an earned combined ratio over slightly ahead of our long-term 75% target. Before that -- reduce to below in our combined range during '21, very strong capital generation to fund growth to support dividends. And having covered and continued to cover claims inflation being well positioned to take that margin and volume growth.

Clearly the COVID-19 impacts on Slide 43 have thrown in a great degree of uncertainty, I would say. The premium out-turn for the year must be uncertain, reduced car sales and customer behaviours may impact our currently driving lower quotation volumes. As I mentioned, the list of competitors chasing that volume to discounts. In my view this may set the market -- turn back, the markets have to turn back by upto 12 months. We will continue to price rationally and maintain our COR corridor. I think it's far too early to talk about windfall profits or excess profits. And for the year, we can see it been a bit of a tale of two halves, excess profitability in the first half, unwinded in the second half of the year as some of those claims inflation factors and potentially quite some claims inflation factors come to the floor. So my best guess, as I hit here today, is a combined operating ratio slightly above our long-term average and a premium income, somehow we decided for that. Clearly we will update as we get more clarity as the year develops.

To state the obvious, we don't have a crystal ball on this. The impacts aren't yet known. The key thing for us is staying focused on righting that combined operating range. I would say we expect to emerge from this period in a very strong and well positioned state, ready to take growth as the market turns. I think at that point, I'm not going draw (inaudible). And hopefully we have both way to take question, some of which I'll handing on to Trevor and James.

Well, I think perhaps the operator can help us take any questions.

Questions And Answers

Operator

Of course. (Operator Instructions) The first question we have comes from Ben Cohen from Investec. Ben, your line is open. Please go ahead.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi, Geoff. Thanks very much for taking my questions. I have two questions please. Firstly, sort of backing out your average premium per policy for last year, it looks like there was a fall in the average premium. I was just wondering if you could give some color around that, presuming it relates to risk mix. And any outlook, you could give for this year? And my second question was in terms of reserve releases, you had higher reserve releases last year. I just wondered, the extent to which your sort of updated guidance for the loss ratio for the combined ratio reflect a view that you're taking about the sustainability of reserve releases at similar levels? And maybe you could just put that into the context of the sort of benefits that you're seeing at the moment from the social distancing and how that could come through in terms of reserve releases? Thank you.

A - Geoff Carter {BIO 20756770 <GO>}

Yeah, sure. James, perhaps you can take the third one and the second about reserve releases and social distancing. On average premium and risk mix now, average mix changes all the time. It depends partly which of our distributors are pushing hard on volume, some of them tend to target slightly lower average premium than others. I would say overall as we came through the end of last year, our average premium grew pretty strongly. We were knocking on the door GBP700 as we came into this year. So, if that does change all the time then depending on the mix of business we're writing at the time.

At the moment reserve releases and how they impact our numbers, do you want to comment on that?

A - Adam Westwood {BIO 20481660 <GO>}

Yeah, just briefly. So, our reserve releases or prior year reserve movements benefited our combined ratio to the tune of 11.3% for 2019. I have stood here a number of times and said that those reserve releases are going to move from exceptional to sort of BAU levels of reserve release. It can be difficult to quantify and particularly difficult to guide on the timing of that. Clearly, we have been fortunate in that -- those exceptional releases haven't dried up in 2019. But, I am putting strong guidance towards the fact that they will reduce during 2020, they are clearly by nature exceptional. So, I do expect those to come down, absent any other factors during 2020.

We should be part of the reason. We're guiding towards a COR for '20, which is above that for 2019. So, yeah, I mean what -- what I've said previously is that, when reserve releases were 10%, probably about half of that was the sort of the run-off of just prudence within reserves and half of that was exceptional, that's still not the terrible rule of thumb. And like I said, I do expect them to come down in 2020.

Q - Ben Cohen {BIO 1541726 <GO>}

Thanks. James, the third question was around social distancing and whether that has any impact on our sort of backlog reserves, I think.

A - James Ockenden {BIO 20485926 <GO>}

So, I'd just echo Adam's comment on the reserve releases, but to talk about social distancing, I mean, I think like every other insurer we will be looking at our claims statistics, previous reserving statistics. And looking to see, are there any trends emerging, clearly such distancing start on the 23rd of March. So it's quite early to say, so whilst we see some operational benefits we kind of need to shift out the volatility potentially because it's 13th of the first quarter.

So this is something we're going to keep a very close eye on. I mean, our approach to how we treat claims within the claims department has remained the same. And the way in which we reserve has remained remain the same. So, I think we just need to keep a very close eye on the diagnostics and see things as they emerge as the data comes through. And I think as Geoff alluded to, there's lots of potential, inflationary trends that may arise as a result, both from a frequency and a severity point of view. So again, we're just remaining mindful to this and looking for things in the data as it becomes available.

Q - Ben Cohen {BIO 1541726 <GO>}

Great. Thank you very much.

A - Geoff Carter {BIO 20756770 <GO>}

Thanks, Ben. Next question?

Operator

The next question comes from Ming Xu from Panmure Gordon. Ming your line is open. Please go ahead.

Q - Ming Xu {BIO 17285759 <GO>}

Thank you. Hi. Good morning, everyone.

A - Adam Westwood {BIO 20481660 <GO>}

Hi Ming.

Q - Ming Xu {BIO 17285759 <GO>}

Just two questions please. Hi. And the first question, you just mentioned that you guiding slightly higher combined ratio in 2020 than 2019 due to reserve release is not going to be as exceptional as before. So I get that bit. But what I can't get my head around is, you said and you've increased your premium pricing around 10% last year, which is more than the claims inflation, 7.5% to 8.5%, you expecting. And should that sort of help your combined ratio for this year?

And I mean, that's the bit -- I'm sort of missing, maybe I don't think I quite understand that bit. And second is special dividend. Could you give a little bit more color in terms of the timing and amount? So are you going to pay for that special dividend and together with the interim dividend? Or is it going to come as a separate interim? And is that still going to be 5.2p or a bit more than that? Thank you.

A - Geoff Carter {BIO 20756770 <GO>}

Okay. Thanks, Ming. If I start -- Adam, in fact you can chip in as you are allowed at the end. I think maybe on the premium place and claims, what we really decided, claims inflation is (inaudible), let's say around (inaudible). You then need to add on the reinsurance cost increase is potentially the MIB increases. So our view is that the total cost increase is going to be over 10%. So we believe, we are broadly keeping track with the overall cost inflation picture. So we would have expected to be having this year to be -- move our way down the combined operating range a little bit. I'm not sure we're going able to sustain putting through very significant price increases in the current market conditions. So, I think we need to break out cost and claims inflation, think about cost inflation as we look at our price increases...

A - James Ockenden {BIO 20485926 <GO>}

Geoff, it's James. Sorry, -- so I just going to see if I could just add to that. I think, yeah, I'll talk about -- when we do claims inflation, we tend to view a probably a low -- we don't just look at the past 12 months, to take a medium term view claims inflation. And clearly the direction of travel has been upwards. So things continue, I think all else being equal, we would expect claims inflation itself to increase.

A - Geoff Carter {BIO 20756770 <GO>}

On the special dividend question, I think what we've said in here is, well, a couple of things, really. One is our approach to excess capital hasn't changed. We think our excess capital is better off in the hands of our shareholders, than it is us keeping it under the sort of (inaudible) on very low returns. I don't know when the situation is going to become clearer. It could be two weeks, it could be two months. The Board wants to return that excess capital at an appropriate time. But I think that would be -- I think I'd be foolish at time put a timescale on that given right we're in the midst of the current uncertainty.

(Multiple Speakers) Well, I mean, I think we have been showing in the RNS where we were. We think the COVID-19 is going to -- is going to generate an increased level of uncertainty for the rest of this year, until we understand what the net impact is at the first half benefits and the second half unwinding of those benefits simplistically. So I think we showed you where the Board was a few weeks ago. I think the Board will have to think about that special dividend as and when things quantify and as and when we get a better view on how the year looks. So I wouldn't want to over speculate at this point.

Q - Ming Xu {BIO 17285759 <GO>}

Okay. Thank you.

A - Geoff Carter {BIO 20756770 <GO>}

Okay. Thanks Ming.

Operator

Your next question comes from Andreas van Embden from Peel Hunt. Andreas, your line is open.

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

Yeah, hello, good morning. I just had one question. Just interested in your stress test scenarios. I know you -- an extremely worst case one with a 50% decline in premium. So I just want to see within the range of stress tests you sort of run internally, to what range does your solvency ratio fall from that 180%? Thank you.

A - Geoff Carter {BIO 20756770 <GO>}

Yeah. And I'll just give (inaudible) numbers in his head. I mean, so the 50% we put in there was really a sign, if you went back a few weeks, our big concern was a very significant amount of cancellations, if the lockdown had really hit to a point where (inaudible) that doesn't seem to have occurred. So who wants to say how bad could it look if half of customers canceled and stayed canceled for the rest of the year. That was not a planned assumption, that was designed to be a very extreme scenario. Perhaps I think you got a chance to cover your thoughts on that?

A - Adam Westwood {BIO 20481660 <GO>}

Yeah, I mean it's been an interesting challenge for us to think through the impacts of the current environment. Most insurers are asset holders, we probably look at the variations in the values of their underlying assets, that could lead to solvency strain, and sort of how that trading might be effective. If we take one and then the other, on the asset side, as I said we are primarily invested in gilts. We've got considerably more cash on our balance sheet now that we have at the year-end to make sure that we've got enough liquidity. And we do have a small amount, so GBP10 million, GBP15 million worth of high quality corporate bonds on the balance sheet.

We're not exposed to the equity markets, clearly yields can move around, as kind of the values of corporate bonds. We are asset liability matched, to the extent we can't be against the technical provisions. So movements in the low-risk assets are reflected in the movement in the discount rates, in the Solvency II balance sheet. And therefore volatility on that side doesn't really call the huge amount of capital strain. I'm not going to put an exact number on it, at this point. There is some indication in the accounts, but generally we're well protected against movements in asset values. So the other thing is the more operational and trading things we've looked at has been, for example, the reduction -- the extreme reduction in premium that we called out in the RNS. In that scenario, we were still generating capital. So we are still writing enough business to cover our cost base and a little bit more.

So there was no real immediate or indeed long-term capital shock [ph] in that perspective. But clearly, that impacts our ability to distribute capital in the future, because we would be earning quite smart. Where else do we look, I guess at increases in loss ratio, unexpected increases in claims which happened too quickly for us to be able to price. Again, we've got a considerable amount of headroom on our combined ratio at 70% to 80%. We -- that 20% to 30% of headroom for loss ratio to deteriorate. And we don't think that it is likely to deteriorate by that much. So again, we would continue to generate capital in that scenario and therefore there wouldn't be any immediate, significant strain. We then look at things like counterparty risk and what might happen there. We don't have a significant amount of counterparty exposure on our balance sheet. Our brokers generally pay us for the premium upfront. And therefore the outstanding balance of them is pretty small. We do run a finance policies on our direct book which -- our direct book is 30% of our overall book.

So again, there is not a huge amount of exposure there. Where are our big counterparty exposures? I suppose the reinsurance market. That said, that's a well diversified reinsurance panel. They're all highly rated. They're clearly under a significant amount of scrutiny at the moment. And we would need for really more than one of the reinsurers to fail to cause a significant movement in our capital base, which we consider to be unlikely. But even if they did, that wouldn't take us below 100% of our capital requirements. So that's the kind of thought process that we've had on modeling the impact of COVID. It might seem sort of mildly simplistic, but when you think about the nature of the investments, I think it makes sense to think about it in that way. So, yes, so that, Geoff that's my summarized (inaudible)...

A - Geoff Carter {BIO 20756770 <GO>}

I think, I think just to give a bit of context, I think 180 and 160 is about GBP12 million, Adam, something of that...

A - Adam Westwood {BIO 20481660 <GO>}

Yeah, that's right.

A - Geoff Carter {BIO 20756770 <GO>}

And so down to 140 would be GBP24 million. So we've got a lot as capital before we go anywhere near a danger. And as you go all the way down to 100 would be as -- be about sort of GBP48 million, GBP49 million so we've got a lot of spare capital here, before we get concerned about our capital range. Andreas, did that answer the question?

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

Yes, yes. Yeah. Thank you very much. Very clear.

A - Geoff Carter {BIO 20756770 <GO>}

Okay. Thank you.

Operator

The next question we have comes from Nick Johnson from Numis Securities. Nick, your line is open. Please go ahead.

Q - Nick Johnson {BIO 1774629 <GO>}

Hi, good morning all. Just one or two questions, one follows on from Andreas, actually. So in terms of how insurers are responding to COVID-19, there is an article on the BBC today saying that U.S. insurers are handing back some premiums to customers to reflect lower claims during lockdown. I appreciate the U.S. is a very different market, but is there any sense that you could do something similar in the UK? Any discussions that you're aware of at the moment, perhaps you can just talk around the issues on that, please?

And the second question was on rollout of new rating factors. I was wondering if you could elaborate a bit on where you are on those? Were there a significant factor in the 2019 numbers? Or is there really more to come in 2020? So where can we see the likely benefits of those new factors? Thank you.

A - Geoff Carter {BIO 20756770 <GO>}

Okay. Yeah, thanks Nick. Yeah, I mean obviously, I think all states, some of the people in the states have started giving sort of two months (inaudible) a discount for two months. I think in the UK that would be a very, very valid thing to do, given we don't know what the full-year impact is. So we can see some impact for the last few weeks. So as we mentioned in our presentation, we can see those benefits in the short-term being unwound in the second half, and we don't know what the net position of those two competing factors will be.

So I don't think we're in any position to say we're making surplus profits at this point. I think the UK market is also a bit different. We mentioned that I can see in the market, vast discounting going through. So I think there is already market movements for some insurers, discounts in the price -- on the assumption there may be lower discounts coming soon. So I think also that first question, I think it would be -- I don't think we have any data that proves we could possibly discount premiums at this point. On the rating factors side, James, do you want to say anything on that? I know you're not given any details what you've actually done, but any more general comments?

A - James Ockenden {BIO 20485926 <GO>}

So we did introduce a small -- I mean, I think, Nick, the -- it's pretty much more of the same side. We -- obviously we are continuously tweaking the right thing, across the portfolio responding to changes in risk. We did introduce a new factor, which looked at relationships between individuals and the policy (inaudible) any more than that. So it is a quite small factor, but we believe it was predictive of additionally predictive risk on top of our car modeling. We are continuing to look at new data sources is becoming more tricky to find new bids. But then we have something in the pipeline. We've had it in pipeline for a little while, but it's the (inaudible) in the detail of deployment and how we deploy it. So hopefully we will be looking to get that done this year, and take the rating forward even further.

A - Geoff Carter {BIO 20756770 <GO>}

Thanks, James.

Q - Nick Johnson {BIO 1774629 <GO>}

Okay. Thanks very much.

A - Geoff Carter {BIO 20756770 <GO>}

(inaudible) balance of your question, Nick?

Q - Nick Johnson {BIO 1774629 <GO>}

Yeah, I'm happy with that. That's great. Thank you.

A - Geoff Carter {BIO 20756770 <GO>}

Thanks a lot.

Operator

Next we have Trevor Moss from Agency Partners. Trevor, please go ahead.

Q - Trevor Moss {BIO 1741504 <GO>}

Very good morning Geoff. Good morning everybody. Very comprehensive presentation, Geoff. Thank you. Couple of things if I may. Credit repair, talk a little bit about that, how prevalent it is becoming as a trend? How you might tackle it? And how much more expense will it sort of add to claims? It looks slightly worrying to me, not that it's necessarily a particular issue, but it's an interesting one. The second thing is just could you talk a little bit about Saga, what you're intending to achieve there? What sort of policies, you think you might pick up through Saga?

A - Geoff Carter {BIO 20756770 <GO>}

Yeah sure. So if I take -- start the question first, and then Trevor you can pick-up credit repair. Going further, I think quite interesting, obviously it's all people over (inaudible). I think what we see here is (Multiple Speakers) the full year -- the actual full year policy is a differentiated offering, which I think is going to be quite attractive to certain customer demographics. So I understand, and I don't want to talk too much about their business, generate more business on a direct basis than through aggregators. So that's quite an interesting sort of new customer pull, that perhaps we don't currently get -- to get sort of efficient. So I think we can add value by -- to Saga had by providing some of the more lively cars and some of the more non-standard customer risks. And I think what Saga brings to us is a slightly different pool of customers.

Trevor, do you answer about credit repair?

A - Trevor Webb {BIO 21909270 <GO>}

Yes. Okay. So when we talk about credit repair, we talk about the cost of repairs, we also talk about some of those additional costs. For example, vehicle recovery and towing and storage charges. So we're seeing two things going on, really. And if I look back over the last five years, we are seeing a greater penetration of credit repair, so a greater proportion of the claims are being subrogated or pursued against us -- on a credit repair basis. And that's going up year-on-year. I'm looking at some data since 2014, so that's gone up year-on-year over that period of time.

And in addition, the cost of the repair through that model is significantly higher than the cost of the repair, that's being recovered if it goes through a traditional insurance model. So the inflation levels on repair are exceeding inflation of straightforward bent metal. How can we do with it? The way in which we look to deal with it is we look to capture that innocent [ph] third-party and manage that individuals repair through our own processes, and contain costs that way. The extent to which we are successful is does vary, but it's something that we're highly focused on addressing, so that we can look to control that claims inflation.

Q - Trevor Moss {BIO 1741504 <GO>}

Yeah, okay. Trevor, thanks.

A - Geoff Carter {BIO 20756770 <GO>}

So, do that -- okay, thanks.

Q - Trevor Moss {BIO 1741504 <GO>}

Yeah, that's fine.

A - Geoff Carter {BIO 20756770 <GO>}

Thank you.

Operator

There are no further questions on the line.

A - Geoff Carter {BIO 20756770 <GO>}

Okay. Well, in that case, thank you all very much for dialing-in. We finished just inside the hour, I think. Hopefully, that works okay for you doing it by phone. Any other questions, we've not been able to pick-up now or if it wasn't clear, me and Adam are available all day. So, please feel free to get in touch. Thank you very much for your time, and hopefully be able to see you in person next time. Thanks a lot. Bye now.

Operator

Ladies and gentlemen, this concludes today's call. Thank you all for joining. You may now disconnect your lines.