Q1 2017 Sales and Revenue Call - Trading Update

Company Participants

- Anthony Jonathan Reizenstein, Chief Financial Officer & Executive Director
- Paul Robert Geddes, Chief Executive Officer & Executive Director

Other Participants

- Alan Devlin, Analyst
- Andrew J. Crean, Analyst
- Arjan van Veen, Analyst
- David Andrew Bracewell, Analyst
- Dhruv Gahlaut, Analyst
- Edward Morris, Analyst
- Greig N. Paterson, Analyst
- Kamran Hossain, Analyst
- Thomas Seidl, Analyst
- Wajahat Rizvi, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to the Direct Line Group Q1 Trading Update. My name is Tom, and I'll be your coordinator for today's conference. For the duration of the call, you'll be on a listen-only. However, at the end of the call, you will have the opportunity to ask questions. [Operator Instruction]

I'm now handing you over to your host, Paul Geddes, to begin today's conference. Thank you.

Paul Robert Geddes {BIO 2474781 <GO>}

Morning, everyone, and thank you for joining us for this brief trading update on what has been a busy quarter for us. You'll have seen our trading statement this morning, so I'm just going to call out the key highlights and then open up for your questions. As usual, I'm joined by members of the management team.

Overall, I'm pleased with how we traded this quarter, growing our overall written premiums 4.2%, while remaining on track to reduce our expense and commission ratios. And although there is still much of the year still to go, we are today reiterating our combined ratio target of 93% to 95% with of course the usual weather caveat and assuming no further Ogden rate change. Motor has so far exceeded our expectations, partially offset by difficult Home conditions, whilst both Rescue and Commercial had another good quarter.

Before we get into the individual category performances, I'm pleased to say that we've continued the excellent momentum in our Direct Line brands, particularly in Motor and SME, which has been driving much of our growth. We're excited by this momentum and continue to invest with additional unique propositions in both Motor and Direct Line for Business launch in the quarter.

So, now, as to performance of the individual categories, in Motor, we continued to make good progress growing our own brand policies 5.9% compared to Q1 last year and our own brand premiums by 11.2%. Average premiums rose 6.6% compared to Q1 last year, with risk-adjusted prices increasing significantly more than that, comfortably ahead of our current view of claims inflation.

Ogden only had a modest impact in the quarter. But including our trading experience up to last week, I can report that we have increased our prices in response to the expected higher costs arising from Ogden. At the same time, we've also continued to grow policy count since the announcement, which highlights our continued competitiveness and perhaps the benefits of our low reinsurance retention through 2017.

Pre-Ogden, the trends on claims inflation were broadly as we described before, with damage driving overall inflation around the top end of our long-term average. And large bodily injury, whilst too early to discuss the trends for 2017, experience on older years have continued to develop favorably. So, overall in Motor, we are slightly ahead of where we thought we'd be at this stage of the year.

We expect some of this outperformance to be used to offset pressure in Home. Here, claims inflation continued to rise above our long-term expectations, driven by escape of water claims arising from higher building costs. Against this backdrop, market pricing has remained soft. As we highlighted in Q4, we have been taking price action, which continued in Q1. And this has started to slow our new business performance, although retention has remained strong. As always, we seek to protect the value of our portfolio and we are prepared to lose some volume in order to do so.

Turning to Commercial, where we had another good quarter, growing in-force policies 5.1% versus last year. As you know, Commercial has two distinct stores within it. Direct Line for Business or DL4B is already a highly profitable growing business and adds to the overall Direct Line franchise. So, we're continuing to invest behind this business. DL4B grew in-force policies 5% and premiums 11%.

In our broker business, NIG, we're continuing to move returns towards the group's target levels. While our business mix shifted slightly to lower-value, higher-volume business, we were able to increase prices sufficiently to at least meet claims cost inflation.

In Rescue, premiums also grew, up 3.3%, driven by our direct Green Flag business, which grew premiums 11.5%. The direct business has continued to more than offset the continued decline in packaged bank accounts, and at better margins. Green Flag is another of our businesses with strong potential, and we've recently recruited a heavyweight managing director, Dean Keeling, to work for Mike with a view to grow this business further.

On to expenses, at the full year, we set up our aim to reduce the expense ratio in 2017 along with the commission ratio. Given the move away from a pound target to ratio, we aren't disclosing cost numbers today, but we are on track to achieve reduction in both of these ratios.

Moving on to investments. Here, we had a good start to the year with income of £42 million. Net realized and unrealized gains were ahead of our expectations at £9 million, of which £5 million was due to property revaluations. The outlook for investments remains unchanged. We still aim to achieve an income yield of 2.4% in 2017 on modestly declining AUMs.

Finally, I can confirm our year-end 2016 solvency ratio at 165% in line with the estimate we gave at the premium results in March.

So, a quick wrap-up before questions. Our multi-brands, multi-channel strategy that succeeded in 2016 has maintained its momentum into Q1. Overall, we've had a positive start to the year from a trading perspective. And assuming, as usual, a normal annual level of claims for major weather events and no further change to the Ogden discount rate, we reiterate our target of a combined ratio in the range, 93% to 95%.

And with that, I'll hand back to Tom for questions.

Q&A

Operator

Our first question comes from the line of Edward Morris from JPMorgan. Please go ahead.

Q - Edward Morris {BIO 16274236 <GO>}

Hi. Thank you. Ed Morris here, JP Morgan. First question is on price increase in Motor. So, you said pricing, up 6.6%, and that risk-adjusted pricing was significantly ahead of that. Can you talk through the reason for that? Is that a conscious decision to reduce risk mix following Ogden?

And similarly, when you say constantly ahead of the view of claims inflation, can you just talk how the Ogden change influences claims inflation? I think you'd normally sort of suggest the upper end of your range is about 5%. Is there any one-off influence on claims inflation? How would you confer (07:24)?

And then, the second question is just on Home, so £9 million in weather losses so far. Can you just remind us what a long-term average or typical budget would be for Q1? So, sort of how far ahead of budget are we on weather losses, please? Thank you.

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

So, yeah, imagine around £50 million (07:47) of weather losses. That's on our new slightly lower level for the quarter for the year. So, we're a bit ahead of that. On pricing, yeah, that's (07:55) a little bit about – we put our Ogden price rises through with quite a clear view of how Ogden would hit various cohorts of age. Obviously, young drivers particularly have young passengers, and therefore, they're going to be more exposed (08:10). So, we put in – I'm sure a lot of people have (08:16) are slightly more younger driver-weighted increase post Ogden. We've seen that slightly reduce our mix. So, implies that not everyone's taken exactly the same view of how that will impact.

3% to 5% is a long-term trend. We haven't split out our specific net Ogden costs, which are relatively modest actually because we've got this £1 million deductable. We look at, with interest, how the market will respond to – because some of the market has an earlier reinsurance renewal 1-7 (08:47). And obviously, we'll get to see the impact on those players in terms of what they do in the market. And then, obviously, it will be interesting to see how the market develops ahead of our renewal in the 1st of January 2017.

Q - Edward Morris {BIO 16274236 <GO>}

That's great. Thank you very much.

Operator

The next question comes from the line of Dhruv Gahlaut from HSBC. Please go ahead.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good morning. Just a couple of questions. First, could you quantify what the claim inflation was in the Home business? Secondly, on the reserve trends on the bodily injury, could you quantify and then could you say a bit more in terms of which years are developing positive at this point? And thirdly, also if you could give a retention level to what the number is for Motor and Home in Q1?

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

Yes. On Home, (09:42) have a similar long-term trend to Motor, 3% to 5%. We're already seeing significantly more than that on Home. And we're taking - just to be really clear, we're taking some pricing action. We're taking some underwriting action. And we're taking some action on claims processes and claims initiatives. We won't fully recover it in 2017, which is why we flagged that we're going to take some the outperformance (10:05) in Motor will be used up by dealing with that on Home.

John, do you want - I mean, all years, I get on...

A - Anthony Jonathan Reizenstein

All years, yeah.

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

Yeah. All years on prior development.

A - Anthony Jonathan Reizenstein

The old prior years of developing - are developing favorably compared to our expectations, Dhruv.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

All right.

A - Anthony Jonathan Reizenstein

On (10:23).

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

Yeah. I mean it's retention - retention is stable at very good levels, particularly our Direct Line brands. We don't specifically disclose it, but we're very happy with our retention levels at the moment.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Has it changed much since full year?

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

No.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

All right. Thanks.

Operator

Our next question comes from the line of Rick Paterson from ABW (sic) [Greig Paterson from KBW] (10:49). Please go ahead.

Q - Greig N. Paterson {BIO 6587493 <GO>}

(10:53) so, you would know it's me.

A - Paul Robert Geddes {BIO 2474781 <GO>}
Hi, Greig.

Q - Greig N. Paterson {BIO 6587493 <GO>}
How's it going?

A - Paul Robert Geddes {BIO 2474781 <GO>}
Can you speak up?

Q - Greig N. Paterson {BIO 6587493 <GO>}
Yeah. Can you hear me? Can you hear me now?

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

Q - Greig N. Paterson {BIO 6587493 <GO>}
Yeah. Three questions. One is technical one. On your UK retail Motor, on your current year loss ratio, what was the benefit from reinsurance deductibles in 2016? And how is it compared to the benefit of the loss ratio for Motor in 2015? That's the first question.

The second one is I wondered if you could give us an update on your new Motor system. When is it coming live? When should we see the benefits, all those benefits of the expense ratio or loss ratio, et cetera? And then, just could you just remind us where we are now post Ogden? How much capital in terms of SCR is locked into the legacy business, the runoff business? Thanks.

A - Paul Robert Geddes {BIO 2474781 <GO>}
Okay, very good. John, do you want to take the – some of those (12:05) questions?

A - Anthony Jonathan Reizenstein
Yeah. I think the first question, Greig, was – if I got you right, was what benefit could we get from reinsurance in 2016 and 2015.

Q - Greig N. Paterson {BIO 6587493 <GO>}
Yes, in terms of percentage points, the actual or comparable, how much...

A - Anthony Jonathan Reizenstein
I'm not sure I'm going to be able to get everything there, but I think we can give you some thoughts. So, if you remember at the year-end, we said that the cost of the Ogden rate change to minus 0.75 for accident year 2016 was £12 million.

Q - Greig N. Paterson {BIO 6587493 <GO>}
Yes.

A - Anthony Jonathan Reizenstein
And we haven't actually said what it was the year before. But anyway, at least we've given you something there, around (12:40) £12 million in 2016. And what I can say on the growth side is that the cost to reinsure would be a multiple of that. I'm not going to give you what exactly that multiple is (12:55) misleading, so we tell you about that year, but might not (12:58) tell you about the next year.

(13:01) is a significant multiple of that £12 million. It would have gone to reinsurers. Obviously, in terms of where that's going to take us for the next renewal, we will see. But obviously, there's been a lot of press comment to the effect that rate's going to go up. There's been press comment to the effect that new action's going to come in, which is slightly better.

And we haven't started talking yet because we didn't have to do that. But we're going to renew (13:28) till 1st of January. Obviously, we don't have a choice about whether we want to reinsure same degree of protection, which may have (13:38) to take – and we look at that every year and don't – but we didn't necessarily have to take exactly same (13:42) the year before. So, I think we're in a reasonable position to have a discussions with them.

And the other thing to say is I think over time, they have done reasonably well. We haven't been too bad a client to them (13:54). And so, we have (13:56) productive discussions. But – so, I hope that's given you a bit of guidance on that question.

In terms of...

Q - Greig N. Paterson {BIO 6587493 <GO>}

When you say significant multiple, is it 5 times, is it 10 times, is it 3 times? I mean, what is significant? Like, is it £100 million, is it (14:10). I mean, this is material for the – it's a very material item, yeah?

A - Anthony Jonathan Reizenstein

The cost to us is a bit over three figures. And the market – I've been talking about 50% price rises (14:24). I mean, your guess is as good as mine. That's kind of where...

Q - Greig N. Paterson {BIO 6587493 <GO>}

Could you say it again? The cost to you is just over three figures?

A - Anthony Jonathan Reizenstein

Yeah. And the...

Q - Greig N. Paterson {BIO 6587493 <GO>}

So, in other words, your gross cost from the Ogden impact is (14:37)...

A - Anthony Jonathan Reizenstein

No, our premium. Our premium. Our premium.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Yeah. Yeah. Which is 8.5% of your...

A - Anthony Jonathan Reizenstein

And (14:44) has been talking about 50% rises based on the gross cost this year. So, you'd have to (14:52)...

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

And look – yeah, in 1 million layer (14:54). So, I think that we are – we've got a balance sheet. We've got options. And (14:59) as I'm sure you know, if there's an event and pricing goes up there's also a capacity increase which sometimes has a dampening effect on prices. So...

A - Anthony Jonathan Reizenstein

We'll see when we get there. And obviously, we'll take corrective (15:11) actions to protect (15:11) ratio.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Sorry to be so (15:14). But on that 50% increase in costs...

A - Anthony Jonathan Reizenstein

No. No. No. No.

(15:18)

Q - Greig N. Paterson {BIO 6587493 <GO>}

People with 1 million (15:19) retention.

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

Yeah. That's right.

(15:21)

A - Anthony Jonathan Reizenstein

You read in the newspaper, some people are saying (15:25) 50% (15:26) or a number that we have experienced, okay? On the runoff, we'll probably come back to you on that. But the capital for reserve is with the whole £400 million at year-end. And it – so, you can probably say that (15:41) in terms of the (15:43) of that book.

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

So, we'll come back to you on that. And then, systems, listen, we're taking our time. We're trading really well on (15:49). So, we're in no particular rush. But we can continue to work on next-generation systems. But as of today, we've got awesome website, great mobile (15:59) great customer experience, great claims experience. So, we're in no particular rush to do it, Greig. And you'll be the first to know...

(16:07)

Q - Greig N. Paterson {BIO 6587493 <GO>}

The reason I asked the question just out of concern, I mean, (16:10) mutual came in at £0.5 billion on the life business transferring it. I'm just saying these can be significant (16:16) issues. My understanding is that you would eventually – (16:20) going to roll this out about 18 months ago.

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

No, I didn't...

Q - Greig N. Paterson {BIO 6587493 <GO>}

(16:22) delay, and so, I'm trying to understand what's going on there.

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

No, I mean, I think about a year ago, we said, we hope that we might do it in that year. So, we're not – I don't recognize 18 months. But we're just – and so, we're taking our time for building systems for the next 5, 10, 15 years, as I say, against the backdrop of delivering awesome customer experience, awesome digital experience, great loss ratios, growth, and new propositions in Direct Line. So, we're in no particular rush. So, we're approaching that very calmly and we'll launch it when we're good and ready to do so, and making sure it's ready to go. And so, we'll take our time.

Q - Greig N. Paterson {BIO 6587493 <GO>}

(17:05). Thank you. Thank you. Farewell.

Operator

The next question comes from the line of Thomas Seidl from Bernstein. Please go ahead.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Good morning. Three questions. First, one more on pricing – I'm sorry about this. So, it appears that you took a little bit less price actions than some of the peers, one side is it's mixed driven. But then, it seems (17:29) that it is based on your assumption about reinsurance prices. So, is it fair to say that the current price change you have taken is assuming flat reinsurance price next to renewal? That's my first question.

Second question, at the full year numbers, we reported a strong rise in price comparison business on Home eating (17:52) into the margin. To what extent has this continued in Q1? And the third question is your comment on bodily injury in the context of your guidance of slightly lower reserve releases for this year. So, does this make you more confident on the reserve release side or stable to full year numbers?

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

Very good. So, let me try and pick the pricing a little bit. So, Q1 data, which we give here, are 6.6% (18:21) like-for-like price strategy because we had some risk reduction in there. We've said that it's significantly higher than that if you take a like-for-like pure pricing view. And we said, actually, it's significantly higher than the industry data for Q1, which was we take IPT, up 7.2%. So, (18:41), which is the most reliable source, 7.2% Q1 pricing. And we're saying our true pricing is higher than that. So, that's Q1.

Q2, obviously, we've seen a bit more price go through post Ogden. People like brokers, who have quite a delay in how they price and some of the go through panels (19:00). Their Ogden response wasn't in March, and it only comes through in April. So, we have taken collective pricing actions, quite specific ones. Again, in April, some of the market has as well. All the market (19:13) we have to do in terms of covering our cost is to price our net costs to reinsurance. So, all the claims for the business we write today will be at the £1 million reinsurance deductible. So, the arrangement covers all business written in 2017.

The point about the gross cost is at some stage, obviously, there, we have to face the fact that reinsurers – unless the rate goes back to the consultation to where it started, the reinsurers have an extra cost to pass back to the insurers. And all we're saying is at some stage, that has to be faced. We have to face that later than some of our peers. And that's the only comment that we're making. So generally, I'm feeling that we are – we're very comfortable that we price at the cost that we see, and we're pleased at the same time (19:59) pricing what we need to price to hit the loss ratios we want to hit. We're also headed (20:03) to grow our share. So...

Q - Thomas Seidl {BIO 17755912 <GO>}

And there are risks then that basically now, we see flat cost for 2017, you gain market share. And then when you – we don't know that – hit by a price increase, you take more price action next year and then give back this gained market share next year then.

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

Yeah. I mean, we're cognizant of future costs, and we have a view to that. And I think the market does as well, which is why it looks to us that the market has been taking more pricing that needs to cover the net costs. But yes, so we are quite sophisticated in thinking through how pricing will evolve in the market and for our customers.

Yes. Now, the final thing, I think you talked about – Home profitability and PCW. What we're calling out today isn't anything to do with channel mix. What we're saying is across all brands and all channels and across the market, the claims costs have gone up significantly to this – the biggest peril which is escape of water, driven by all these tradesmen's costs, shortage of tradesmen, building cost going up, that's kicking (21:12) the whole industry, we are taking pricing, claims and underwriting action, we haven't yet seen the market do the same. So, the market price is stable, not going up. So, we're just calling that out.

Now that could be evidence of what we talked about for a while, which is a market which has got quite a lot of supply into it, the reinsurers entering the markets (21:36) some of the motor competitors entering the home market.

Q - Thomas Seidl {BIO 17755912 <GO>}

(21:38) Yeah. But is there more switching and more business done through price comparison in Q1?

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

A slight uptick of price comparisons, but that's not really at the expense of Direct, it's the expense of other channels like kind of the bank channel. So, we're seeing generally, we're pleased with how Direct is going within the mix.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. And the reserve outlook for the year, has it changed with bodily injury benign (22:03) in Q1?

A - Anthony Jonathan Reizenstein

Yeah. I mean, it's improved. The outlook for Motor reserve release is better than it was. Obviously, we'd said it would be lower. And it's a bit early to adjust that statement from, yes, it will be lower. Obviously, the movement we thought at the time they would be contributed to our 93% to 95%. And the movement we're currently playing (22:29) will contribute to our 93% to 95%. So, we're not really saying in total group that there's any change in our overall picture, and we said there's offsets from Home to that benefit on the bodily injury on Motor.

Obviously, as a comparison, I should say probably, lower is pre-Ogden, because, obviously, post-Ogden, it probably will be higher. So, I'm sure you'd already worked that one out. Let's wait to Q2, we'll give much more guidance, and obviously, we'll have a reserve review we'll publish net (22:58) profit and everything else. But obviously, we're pleased that it's going in the right direction.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Okay. Thank you very much.

Operator

The next question comes from the line of Wajahat Rizvi from Deutsche Bank. Please go ahead.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

I'm Wajahat Rizvi, Deutsche Bank. Thank you for taking my questions. Couple of questions on reinsurance again. With your reinsurance arrangement, do you expect further growth pickup in the

Motor books for the rest of 2017 as you mentioned other players like broker with push further price increases?

And, secondly, as you mentioned, we've been hearing like reinsurers talking about 50% to 100% increase in excess of loss prices, given now PPOs are likely to be much less of an issue with the Ogden rate where it is. Could you consider increasing the attachment point back up again to reduce the impact of higher insurance prices? Thank you.

A - Anthony Jonathan Reizenstein

Well, on the second point, yes, we would consider that. We considered it last year actually and we certainly will consider it this year. And we've got the balance sheet just for that. So, yeah. Good point.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

On the lower layers?

A - Anthony Jonathan Reizenstein

On the lower layers, yeah. The first point, I didn't quite catch the point,(24:11) the market, the question about (24:12)

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

Can you just – sorry, just restate the question again, first question.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

Yeah. So, the first question was like, you have your reinsurance arrangement fixed for the year and you would expect other players to push price increases through, let's say, (24:22) renew their reinsurance program in the summer. And as you mentioned, some brokers would push further price increases through. So, would you expect some pickup in growth in the Motor book during the year as the Ogden impact really starts to come through in prices?

A - Anthony Jonathan Reizenstein

Look, I think we'll trade the (24:43) market as best we can. And if there are opportunities to (24:48) at the right loss ratio, and so we will do that. So, it may be an opportunity, so we'll have to see. We don't know how people are going to behave. We know (24:57) what their attitude is to the costs they may or may not pay on reinsurance. They may also have choice (25:02) about what they do. So, I think it's a kind of speculation, that's your job more than our job. (25:06)

Q - Wajahat Rizvi {BIO 19928187 <GO>}

Yeah.

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

(25:06) I think we may have some more clarity, and I think we're very clear, we have a North Star, which is we'll only write business for the value we want to write it at. And we'd like to grow as much as we can once we're writing at that level. So, we'll see what opportunity the market gives us.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

Thank you.

A - Operator

(25:28)

The next question comes from the line of Kamran Hossain from RBC. Please go ahead.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi. Morning, everyone. Can I ask about the, I guess, the change in environment since the FCA Disclosure Rules came in? Have you seen an increase in switching behavior? And also how are kind of own brands trading in this new environment? Thank you.

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

Yes. I mean, pretty early days, this was a change that we were very much in favor of. We think transparency's a very good thing. And so we're pleased it's happened, we've kind of staffed it up a bit for extra calls and we are – generally, our experience has been kind of in line with expectations and we're having good conservations with customers. They were already actually pretty aware of their previous year's premium but it just makes it easier for them to do it. So, I think in line with our expectations, which is this is positive thing.

And we further raise customers' awareness of what they were buying before. And as we said before, in a high-shopping market, which just continues to be, the great news is we do well in that market. Customers like our combination of price and service and proposition and products and brands. And that was true in 2016 and that's proving to be true in 2017, very pleased with our retention rates in the quarter. So, yes, as anticipated.

Q - Kamran Hossain {BIO 17666412 <GO>}

Great. Thanks very much.

Operator

The next question comes from the line of Andrew Crean from Autonomous. Please go ahead.

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

Good morning, all. Actually, three questions if I can. Firstly, (27:10) from the Solvency II ratio, are you considering the sale of your legacy book? Secondly, do you have any views on the political timetable, post the snap election, in terms of both the whiplash reforms and attaching any Ogden changes?

And then, thirdly, when you're talking about large BI runoff, is the positive impact coming from claims settling lower than you'd anticipated or is it coming from a lower anticipated PPO settlement pattern, which would obviously, if Ogden stays where it is, no longer be a positive force (27:57)?

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

Yeah. Let me just deal with the easy one first on the election, Andrew. So, the good news is since we last spoke all together, we said at that phase (28:12) the government was talking about doing a quick consultation and wants to find a fairer solution, and they've backed it up with actions, which is a commendably concise consultation periods and we're right in the mix of submitting I think quite compelling case for change.

We were obviously, cognizant of the fact that if that required primary legislation, it needs a (28:33) legislative vehicle and the obvious one of that was the Prison and Courts Bill, which also houses the whiplash reforms. I guess, in some way, the good news is that train is firmly in the station with the election. So we don't think we're going to miss that train, but there's (28:46) bit more of a doubt about when that train leaves the station post the election.

And we are hopeful that it will be an early priority of the government because obviously, there's a range of positive measures in there. So, we hope that that bill will get going again. But clearly, the delay is going to be a delay to that bill and whether that therefore, can be enacted this year or early next is really the debate. So I think it slightly pushes the prospects for the inaction (29:15) of a consultation back a bit. And of course, the whiplash measures were in there and it probably pushes them back a bit as well.

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

Paul, just one thing on that, if the Prison and Courts Bill pushes back beyond the year-end, would that lead, therefore, to the three-year rolling average minus 0.75% actually getting worse?

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

Well, they haven't – obviously, they didn't say what their ongoing process would be. And I guess it will be in the context of where the consultation comes out. So, I think – let's wait and see what the consultation (29:51)

A - Anthony Jonathan Reizenstein

I think the other thing is if in that scenario, nothing happened, (29:55) government on this topic, we were left with what little chance it's had (29:59) at the end of February. Then the next question would be, well, how often are you going to review that, and so on. So, there are some adverse scenarios and you pick one.

Just on the other two, the legacy book, we have – obviously, it's mainly PPOs. We've talked to people in the past. We've had a lot of messy (30:19) debates about the cost of a PPO, and it's very hard to reach agreement with people. And so, we've not been able to trade, but we're open to people who've got – (30:28) and we always say people that want to come and talk, we'll talk to them about it.

Large BI, yeah, PPO certainly (30:34) has been better than expected. And we've also had good experience on severity and lump sums.

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

The question on the large BI was, is this a function of the fact that lump sums are settling at less, or is it because you're assuming less PPOs, which are obviously more expensive, which is leading to the release?

A - Anthony Jonathan Reizenstein

Both. Both. Mix. Mix. (30:56) Both.

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

Okay. Thanks.

Operator

The next question comes from the line of Arjan van Veen from UBS. Please go ahead.

Q - Arjan van Veen {BIO 5197778 <GO>}

Thank you, gentlemen. Two questions, if I may. Firstly on the Motor own-brand growth of 5.9% in-force policies, and 11.2% in gross written premium. Can you give some color as to the split there between Direct Line brand and other brands?

And then secondly, you did an update this quarter on expenses, which you had done in previous quarterly updates. Could you give some commentary either in absolute terms or on an expense ratio basis how expenses are trending? Thank you.

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

Yeah. I mean, most of our Motor growth has been through Direct Line brand, which is very positive, but we are holding our own – our PCW brands are holding their own but a lot of the growth is through Direct Line, which is positive in line with the trend that we highlighted with all the benefits that we highlighted last time. John, costs?

A - Anthony Jonathan Reizenstein

Yeah, it remains a big focus, especially fixed costs. Obviously, there is an advantage of moving to the ratio, I mean if you are growing, which we are, that gives you the ability to spend money carefully on those two pretty (32:11) variable costs. As Paul's already mentioned, we put more people in the front line to deal with calls and that's sort of cost I'm happy to see increase but very, very tight on fixed cost. And we've got to pay for investment as well.

(32:24) for this ratio approach caters (32:26) better actually for us, now, we are continuing to grow than the old absolute cost targeting and publicizing that target. But clearly, internally, we have very clear absolute cost numbers. And don't read anything into the fact we haven't published the absolute costs, they move up and down quarter to quarter and there's nothing to worry about. And the fact we haven't published it this quarter, we're on track (32:54) to get our ratio to be below – our cost ratio to get to be below what it was last year.

Q - Arjan van Veen {BIO 5197778 <GO>}

And any sort of rough idea in terms of I don't know if the (33:02) question was asked before around when we could expect to see some of the additional cost-out to fall out as you start switching out some of the legacy systems?

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

Yeah. I mean, I'd tell you this. We've got huge range of cost initiatives, all of which are kind of have been delivering and will continue to deliver. So, there's not one silver bullet to this. There's a lot of individual initiatives which I've got a good track record of delivery and have got further to travel on many of those levers. So...

A - Anthony Jonathan Reizenstein

But I mean you're referring to automation, I mean we're continually looking at ways to automate.

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

Robotics, off-shoring, on pretty much most cost headings we have initiatives: procurement, IT costs. So, we have a very firm view of what our cost ratio needs to get to in our plan and we have a range of initiatives to do it, and we work hard to deliver it. We got a good track record.

Q - Arjan van Veen {BIO 5197778 <GO>}

Okay. Thank you.

Operator

In the meantime, our next question comes from the line of David Bracewell from Redburn. Please go ahead.

Q - David Andrew Bracewell {BIO 16394801 <GO>}

Yeah. Good morning, guys. Two quick questions. One, just on Motor insurance. I'm just wondering, post-Ogden, whether (34:27) you've seen a change to competition, and I'm thinking perhaps some of the smaller insurers who have maybe taken a bigger hit to capital, I don't know if that's affected their appetite for new business and, therefore, competition levels in the Motor insurance market.

And the second level is on your own Motor book, and it seems to me that every quarter, we see your risk mix reducing. I'm just wondering (34:48) how much more – how long can we continue to see kind of your risks in your Motor insurance business continue to reduce? And just on that, I mean, is that actually you physically writing lower risk business, I don't know less younger drivers? Or is that actually – you're actually looking at the data and just saying that the actual – your current book of business is now being modeled to be less risky as opposed to actually physically reducing the risk of the business that you're actually writing. I hope that make sense. Thank you.

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

Yeah. No. Very good question. And I think on the latter question, it's a bit of both So, I think the first point is we don't target a reducing risk mix per se. So, it's not like we don't want to write young drivers. We have very rational prices, scientific prices. So, it'd be great actually to – sometimes it helps some of the optics if you can get your OBP (35:45) increasing. So, it's that will always be that way around. It happens to be this time, we probably have priced more firmly on young drivers, particularly post-Ogden for reasons that I talked about and the market we observe.

There is – as you rightly to picked up, there is kind of a modeling phenomenon here which is, as our pricing models improve, we will tend to write more of the risks that we think are lower risk almost by definition. And that is a real thing, but that's slightly separate from us targeting specific groups of risk differently. As I say, we have quite a high appetite to be able to write these bigger ticket-sized risks if our pricing models find them attractive. So, it's not a religious point, this kind of – it's all about science.

In terms of smaller players, I mean, I think it's far too early to say who's competitive in the market, that (36:38) tends to move around a bit like a (36:39) as I've said certainly before. (36:40) But I think – yeah, that's probably all I should say for now, I suspect at the half year, we can give you probably a bit more of insight into the market.

It's still relatively early days. You've got to remember, the renewals, there's about a 30-day lag to renewals being priced because renewal notices would have already gone out for the March renewals. People like the broker panels take pretty much a month to turn around their pricing. So, really, we are still at the start of kind of some of those things. So, why don't I reserve an answer for how we think it might slightly change market dynamics for the half year, if that's the case, David.

Q - David Andrew Bracewell {BIO 16394801 <GO>}

Yeah. Thanks. Thanks, guys.

Operator

The next question comes from the line of Alan Devlin from Barclays. Please go ahead.

Q - Alan Devlin {BIO 5936254 <GO>}

Hi. Thanks, guys. Two quick questions. First of all on Ogden, again also on the claims side. Are you seeing a big decline in PPOs that we would expect? And if you are, how should we think about that from a capital perspective? Presuming that we'd have a (37:40) capital benefit as well?

And just second on Commercial. On your Direct Line for Business, you're pretty optimistic about that one, what initiatives you're running there. Can you give us more details? And then also on the broker business in Commercial, your policies are up, but you're premiums down. And what are you doing at that to (37:59) improve the loss ratios and returns? Thanks.

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

Okay. Thanks, Alan, for your quick questions. Some quick some quick answers really. Too early to say on PPOs. DL4B, lots of great stuff, probably say more at the half year, we'll do a little bit of a focus I think at the half year on DL4B, we have some really good stuff to tell you, but a little bit early to tell you now. Alan, the broker business, that mix really is mixed between various products that's driving that trend. Your friends are mine, the old mantra (38:29) very much got a brief (38:33) on that business to certainly strike a balance between volume and value. And in particular, we've got a little bit more to go in terms of getting the type of (38:43) value we want and you're getting good rates away (38:45) whilst cognizant of the volume as well. Yeah. So, I'm pleased with each of the components of Commercial against slightly different objectives.

Q - Alan Devlin {BIO 5936254 <GO>}

Thanks for the answers.

Operator

Our final question comes from the line of Rick Paterson from ABW (sic) [Greig Paterson from KBW] (39:05). Please go ahead.

Q - Greig N. Paterson {BIO 6587493 <GO>}

It's Greig again (39:08) Can you hear me?

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

Hi, that's Greig again. (39:13) More aliases, Greig.

Q - Greig N. Paterson {BIO 6587493 <GO>}

Told you I'm in disguise. I was speaking to someone the other day, PPO costs. Is it not true that the way retention levels work on PPOs and how – or deductibles work and how they are indexed to claims inflation, ultimately means that even after these Ogden changes, the PPO cost is higher than the lump sum? I don't know if you get my question. In other words, apparently, the retention deductible levels change, they're linked to claims inflation. It also means that PPOs are more expensive than large BI. Do you recognize that point?

A - Anthony Jonathan Reizenstein

PPO's definitely more expensive both in terms of cost and capital than lump sum claims and...

Q - Greig N. Paterson {BIO 6587493 <GO>}

This is post Ogden? Post Ogden?

A - Anthony Jonathan Reizenstein

Post Ogden, relatively more expensive. Oh, don't know, need to think about that.

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

Yeah. We'll come back to you, Greig. Good question.

Q - Greig N. Paterson {BIO 6587493 <GO>}

All right. Good. Thank you.

Operator

There are no further questions in the queue, so I'll turn the call back over to your host for any concluding remarks.

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

Terrific, guys. Well, listen, I've given you two things we're going to discuss for the half year and plenty more. It's been a good quarter. Look forward to speaking to you again soon. Thanks very much.

Operator

Ladies and gentlemen, thank you for joining today's call. You may now disconnect your handsets.
