Admiral Group PLC Interim Management Statement Presentation

Company Participants

- David Stevens, COO
- Henry Engelhardt, Chief Executive
- Kevin Chidwick, Finance Director

Presentation

Henry Engelhardt {BIO 3022947 <GO>}

Good afternoon. And welcome, everybody. Thank you for fighting your way through, I guess, what is it? It is Youth Day in London; is that the idea? Thanks for joining us here this afternoon. I'm Henry Engelhardt, Chief Executive of Admiral Group. And this is the analyst part of our investor day. So what we are going to do here today is first me, I will talk for a few minutes. Sorry. Plan B. (multiple speakers)

Good afternoon. We will keep going. So what do we have today? I will talk for a few minutes. David is going to go into quite a lot of good detail on the UK market and what our announcement today means. Kevin is going to talk about one of his favorite subjects, accounting. And then I'm going to wrap up. And then we will have some questions and some answers. Well we will have some questions anyway.

When I'm doing a talk, I always start creating the talk by trying to think what do I want my audience to come away with. And I recognize if I'm going to talk for 15 minutes or half an hour -- and, believe me, anything over half an hour and I put myself to sleep -- you are only going to come away with a couple of points out of that at best. So what I would like to do now is tell you what I would like you to come away with. This is what I would like you to walk out of here with, if you hear all the evidence and it is all trundling back and forth in the head. But what are really the main points here?

And the first main point is that management is disappointed with the second-half numbers to date. That is, without a doubt, we are disappointed. This is not, however, a disaster. Not winning the World Series for 103 years, that is a disaster. This is a disappointment. And we are working flat out, everyone at Admiral is working flat out to ensure that 2012 does not disappoint.

Second point, Admiral is a good business. The model, as it were, is not broken. We still have market-leading combined ratios. We still give great service to millions of customers. And we are still a very cash flow positive enterprise.

And lastly, long-term we are very positively placed. We have superior economics. We are an environment, particularly in the UK but growing in the other countries to which we trade, where survival of the fittest is important. And particularly in the UK, we are the fittest.

So we are going to go into a lot more detail in the next few minutes on those items. But if you do take nothing more away from this presentation, take that. The management is disappointed. But it is not a disaster, the model is not broken. And we are very well placed for the long-term.

So what are we saying? We are saying that the second-half profits are likely to be less large than the first half. Your good selves, the analysts, have said -- given us a range of forecasts for the second half from GBP121 million all the way up to GBP207 million with the mean being GBP162 million. And at the end of the Third Quarter, I would not say our guess but our view of the situation is that we would finish between the GBP120 million and the GBP160 million for the second half. This would be about a 10% profit increase year on year, 2011 over 2010. It would represent, as far as we can see, at least 11th consecutive year of record profits for the Admiral Group.

There are highlights. Turnover increased 30% Q3 to Q3. The vehicle count nearly matching that at 27%. International getting bigger and getting bigger somewhat quickly 45% on turnover and 53% on units. Annualized the UK vehicle growth rate, the rate has dropped to 13%, even though the year to the Third Quarter is 30%. So you can see we are slowly down the growth. We have put through premium rate increases. From the information we can gather, this seems to be faster than the market. And UK ancillary contribution per vehicle in line with what we announced at the end of the half year. The combined ratio remains significantly lower than the market. And I think what you are going to hear about is volatility in our results. But we are still between 85 and 90 on combined ratio. And tell me there is not another British insurer in the market that would not bite our arm off for that kind of combined ratio. And our financial position remains strong.

The second half, as I said, will not be as profitable as the first. This is largely because of the frequency and expected costs of new personal injury claims, mainly the large injury claims. This is not a back year readjustment. This is not 2006 raising its head in an ugly way. This is claims that have come in for the 2010 and 2011 years and come in recently. And we do, therefore, expect some adverse development on those most recent years, 2010 and 2011. But as you all know, the nature of our profit commissions being what it is, a 1% movement in loss ratio on those accounts, 87% to 88% -- and 87% is good and 88% is not bad -- but that will have a pretty big effect on profits.

And so, as I said, if there is no reversal. And there could be a reversal, we still have quite a bit of the half-year left to go. We would anticipate full-year pretax profits to be some 10% ahead of 2010.

In the future we have a lovely history of sustained growth. And the scale of our business, we believe we can make scale pay, particularly in pricing. We are twice as big as we were just two years ago. And our combined ratio advantage over the market is some 20 to 30 points. All this puts us in a very strong position for the future.

And now David will give you a lot more detail. Thank you.

David Stevens {BIO 6807391 <GO>}

Thank you, Henry. I am going to cover three areas -- a brief update on the market what has happened in the last three months, a relatively brief look at the regulatory environment. And a much longer visiting of the underwriting performance.

Market update, we said at the half-year, that probably premium increases were coming to an end. The price index that is publicly available is supporting that assertion. We see the market having gone up in the first half by 7% to 9% and probably down in the Third Quarter by 2% to 3%.

Our own price changes will become available -- have moved ahead of the market. Our price changes here are showing new business and renewal combined. The market is new business because we don't have access to any renewal data. And you can see that we went up 11% in the first half and a slower but still increased rate up 2% in the Third Quarter. So that by the end of the Third Quarter, our rates are up 14% versus the market's 6%. So well as in 2010 our increases, we believe, somewhat lag the market. 2011 we think we are moving somewhat ahead of the market.

Now it is not just rate activity. But it is suggesting some return to appetite out there amongst our competitors. An interesting other data point is advertising spend, direct advertising spend. And we have taken one month here -- okay, one month may be something of a misleading snapshot, although September is traditionally the peak month for advertising and car insurance. And you can see that the spend by the price comparison sites is up year on year by 13%, roughly in line with the volume increase through price comparison sites. But the spend by direct brands is up almost 90%. 75% of that spend is attributable to four brands or four companies -- RBSI, Lebagutoria [ph], AXA. And Aviva.

Now our growth rate in quarter three, the annualized rate was 13%. This is down from the 30% annualized rate we saw in the first half. But still it represents growth in the face of relative price increases and direct advertising spend, although, to be honest, the latter is not really that material in terms of our own performance. It reflects partly the fact the price comparisons you see on the right-hand side here has continued to grow, up 11% quarter three 2011 versus quarter three 2010, pushing that share of new business up 5 to 6percentage points into the late 50s, early 60s.

Actually before I give regulatory environment, I think if you look at our growth prospects and you look at our view for 2012 of the growth in the price comparison market, which would be around 10%-ish, if we maintain our current level of competitiveness, i.e. the level we have at the end of quarter three, then we would anticipate that our business would grow in 2012 by late single digits or early double-digit percentages.

Okay. To touch on the regulatory environment, the regulatory environment has been somewhat changed over the last couple of years. And there are essentially two drivers for this. One driver is an overall change in the tone of regulation of financial services since the banking crisis. We are seeing potentially a more interventionist view on the financial service regulation. And this has been reinforced also by the fact that the rises in car insurance premiums over the last 18 months, two years, makes this something of a political issue and has taken car insurance up the political agenda. And so you are seeing more regulatory activity than historically has been the case.

The obvious and quite high profile example is Jack Straw's initiative in relation to particularly referral fees, which is potentially manifesting itself into a bill that goes before Parliament in early 2012, which has a number of potential facets to it. But obviously the most high profile one is the ban on personal injury referral fees.

There has also been recently a call for evidence by the OFT, which is a sort of a bit of a catchall call in relation to car insurance. That covers the truly macro, why have car insurance premiums gone up? Is there a competition issue here about which one can be confident. And the answer would be no. Two micro issues around you know as far as like Northern Ireland rates versus the rest of the UK and the relationships of insurers to their approver parent networks.

Now an issue in terms of this regulatory activity that is an issue for ourselves and it is an issue for all insurers and certainly all distributors of car insurance is whether the increased regulatory intervention has some potential to compromise the flow of ancillary revenues. And I think what I would like to make as a point in that context is it is important to understand that ancillary revenues are key to many players across the market. And Admiral is not uniquely reliant on that ancillary income. I think the RBSI Investor Day presentation that recently occurred gave some interesting data points. And I have picked a couple just to actually illustrate that one of our key competitors is also -- finds ancillary, or other income as they tend to call it, an important part of their economic model.

So in that Investor Day, RBSI says that on every owned brand they sell, they earn GBP60 of additional income from products within their portfolio such as rescue, which is breakdown, recovery and installments income. If we take our own revenue, our income from legal cover of optionalized service and installment income, it is of the order of GBP55.

Now maybe apples and pears to an extent, the income revenue contribution, these words are imprecise. What exactly is included in products within that portfolio imprecise. But the point I'm making is that they are not a more order of magnitude different. They are of a similar scale. And if we look at another data point referral fees, RBSI made the point that they receive GBP15 million in the first half from referral fees. We have given a data point historically, which is our income from personal injury referral fees. Now our income equates to around 1.1% of our premium. Theirs from referral fees equates to around 1.7%. Again, there is a risk. But it is apples and pears because what is included in referral income and what is not. The point I am making is not a direct 1.7 to 1.1 comparison. It is these things are material for practically all players in the market.

Then let's go on to look at a market-wide view. We did have an exhibit a while back where we took the combined ratio historically. And we attempted to estimate the combined ratio adjusted for the major other sources of income from car insurance, which are investment income and ancillary income. And what you see is that the 17-year average for the combined ratio is around 111%. And when you add in these other elements, the market comes to around 100% over a 17-year period.

Now actually the combined ratio we are showing here because we could not get all the data all the way back is purely a result unadjusted for premium releases. So if you adjust for premium releases, the combined ratio result is probably in more like 108%, 109%. And the results after investments, income and ancillary is probably more like 98%, 97%, which roughly corresponds to what it takes to cover the cost of capital.

But the point I'm making here is that there is a cross subsidy of car insurance in the form of both investment income and ancillary income. Historically it was in the form of investments income. Currently it is more preponderantly in the form of ancillary income. And if there is across-the-board reduction in ancillary income available through to regulatory intervention, the response is likely to be that the underlying car insurance product has to be more profitable. So in a sense there is not necessarily a loser from that change overall.

Now there might be somewhat within the market as a whole, there might be winners and losers. And we would speculate that those people who rely on car insurance profits heavily for their profitability. Pure insurance profits would be as good. Underwriters would be winners. And the losers would probably be particularly price and comparison bakers who run a model of negative commissions where they have to recoup the price comparison cost through very aggressive maximization of ancillary revenues. And there is a frustration in a sense to hear conversations about Admiral's unique reliance on ancillary income when, in fact, we make money on underwriting, assuming a large portion of our competitors lose money on underwriting and truly rely on other sources of income to make any money at all.

But then I hear you say. But surely Admiral is different because of your reinsurance model, whereby a pound of ancillary income is worth a lot more to you than a pound of underwriting income. And I would say that was definitely the case historically. But it is no longer clearly the case.

So what we have done here is we have looked at our historic tracks. And we have said, if we were to achieve an 85% combined, what would be our share of the various different profit flows? And going back 10 years and even five years, essentially we only captured half the underwriting return. Going back -- looking at our more recent contracts, we are up to knocking on the door of 90% of the return. And in fact, if you were to include capital costs in your calculation of underwriting profit, you could argue that it would be higher than 99%, 89% because we don't have the capital costs on the 72% of our business.

So what I'm saying now is, in fact, we are at a point where we are relatively indifferent between ancillary income and underwriting income.

I'm now going to go on to talk about underwriting performance. At the half year, there were some concerns that were raised. One of them was the increasing combined ratios in 2009/2010. And one of them was the fact that despite high premium inflation, 2010 and 2011 accident years were not showing as much of an improvement as one might have anticipated it given that premium inflation. And this was because we were seeing that premium inflation heavily offset by bodily injury.

Now I'm going to start by talking about the high premium inflation. And then I'm going to talk about the other two. And in talking about high premium inflation, what I would first like to do essentially is talk to you about what has really happened in the market in the last 18 months, two years, what has happened to us in terms of actually achieved price increases. And the first point I would make is beware reported rate rises. They are not necessarily one for one indicators of experience rate risers. And we have done a piece of work here to try and illustrate that.

For the market as a whole here, we are looking at premium rises of 11% and 36% in 2009 and 2010, which is taken from the Confused/Towers Watson and IGO4 indices. It relates to new business rates, not all rates. But that is what is available to us. If you then look at the implied written premium at the year-end, if you indexed the premium to 100 at the beginning of 2008 -- sorry, the beginning of 2009, then you see that the implied written premium at the end of 2009 is 111, at the end of 2010 it is 151. If you then get the average written premium from those implied end-year premiums, it is 106 and 131. And then you can derive the implied earned premium of 103, 119. When you divide -- when you look at 119 versus 103, you have an implied increase in earned premium of 17%.

What is the actual achieved increase? Well the treasury returns, which cover around 70% of the market, show a 5% increase in the average earned premium. So you are seeing a materially lower number as you feed through.

Now what are the possible reasons for this? Well one is that the indices are new business and not renewals. And renewals might have gone -- have paid differently. One is there may have been a mixed effect. In a sense, it has to be a cross-market mix effect that some of the higher premium risks might simply have been priced out of car insurance altogether. And what we are also certainly seeing is much more activity by the customer in the face of economic pressure and rising car insurance premiums to get the lowest possible car insurance premiums by fair means or foul. Fair means meaning, for example, accepting the higher excess and the excesses across the market have moved up substantially, or by very active shopping and a very active running through of quote permutations with accurate data to come up with the lowest possible price. Foul means you simply lie. And that is in a sense unfortunately much more of a factor than it would have been two or three years ago.

What about Admiral's own experience? Well we have talked to you about premium rate rises in 2009/2010 and the first three quarters of 2011, which have been 12%, 26% and 14%. This is new business and renewal in this case. And you can feed through mathematically through the same prices, I will not step you through each line. But what you get then is for 2009 and 2010, if these indices have since fed through, these model rate rises have fed through 1 to 1, you would have got written increases of 21% in 2010 versus 2009 and 21% again in the first three quarters of 2011 versus 2010. And the earned increases, which obviously operate with something of a lag, would have been 16% and 21%.

What have they been actually? Well the actual written increase was 16% in 2010 versus 2009 and 14% in the first three quarters of 2011 versus 2010. And the actual earned is 8% and 18%.

Now, if you compound the actual written increase of 16% and 14%, you get 32%. If you compound the actual increase in earned premium of 8% and 18%, you get 27%. That 5-point difference actually represents the elements of premium increase yet to feed through into the earned premium but already built into the written premium.

Okay. So I have talked a bit about the in a sense true underlying situation on premium inflation. And now I'm going to talk about the increase in combined ratios of 2009 and 2010 and the higher personal injury cost on recent years. And I'm going to talk about those in combination first off because I wanted to set the scene in terms of the bodily injury situation overall.

No real news on this one. It is just the bodily injury gets bigger and bigger as a portion of the whole. Factors like people taking higher excesses, of course, accelerate that. But this is a chart that we have centered in the past. But it is important in this context. If you actually then split the value of bodily injury claims into bans by size of claim, what you see is that the bigger claims represents a very big chunk of the total. You know, the coverage in the press, the conversations around regulation and intervention tend to focus very heavily on whiplash, on fraudulent claims, on claims per claim because they actually tend to be mainly down the lower end of value of bodily injury. And in truth, a lot of the value in bodily injury is around the upper end. And if you look at the left-hand side of this segment, 50%, just over 50% of the claims in value are attributable to claims over GBP100,000.

Those claims represent roughly 2% of the volume of bodily injury claims. They equate to around 70 or 80 claims a month coming into Admiral of that sort of scale.

Now there is a large degree of volatility in the evolution of car insurance accounts. And that volatility is largely, although not exclusively, attributable to the timing of new bodily injury claims, the recognition, the movements on those bodily injury claims. And to try and demonstrate that, we have taken the underwriting years 2001 to 2009. And we have tracked the development of Admiral's case reserves from month five to month 24, actually divided by the earned premium. So really it is a loss ratio calculated as the sum of all claims costs divided by earned premium as it evolves in the first 24 months of the life of an underwriting year. So it is unaffected by any actuarial projections, any IBNR, any smoothing of any sort. It is sort of in a sense the sum of all claims in the raw. And what you see is that years take quite different paths to arrive at 100 and the pattern of the walk is quite volatile. And when you are going back, for example, to month nine, which is early in the evolution, there are a number of different positions ultimately ending up at 100. Now obviously the 100 varies. But I think you understand what I mean by this projection.

Now, as some reinsurance that life and car insurance is not totally without predictability, then I think I would add that the evolution of the accounts over the next two years is rather more reassuringly stable. So luckily what we have done is we have taken the equivalent things that if we moved the endpoint, the 100 index to month 48 and we have taken 2001 to 2007. And you can see that the lines converge, the patterns are rather more predictable. Certainly once you have got past the month 30-ish. But in the early stages of an account, life is volatile.

And so I go back to the increase in the combined ratios for 2009 and 2010. And I would say that in the six months -- the first six months of 2011 what we saw is that injury claims in relation to accident years 2009/2010 behaved slightly less well, i.e. the release is slightly more slowly than we would have anticipated based on historic trends. I would say that estimates on ultimate years, as I have talked about, are estimates with a degree of uncertainty. And they can vary materially in either direction. This does affect us more than it used to for two reasons. The growth of bodily injury as a portion of total makes life less predictable. And our increased share of the underwriting makes us in a sense more exposed to that unpredictability, the offset being we have more of the profits at the end of the day. And this is true not just for us. This is a feature of car insurance. And it is true of our competitors. I will not dwell on this. It is just making the point that the fact that 2009 and 2010 got worse is why our reported combined ratio was worse and why in a sense our releases were worse.

Let's move on to the data that supports the assertion that it is a volatile world that we all live in in car insurance. And so what you have here is the releases or strengthening were negatively called strengthening reported in the treasury returns in relation to 2009 and 2010 years of accounts by some of our major competitors. And you can see that the numbers bounce around not always in the same direction. And the movements are quite material. So it is a volatile world.

Admiral arguably is more volatile than some of our competitors because if you look at, for example, AXA, the fact that UK car insurance is volatile, it's neither here nor there in the big picture of AXA's overall accounts. And the same is even true of Aviva. So the fact that we are a UK, largely a UK only, an exclusively car insurance player does not mean that we are more volatile in that sense.

I think beyond that true volatility we have also perhaps given ourselves a higher perceived level of volatility through a couple of things. One is that we are very open in our actuarial projections. We show them every six months year by year. And they move around. And some of our competitors are giving less disclosure and limiting themselves to book loss ratios.

And the other point is historically our volatility was very much hidden by the fact that historically our actuarial projections have very large degrees of conservatism built into them due to lack of maturity of the accounts. And as the account matured, those degrees of conservatism tended to get stripped out. And we said two or three years ago, look, guys, we are getting to the point now where this can move up as well as down. Because historically it looked like it could only stay flat or get better. Because if you had a randomly bad quarter or randomly bad half-year that tended to be in an element of conservatism, which was beginning to look less and less plausible that could be removed and then you ended up as flat. And if it was a good random half, you had the ability -- it tended to show through.

So I gave perhaps an appropriate impression that, in fact, this can only stay flat or get better. And we did flag two or three years ago, this is not only the case, maybe I apologize if I did not flag that vigorously and effectively enough. But that is definitely is the case. It can go up as well as down. But it can go down as well.

Let's move on to higher personal injury cases. We made the point that the benefits of high premium inflation in 2010 and 2011 appears to be somewhat eroded by higher bodily injury costs. This is true in the first half when we saw more high-value cases. And the average value on those high-value cases was higher. Then in quarter three, we have seen that pattern somewhat extended. It has been another disappointing quarter in terms of bigger claims.

But as these bigger claims mature, it is possible that the projected value of those claims, which are very, very immature, will prove to be prudent, overly prudent in a sense. And that will change the outlook for those years. But there is certainly no guarantee. And, of course, it can go the other way as well.

Let's just quantify the extent of bodily injury claim inflation built into our projections. And let's do it, first of all, by looking at H1 2011 numbers that we showed you at the half-year results. And we split the movements between 2009 loss ratio, 2010 loss ratio. And H1 2011 loss ratio into the component parts. And we look at 2010 versus 2009 and we see the earned premium was already mentioned up 8%, the frequency down slightly 4% -- all good news. Average claims, it's a little bit back up, plus 11%. When you take 2010 versus H1 2011, you get a pleasant frequency result, a result partly of high petrol prices, partly of lack of disposable income. Partly also of this movement of people towards more self-insurance faced with higher premiums and high excesses, less inclined to make a claim, less inclined to compromise their no claims bonus. And offsetting that, a very substantial increase in average claim equipment to 17%.

Now, when you bear in mind that non-bodily injury inflation costs have not really materially changed and we are looking at low single digits on that, you can see that the implied bodily injury inflation is very, very substantial. And the issue in terms of projecting the account is, does it stay that substantial? Does it come down as they go further up?

Now unfortunately in quarter three you would have seen that nudge slightly further up because in quarter three we had another relatively high frequency and size of big claims. And one way of demonstrating the scale of this is to look at the data at the end of quarter three 2011 and to look at the value of case reserves in excess of GBP100,000 and express them as a percentage of premium. And so you are seeing there that in accident year 2009, 19% of our premium was going to paying towards reserving for, very much reserving for, not paying for, big claims. And by 2011 it has increased to 26%.

Now when you bear in mind that premiums over the same period are up almost 30%, the actual pounds per vehicle covered devoted to big claims is very, very substantially up. And this is very much a glass half full, glass half empty exhibit in the sense that the glass half full people would say 26% is clearly a very high number. These projected ultimate inflations are very, very high. The scope for this is coming down over time. And the glass half empty people would say there is a lot of new bodily injury cases here. There's some very serious inflation issues. And unfortunately the maturity of the numbers is such that you cannot resolve that debate with any great meaningfulness. And one way of demonstrating maturity in the numbers is to look at the paid percentage. Now when I say the paid percentage, I mean of the total value of those claims, for example, in 2011, which make up 26% of the premium, how much is paid and how much is reserved? And the answer is 1% paid and 99% reserved. And if you look at 2008, it is sort of roughly 20% paid and 80% reserved. And you have to get to 2006 before you are actually majority paid.

Now you did see that from the earlier exhibits that actually the certainly as to the likely outcome increases rapidly as you get towards month 24 and month 30 and month 35. And what does happen is the paid is not a definite proxy for certainty because often the paid is just telling you about the time it takes to go through judicial process. But when you are looking at 1% paid and 99% reserved, you know it is very much an uncertain number at this point of its evolution.

What might have caused higher levels of big claims and higher costs for those big claims? This page addresses the issue about whether perhaps it is a substantial shift in portfolio. Have we moved towards segments of the market that historically are associated with high numbers of big claims?

And what I'm showing here is, if you look at some of the obvious areas, non-comprehensive zero, no claims bonus, young male drivers, there has not been a radical shift in that direction. This is a percentage point analysis. So for example, if a non-comprehensive is saying our share of new business in 2009, which was non-comprehensive versus comprehensive, was down 3percentage points, up 3percentage points in 2010, down 2percentage points in 2011, therefore down 2percentage points over the whole period. So that, for example, if in 2008 we were 10% non-comp by the end of -- by the Third Quarter of 2011, we would be 8% non-comp, or if we were 20% non-comp, we would now be 18% non-comp. I think this demonstrates that if you look at these sort of, okay, relatively macro measures, you are not seeing radical shifts in the portfolio.

Another data point relates to frequency. And had we gone for a very substantially riskier portfolio, you would expect to see some deviation in our frequency versus the market. The market provides data through the ABI on frequency. And that is showing a minus 11% frequency change in H1 2011 versus H2, that versus H1 2010 poses [ph]. And our own frequency change is 10%. Again, supporting the assertion that we are not -- we don't think are looking at a radically different portfolio here that might actually explain some of these patterns.

So what might explain it? Well one possible explanation is there is something happening market wide that is causing a lot more big claims and making them a lot more expensive and that it has emerged in 2011 because you are largely talking about accidents that happens in 2011. Somewhat about accidents that happen in 2010 whose full seriousness did not become apparent until 2011. But heavily this is about 2011.

It is probably not the explanation because it is difficult to understand what factor could drive the market-wide change in that sort of frequency, apart from some legislative change on costs. And we have not seen that. It is not impossible, though. But it is one that we would perhaps downplay somewhat.

Randomness. Now if you had randomness, you would have potentially a poor 2011 outcome. But you would expect it to potentially bounce back in 2012. Now you might say, well, surely Admiral cannot be experiencing randomness because it is a big player; it has got 10% of the market. I think that is a valid point to make. But I would in a sense counter it by showing you a piece that has recently been available on the Institute of Actuaries website, which looks at the whole market experience for claims over GBP100,000. And it's looking at the average value of claims over GBP100,000 by year. And the interesting numbers are ringed. And you have got 3 versus 4, 18% claim inflation, then minus 10, plus 18, 1, 12, 18, 2. You know, bizarrely and extremely variable numbers at the whole market level. I mean it's actually not the whole market. It is about 80%, 85% of the market.

But I'm just making the point, if you can see that randomness for which there are no obvious explanations, if you talk to the actuaries that did this piece of work, is there some concrete reason you could point to that 6 is up 18 but 7 is only up 1. Was there some change at that point that you can point to? And the answer is no. And they struggled to explain it other than a sense by degree of randomness. But if you can get that randomness at a whole market level, you can get randomness as a factor as an individual player within the market.

And the last potential factor that we will talk about is high initial reserve of new claims. Are we being somewhat more prudent on new claims, which, of course, pushes some claims above the GBP100,000 barrier and would take some of the claims that would be over the GBP100,000 and make them higher average costs. And of course, what you do see is you look at the initial reserves on our new claims. And they are higher, materially high. Now what you cannot say, well, that is because we are reserving more cautiously because the alternative explanation is because they are genuinely worth the more severe claims.

Now there is no policy that we have introduced that says we shall be more prudent. But there are factors that can make a claims department collectively more cautious. And we have always sought a high degree of caution and prudence from our claims department. But some of the -- one of the potential outcomes of our growth is that the large claim team, which is a relatively small team and just by virtue of numbers is seeing more individual claims go the wrong way. And our claims team hates numbers that go the wrong way. It might actually be not a higher proportion. But it is more of an experience that we see a claim go the wrong way. And a possible response to that is that you put more and more on new claims.

There is also a PPO fear factor that influences individual claims. Handlers we hold a very complete reserve in our view on PPOs at the whole account level. And we don't hold it on the individual claim level. And the proper application of that is actually a claim handler aware that a claim could turn into a PPO and unwilling to see it deteriorate has an element of in a sense a PPO addition to the reserve that they put in. And these claims are incredibly subjective. In other words, a very wide range in the early years of the claim of possible best case and possible worst-case. And there is a huge information vacuum, which really does not get filled fully until often two or three years into the claim. And then it is actually sometimes until six or seven years into the claim, you are on the court steps and you have a real feeling for what they might settle for.

Now in our view, the likely diagnosis is that it is a combination of these three factors, rather than one. And you can more likely to be primarily randomness and higher initial reserving. But unfortunately we cannot attempt any quantification of that.

Before moving on now, I would just like to just move back from the half-year issues that were raised and the issues that are raised by quarter three having another large number of big claims and just talk a bit about the overall scale of underwriting outperformance. We saw these factors which were clearly important and have led to a disappointing second-half, as Henry said. But in the big picture in terms of long-term situation, is the model fundamentally compromised? And we believe not. Growth has cost us.

Our combined ratio advantage in 2010 will almost definitely be smaller than in 2009. And in 2011 it will probably be smaller than in 2010. And what we have said this morning is that if we see the sort of patterns that we would expect to happen in quarter three and lay those on top of what we have actually seen in the first three quarters, we are looking more at a mid-80s outcome for 2011 combined than the early 80s that we were talking about at the first half.

So growth has cost us. I think it is interesting that we have put on this exhibit also the history of our growth. And you can see that it is not the first year that we have been 30% growth. The last time we did that was in 2004. And it is interesting that in that instance it cost us 4percentage points on our combined ratio advantage over the course of 2004/2005 when that business effect essentially earned through. But that does not necessarily mean you are necessarily committed to a permanent shrinkage of our performance.

And the next page shows the outperformance versus the market. In a different way, it is just a bar chart showing the size of the outperformance as we exhibited it at the half-year. And it's got overlaid on it the market share evolution of Admiral.

Now what we have talked about is the unpredictability of car insurance. And so you can be sure that 2009 and 2010 for the market as a whole will not finish where it is currently showing. And Admiral is very unlikely to finish where it is currently showing exactly. It would not be at all surprising, especially in the context of the very conservative reserving action taken by our RBSI, which particularly impacted the market in 2009. It would not be at all surprising if the gap between the two when we know what it is for sure in three or four years' time was less than the numbers we are showing here. But does that fundamentally challenge the model question? If we are in the late 20s rather than the early 30s, does it fundamentally change the model when you see a history there of sustained outperformance and sustained outperformance while also growing the book?

Just touch briefly on the constituents of the outperformance and make the point that the expense ratio outperformance is a stable piece of the equation. I will expand a bit on that, partly because actually there has been some comment that maybe we have not gotten an expense ratio advantage in the scale we have talked about. And the only data point we can bring to bear is the FSA or treasury returns, which Admiral at 14% in 2010, including roughly 3% levies, the whole market at 27%. If you exclude UKI, including 3% levies. So substantial outperformance versus the market.

And on the left-hand side, you have got some of our key competitors just to make the point that there is also a material outperformance versus our bigger competitors. And there is a material outperformance against our competitors that one might perceive to be our most competent competitors. And that outperformance extends across the three components of expense -- claims costs, admin costs. And acquisition cost -- and has been sustained on the acquisition side despite the fact that we have grown very fast, which you will expect to lead to a heavier acquisition cost than market norms.

The last point I would like to make is that although growth costs, I think, scale benefits -- and you need growth to get to scale -- it is not an expense issue. The minimum economic scale for expenses in car insurance are not that big. And we are well past it. It is a data issue. It is a claims ratio. A loss ratio issue with the minimum economic scale for maximum loss ratio advantage is infinite. You cannot have too much data. It gives you the ability to disaggregate to greater and greater level of detail. And increasingly interestingly, it gives us an ability to have a more personalized rating based on sometimes prior experience of these individuals as previous policyholders, which is actually quite a powerful rating variable.

And if, as I admit, historically has not been the case, scale becomes increasingly important in being effective in the car insurance market. It does open the door on an interesting possible shift in industry structure five, six, ten years out where we go from relatively whole economics in a very fragmented close to perfect competition market the car insurance is to one which is a little less fragmented, a little mixed scope for more stability and overall potentially higher-margins. And in that context, I take some comfort from the outcome of -- or the results for some competitors that three or four years ago, two or three years ago, were a source of some significant worry to Admiral. Because we were seeing new players come in -- I have touched on this in previous presentations -- which were quite interesting in terms of being very lean, being focused on car insurance distribution through price comparison, often using third-party capital. And we were looking at these new players and saying, well, maybe these are potentially powerful competitors for us in the future. And indeed, going back two years, they probably got up to about 10%, 11%, 12% of the price comparison market. So they became material. But they have become, again, much less material.

Why is that? That is because their loss ratios have been almost universally very disappointing. And that is because it is a very Darwinian world on price comparison sites. And if you put a bad set of rates out there, you write a lot of business and it hurts. And that makes it very difficult for new entrants. So I do have some degree of optimism about the scope for a more attractive industry structure going a long way out.

So a recap of what we are saying really is our personal injury claims experience during 2011 has, indeed, led us to reduce our profit growth in the short-term compared to our expectations. And that is a disappointment for us. There is some possibility as those claims mature the initial reserves may prove to be overly prudent. But you have to qualify it by saying that it is not the only possible outcome. But either way Admiral's outperformance versus the market remains very substantial.

Thank you.

Kevin Chidwick {BIO 15100612 <GO>}

Thanks, David. Good afternoon, everybody. Okay. We thought this might be useful to have a little session on some of the technical accounting stuff that has been talked about quite a lot about that Admiral over the last six to nine months or so. And there has been quite a lot of discussion about some of the numbers and what they really mean. And therefore, we thought it might be helpful to have a bit of, if you like, a bit of a teaching session on what is going on underneath these numbers.

I'm going to focus on the top two on this list. And I'm not going to cover the others. But they are all in the appendices. So if you would like to go through them, please do so. If you feel the need to do so, if you want to come in and talk to me afterwards, I'm very happy to take any questions on them.

For those of you very familiar with this stuff, you can take a good 5 or 10 minutes, not now. And we will have a good rescue for the Q&A session.

But the reserve buffer first. At Admiral, when we talk about buffer, we are thinking about an amount of capital we are holding aside for shocks on the development of the projected ultimate loss ratios. And a buffer, therefore, means that we can take that shock without it having to come through the P&L account. And when we are thinking about the size of that buffer, we are looking at it across all of our years in aggregate rather than keeping a particular buffer in any one year at any one level. And we think about it in terms of the accumulation of both our own reserve buffer on our loss ratio picks and the amount of capital or deferred profit, if you like, that is in the proper commissions that are associated with that loss ratio pick.

And so you can see from the bars on the left-hand side here these are our first picks that we booked into the accounts, the book loss ratios at the end of the year in which those years were originally occurring, compared to the loss ratio ultimate outcomes we expected it to be at the end of the year in which that year first occurred. So for instance, in 2009, at the end of 2009, we booked the 2009 underwriting year 84 in the accounts, expecting it to finish at that point at just under 74. So we booked about 10% of reserve buffer in the 2009 year at the end of 2009. And so you can see from these four years compared that it has gone from being a buffer of about 12 points in 2008 to 10 in 2009 to 7 in 2010 and now back up to 11 in 2011. And so the buffer on reserve terms is basically the difference between our book numbers and our ultimate's. And you can see that on the lines on the right-hand side.

And as I said, we are thinking about buffers and that accumulated amount of deferred profit, which may or may not than be released as reserve releases and profit commissions in the future. If we see no change at all in our ultimate loss ratios, then, of course, it will be released as reserve releases and profit commission. But if those ultimate loss ratios picks turn out to be wrong on the wrong side, i.e. they get worse, then this buffer will be chewed up by those increases in loss ratios. If they develop to be better, then, of course, the buffer gets bigger.

But the buffer is in total terms. And in recent years, the level of profit commission on that buffer has gotten higher because our share of the reinsurance profits, as David was talking about early on, has become greater over the last few years. And so now we are in a position where we, in fact, take an income interest in 89% of all of our reinsurers' results. And that is effectively in this part of the -- the element that's in the difference between our booked and our ultimate loss ratios, that 89% is in this future profit commission figure here. And that has meant that we have had a trend over the last few years, which I have talked about on previous occasions, about booking slightly closer to the ultimate loss ratios because of the quantum of the additional future profit commissions. But of course, that was not the case in 2011 because we saw at the half-year point that the 2009 and 2010 years deteriorated. And we felt the need to build back up that buffer from the 2011 year by booking at that little bit higher than we would, otherwise, have thought to do so.

And that is because we look at this buffer in aggregate terms. And what I have done here is try to show you exactly how that is calculated if you like, as Jenna and John [ph] do, loss ratio buffering.

So this shows on the left-hand side the same chart again with the differences between the booked and the ultimate's. I have picked the 2010 year where there is a difference of 3.8% between where we booked it at the half-year and where at that point we are expecting it to finish. And I have shown you how we have calculated that buffer as an illustrative example.

So our share of the 2010 year was 27.5%, which was GBP303 million of the earned, which meant not by that by 3.8%, we have got a reserve buffer of GBP11.5 million. Munich Re took 45% of that yield, which is just under GBP500 million. So 3.8% comes in at just under GBP500 million. And I put a plug in a figure of 50% as being a guesstimate of what our share of that profit might be. So let's call it that. And that makes it GBP9.2 million.

Then in the reinsurance -- the rest of the reinsurers, they took the other 27.5% of the book in 2010. That's another GBP300 million. 3.8% of that times 100% in this instance because with the reinsurers, as I'm sure you are all aware, once we have paid the fixed fees of the reinsurer, any further movement in the profitability of that book is entirely down to us. We take 100% of it back as a profit commission. And so, therefore, that is another GBP11.5 million. And so that is GBP21 million of profit commission buffer, GBP11.5 million of reserve buffer, making a total buffer of GBP32 million on the 2010 year. And you can do the same calculation for the 2011 year. And you are getting close to what our overall buffer might look like at the half-year of this year. That is how we work out the buffer.

The second issue I said I would talk about was this question of negative IBNR that has come up recently. And what is negative IBNR? It sounds bad. What does it mean. And why does Admiral have lots of it?

Here I have introduced another line to this graph. Now we have got the two lines we saw before, which is the lowest one is the projected ultimate loss ratios. The next one up is where we have booked the loss ratios. The difference between the two is the buffer. And now we choose a third line in the green area at the top, which is the case reserve, the individual case reserves in the claim system that our claims handlers have plugged in for each individual claim. And if you add together all those individual claims and just sum it all up, you would end up with a number far higher than the number we booked in the accounts and obviously far higher than the projected ultimate loss ratio. And that is because of our long established practice in the way that Admiral's claims handlers set the claims reserves is that in aggregate they are typically far higher than they need to be for the actual claims that will get settled. So you end up with a long-term pattern of maybe -- I am just picking a number out of the air here -- but maybe you reserve a claim at GBP10,000 on the average. And on the average, it pays at GBP7,000. So you have this negative IBNR between the two, between what we have booked in the accounts and what we expect -- and what sort of the actual case reserves add up to.

And the negative IBNR only appears on our FSA return. It is not a figure in our accounts at all, in our statutory accounts. The crucial number here is the number of the difference between the red line and the blue one, which is what we've booked in the accounts, what we have already shown as profit in the past. And how much we are holding back for changing those ultimate loss ratios, i.e. moving up in that blue line.

The negative IBNR, the difference between the green and the red line is only shown in the FSA returns because of technically the way they are presented, which is you show all the case reserves added up and then you show your book ratios. And the difference between the two is the negative IBNR. It is basically irrelevant as long as you believe the case.

But of course, the individual cases those are somewhat higher than they generally need to be. And I think what we have shown on the bottom of the slide is this sort of cascading fountain of all the individual case reserves. As they develop over the years, this pattern is well-established and typically follows a very similar pattern, which is the case reserves built up over the first couple of years. And then as they all get paid off, they will come back down and eventually they flatten out and they flatten out at somewhere close to hopefully the projected ultimate loss ratio. But the point is they do drop a lot before they get there. And that is a typical pattern. And that is really a reason why we end up with an unusual negative IBNR.

Now you may ask yourselves, why do you have that? Why don't you just tell all your claims handlers that they put the cases in a lower level. And then you would not have this problem in the first place?

And the answer to that question is really one of consistency. We are where we are. And it is extremely important to us to have consistency in our claims handlers' behavior in the claims department in the way they set reserves and the way they tee these things up. Because if we did not have that, it would be very difficult for us to assess trends in claims patterns because you have a disconnect between what is paid and what is going on in comparing periods to periods. So we recognize it's not a particularly helpful number to have in the FSA returns. But it is important for us to maintain our consistency. It is going to continue to be there.

And the last point to make on it is the negative IBNR south has been growing in recent years for several reasons, probably not least of which, of course, is because we've got a lot bigger in the last couple of years. It is also the case of the FSA returns are done on a net of coinsurance but gross of reinsurance basis. So as Munich Re have been stepping down their share, our share has been going up on a gross basis. And therefore, these numbers are getting bigger. And it has also been the case, as I said earlier on, that there had been a movement over the last couple of years to bring the books number closer to the ultimate loss ratio. And therefore, by definition you would end up with it being further away from the case reserves and, therefore, a higher negative IBNR.

I hope that makes sense. I suspect for many of you that was well known. But hopefully for one or two of you it was helpful. As I said, there is more stuff in the back of the packet. If you want to come out with any more questions, then afterwards I'm very happy to take them. Thank you.

Henry Engelhardt {BIO 3022947 <GO>}

Thanks, Kevin. We are just about there. One quick slide on some of the things we have achieved over the last few years which should not be forgotten. We are basically twice as big as we were two years ago, 30 September 2009 to 30 September 2011. The turnover has doubled, profit up 53%. I think by anybody's standard, that is not a bad performance. It is a combination of UK vehicles and international vehicles.

And just a little summary here of why we feel we have got a very good future in front of us. And to remind you as well that the things that we would like to take away, yes, we are disappointed. But it is not a disaster, market-leading combined ratios, etc.. And a very positive look towards the future for us.

So without further talk from us, it's time to hear from you. Questions, comments?
