Q4 2015 Earnings Call

Company Participants

- Anthony Jonathan Reizenstein, Chief Financial Officer & Executive Director
- Mike Holliday-Williams, Managing Director Personal Lines
- Paul Robert Geddes, Chief Executive Officer & Executive Director

Other Participants

- Alan G. Devlin, Analyst
- Andreas van Embden, Analyst
- Andrew J. Crean, Analyst
- Andy Hughes, Analyst
- Dhruv Gahlaut, Analyst
- Farooq Hanif, Analyst
- Gordon Aitken, Analyst
- Greig N. Paterson, Analyst
- James A. Shuck, Analyst
- Jon M. Hocking, Analyst
- Olivia Brindle, Analyst
- Ravi Tanna, Analyst

MANAGEMENT DISCUSSION SECTION

Paul Robert Geddes {BIO 2474781 <GO>}

Okay. Good morning, ladies and gentlemen. Welcome to our full year results. Thank you to Morgan Stanley for hosting us here in Canary Wharf and congratulations to those that have made it in. Nice to see you all.

As usual, I'm joined by our CFO, John Reizenstein, and also Mike Holliday-Williams is going to share his thoughts on a few key topics a bit later. Other members of my Executive Committee are generally on the front row, and you can ask them questions after maybe over a vol-au-vent. So we're going to begin with a brief overview of the highlights before handing over to John.

So we think these are a good set of results in 2015 as we continue to benefit from our long-term improvement program. At the start of 2015, we rearticulated our strategy. And on slide three you can see that, I'm sure you'll agree, some pretty good numbers, all of which demonstrate that the initiatives which underpin our strategy are working.

We're making real progress in becoming a great retailer again. We're more competitive. Customers are responding well to our services and to our propositions. And Direct Line is the most preferred brand in the market, with Churchill at number two.

All of this has led to growth in our Motor and Home own brand portfolio. And we're getting more efficient. Our ongoing focus has helped us to reduce our cost base again down 4.6%. One of the ways we're doing this is by managing customer claims more efficiently through digital channels. And this has led to faster settlement times.

We're also moving back to becoming a disruptor again. Telematics policies more than doubled. Green Flag continued to challenge the AA and the RAC, and Direct Line for Business broke through 400,000 policies.

And our clear strategy has also enabled us to meet or exceed our targets in 2015. We delivered a combined ratio of 94%, which adjusted for normal weather was 93% and better than the guidance we set out at the start of the year. RoTE increased again to 18.5%, well ahead of our 15% target.

Shareholders are also sharing the success with a 5% increase in the regular dividend and an additional special dividend of 8.8p, taking total dividends to over £1.5 billion since the IPO.

I'm really proud of the progress we've made in 2015. Later on, Mike and I are going to tell you more about how we achieved it and how we intend to keep it going in 2016. So, let me now hand over to John for the numbers.

Anthony Jonathan Reizenstein

Thanks, Paul, and good morning, everybody. Let's look at the financial highlights. As Paul said, we think it's a good set of results. Gross written premiums were up almost 2% versus the prior year as Motor premium grew by close to 5%. Ongoing operating profit was up around 3% to £521 million, with the biggest movement being a £27 million increase in underwriting profit driven by better current year attritional performance. Installments and other was up a little to £151 million, whilst investment returns fell £16 million to £195 million on lower AUM and reduced gains.

Combined ratio was 94%, and within that, the total cost base down again to £885 million, a reduction of 4.6%. At a segmental level, all segments were profitable, with Motor and Rescue and other personal lines improving their profit, Home broadly stable, while Commercial was impacted by higher major weather event costs from the December floods.

Turning to IFPs on the next slide, these were down 1.4% overall, but that masked an improving risk mix - improving mix towards our own brands and direct. Starting with total Motor and Home, on the top left, you can see Motor grew by 1%, whilst Home was down 3.1%. But on Motor and Home own brands, which you can see on the top right, both grew, up 1.3% and 1.5%, respectively. We believe that's a good result in a tough market and it's down to giving customers better propositions, combined with improved trading and supported by sharper pricing.

On the bottom left, we split out partnerships to highlight the different trend we're seeing in this channel. Motor partners were around 3.5% during the year, while Home partners were down 7.3%. This reduction mainly reflected lower new business given changes in the banking distribution model. And Paul will update you on partnerships later.

In terms of the other segments, we've seen more mixed trends, but with direct generally performing well. Rescue policy count was down 1.1%, but Green Flag, our direct brand grew 8.3%. And in Commercial, headline IFPs were up 7.2%, with strong growth in direct, with policies up 7.9% during the year.

Turning to premiums, which is just to say all exclude IPT. Total gross premiums were up 1.7% during the year, with growth in Motor, Rescue and other personal lines offsetting lower premiums in Home and Commercial. We saw improving trends during 2015 and like to highlight a few of these.

Overall, Motor premiums were up 4.8%, and on the top right, you can see the rate of growth accelerated each quarter. Premiums were up an impressive 7.1% in the fourth quarter. In Home, the overall premiums were down 3.6%. However, reach reduction slowed from 4.8% in Q1 to 2.3% in Q4. These trends were reflective of the different market conditions across Motor and Home, which I'll come on to later.

Moving down to the bottom left, the picture in Rescue and Commercial was a bit bumpier. In Rescue, premiums were up 4.1%, but within that we saw good growth in the first half of the year, slowing in the second half due to increased competition. And Commercial ended the year with stable premiums following growth in direct, which helped to offset competitive pressures in the regional business during the first half.

All-in-all, a good performance from our own brands portfolio, particularly when you factor in the IPT change and increased shopping in the fourth quarter.

The headline ongoing combined ratio improved by 1 percentage point to 94%, one point better than 2014. You recall that we gave guidance on COR of 94% to 96% at the start of 2015, which we upgraded to 92% to 94% at the mid-year. All these numbers being normalized for major weather cost. Our actual COR on this basis was 93%, which puts us in the middle of the upgraded range.

The loss and expense ratios were stable, with an improvement in the commission ratio. Below this there were some positive trends, which we've highlighted in the waterfalls on the right. The total loss ratio was stable at 59.5%. Within this we saw a 1.4% improvement in the current year attritional loss ratio. This was partially – partly offset by a small reduction in the level of prior year releases and higher weather-related claims.

The headline expense ratio remained stable at 23.6%, even though we've reduced costs again in 2015. Costs in the second half of 2015 were lower than the prior year, but they were higher than in the first half. This was mainly due to write-offs on redundant software, property, plant and equipment. As I mentioned earlier, our cost base was 4.6% lower in 2015. However, this improvement was offset by lower earned premiums.

With GWP growth coming through in 2015, the pressure on NEP should abate going forward. We're saying today that in 2016, we expect total cost to be lower, although with a smaller reduction in 2015. That's in part due to the cost of the Flood Re levy.

The commission ratio improved by 0.9 percentage point to 10.9%, mainly due to the impact of weather on profit share arrangements. Stepping back, we believe achieving a 93% normalized COR and an improvement in the current year loss – attritional loss ratio represents good results.

Let's now go into the ratio trends across the segment, starting with Motor and Home. Overall, a good result in both Motor and Home, with combined ratios in the low 90%s, with both helped by lower current year loss ratios.

In Motor, the lower combined ratio was driven by the loss ratio, which improved by 3.4 points to 63.6%. The improvement came through the current year as the prior releases were broadly flat. As we said, we made a change to the way we allocate margin in current year claims in 2015. This change led to a 2 percentage points reduction. The remaining 1.5 percentage points was primarily due to better performance in large bodily injury versus poor experience in 2014.

In Home, we saw a lower commission and expense ratios, partly offset by a higher loss ratio, the latter being driven by major weather, which accounts for 10.7 points, with claims totaling £90 million in 2015 compared with £63 million in 2014. In terms of the current year attritional loss ratio, our initiatives together with the better underlying claims environment in Home resulted in a 3.5 percentage point improvement in the current year attritional loss ratio, which fell to 45.8%. Prior-year releases in Home were down a bit to £42 million.

Slide 10, we've got the ratios for Rescue and other personal lines and Commercial. In Rescue and other personal lines, the combined ratio improved to 91.2%. Within that, Rescue combined ratio was up 0.8 points to 82.3 percentage points, partly offset by an improved COR across other personal lines. Rescue and other personal lines loss ratio increased to 59.9%. And this was mainly due changes in partners' pricing on the Rescue and travel books following good claims experience in 2014.

Finally, Commercial reported a headline combined ratio of 104.5%, which is 5.7 percentage points higher than prior-year. Commercial result was impacted by approximately £40 million of claims from December storms and floods, about £20 million more than normal. Normalizing for this and other large claims gives a COR of approximately 99%, similar to the previous year. At 12.9 percentage points, Commercial continued to experience large prior year reserve releases as in previous years. You can find more commentary in the appendix where we've included the usual segmental P&L.

Now, let's take a look at Motor in more detail with the familiar pricing and claims trend, starting with claims. You'll recall at the half year we said claims inflation was running slightly ahead of the long-term average. However, the good news is we ended the year back within the range, albeit towards the top end. So let's elaborate on that.

Taking large BI first, we've seen an improvement in our incurred claims on both 2014 and 2015 accident year. While some of this is natural volatility, we now have more certainty that some of the increases spoken about over the last 18 months is down to faster recognition of large cases.

Moving on to the shorter tail peril, damage severity seems to have settled down following the uptick we saw in the first half, but this has been replaced by a slight uptick in frequency in the second half. This has also affected the small BI, but we still believe we've outperformed the market over the longer time period.

Moving down to pricing, we increased prices by 7.7% in the fourth quarter year-on-year, taking the annual increase to 5.8%. Taking the year as a whole, our pricing reflects our 2015 claims trend, plus an element of catch-up from the 2014 claims experience. The eagle-eyed amongst you may have spotted that the full year movements don't quite add across. This gap is explained by the improvements we've made to the Direct Line proposition in 2015. The investment in guaranteed hire car as standard, removing some admin fees means we've given up a bit of other income, which would have come through the premium line.

Moving on to slide 12, we have the usual chart. Moving on to slide 12, showing the accident year development on a gross basis. The majority of prior years have continued to develop favorably, a combination of our prudent approach to reserving and the operational improvements we continue to make. Total Motor prior year releases were £267 million in 2015 or 21.4% of premiums, which as expected was lower than the prior year.

Two key points I'd like to cover here. First, the 2014 position is still showing a deterioration versus last year, which we discussed at length at the half year, but the position did improve in the second half, and on an net basis, it's now only 1.2 percentage points higher than our initial pick. We believe we're well reserved here and over time we'd expect this to run off favorably.

Secondly, 2015 initial loss ratio pick is lower than 2014. And that's consistent with the year-on-year improvement in current year loss ratio. The 2015 accident year loss pick is broadly in line with the view at half year. As has previously been the case, the releases in recent years have mainly been driven by improvements in the actuarial best estimate, reflecting our conservative approach. The margin above actuarial best estimate remains higher than at the IPO.

Looking ahead, we'll continue to reserve conservatively and assuming current claims trends continue, the contribution from prior years is expected to remain significant, albeit will reduce over time.

Now, let's look at Home pricing trends and here you can see our own brand average premium movements split into price and risk mix. The Home market continued to deflate during 2015 and remains highly competitive. This increased competition in Home is driven by a number of factors, including channel changes, lower insurance rates and good underlying claim performance.

We maintained our competitiveness across our strong own brand portfolio, growing policy count by 1.5% during the year. Our underlying claims picture in Home, discarding the major weather, has been good, with overall inflation running below the long-term average. This together with our initiatives in pricing, meant we were able to reduce our own brand risk adjusted prices by around 3% in the fourth quarter year-on-year. This brought the overall reduction for the year to around 2.4%.

The improving risk mix in Home is largely due to our high retention, which increased again and technical pricing development. We believe that our ability to protect value in Home is a result of our high retention rates, strong propositions and continued investment in pricing and claims.

Now for a look at investments on slide 14. Headline assets under management stood at around £6.8 billion at the end of December, 3.3% lower than the previous year. On the top left, you can see we maintained an income yield of 2.4%, but on lower AUMs generated slightly lower income of £166 million. The overall investment return was 2.9%. We recognized £29 million of gains in the year, most of which was as a result of fair value increases on the investment property portfolio.

Moving across to the portfolio allocations on the top right, you can see actual versus our updated benchmarks. In 2015, the primary addition to the investment portfolio was in infrastructure debt where we invested an additional £253 million as part of our ALM strategy. We had planned further investments in commercial property during 2015, but this was limited by the availability of assets at the right price.

We continue to develop our investment strategy and have made some further changes. First, a new commercial real estate lending mandate, which will invest in investment-grade UK commercial real estate loans floating rates, where we're making a 3% allocation. Secondly, we're diversifying our existing investment-grade bond portfolio by establishing a new global credit mandate. Thirdly, we're setting up a separate investment grade sub-debt mandate, which will replace the subordinated debt currently held within the existing mandate.

And finally, we've increased the allocation to high yield from 4% to 6%. This will be funded from a reduction in securitized credit and investment grade credit and we began to do this in December. As we generally hold high yield to maturity and hold sufficient capital, we can cope with volatile markets such as we're currently seeing. You'll find the usual table of yields and durations by asset class in the appendix.

Given market movements year-to-date, I wanted to show you a bit more detail on the high yield portfolio. On the bottom right, we split out the high yield allocation by sector and you can see there's only a small exposure to basic industry and energy. After some realized losses in those segments, we earned a return of approximately 2% and year-end AFS on this part of our portfolio is very modest.

I thought it would be useful to wrap up investments by summarizing the outlook. Starting with AUM, this has been declining over recent years due to a mixture of lower volumes and capital management. Looking ahead, we don't expect this shape to change dramatically. In terms of yield, as you've heard, there's still some work to do to get us to our target allocations and this should enable us to achieve a yield of 2.5% by the end of this year and 2.6% by the end of 2017. But it's worth noting that we've assumed a first rate rise occur in September 2017 of quarter of a point.

Finally gains, at the end of December, we had just £5.4 million of unrealized AFS gains on the balance sheet. Last week, it was around the same level. In any event, the opportunity to realized gains is quite limited now.

On slide 16, the table shows how we get from ongoing operating profit of £521 million to profit after tax of £580 million. Just a couple of points to make here. Run-off profit was higher in 2015 due to better experience from large bodily injury. Restructuring and other one-off costs were broadly in line with guidance of £50 million. Looking ahead, we reiterate our expectation that we'll incur further restructuring cost and these will be substantially offset by profit from run-off over a three year period from 2015 to 2017.

After all of that, profit after tax was up to £580 million versus £373 million in 2014, reflecting a better operating result and the capital gain and profit from sale of international, which total £181 million.

Today, we're announcing the final dividend and a second special. This takes the regular dividend to 13.8% (sic) [13.8p], which represents just under 5% growth on the previous year. We've also announced a special dividend of 8.8p, which is in line with our approach to return capital where it is in excess. This takes the total dividend for the year to 50.1p. Since the IPO, we will have paid out over £1.5 billion of dividend to our shareholders equivalent to nearly 60% of the IPO price.

Following these dividends, our capital position still remains conservative as we transition into Solvency II. As you know, from the 1 of January, we've been operating under the standard formula, and at year end, our coverage was 162% pre-dividend and 147% post. This compares with 148% at the end of 2014 on the old risk based capital basis. We're on track to transition to internal model for our principal underwriter, UKI, as part of a group-wide partial internal model. This is of course subject to PRA approval, but we're hopeful to have that by mid-year. And at that time, we'd also update you on the recalibration of our risk appetite range.

Moving to our internal model will reduce uncertainty over our capital position. However, we don't currently expect this will lead to a step change in the amount of capital we need to hold. In the appendix, we've included the split of standard formula of our risk type and a shareholders' equity to own funds bridge. Leverage remains low at around 18% post dividends and our ratings from S&P and Moody's remains at A and A2.

Before I hand back to Paul, let me just summarize some of the key metrics on slide 19. 2015 marks a third year of our progress since the IPO. We've improved the current year loss ratio again. Our total cost base was lower in 2015. RoTE was up again. We've also increased the regular dividend again and announced another special dividend, while our capital remains strong.

With that, I will hand back to Paul.

Paul Robert Geddes {BIO 2474781 <GO>}

Thank you, John. So, I'm now going to take you through our excellent strategic progress we've made in 2015 and I'm going to hand over to Mike Holliday-Williams. I'll then come back and take you through the 2016 strategic priorities and our outlook for 2016.

So, 2015 deliverables, the good results which John has just outlined are the result of hard work across the whole business. This all starts with the strategy, which we rearticulated last year. As I said back then, the purpose of the strategy is to drive action. In 2015, we challenged ourselves with a stretching set of priorities designed to bring us closer to our mission, which is to be making insurance much easier and better value for our customers. At the beginning of the year, I said that when we have all these elements in place, then we can be a 15% RoTE business that can also grow when the time is right.

On the slide, we've set out the same chart I showed you this time last year. And as you can see, we've done a huge amount of work and delivered against all of our 2015 priorities. We ended the year with an 18.5% RoTE. And for the first time in number of years, we achieved growth across our own brand portfolio. So, let me take you through how we did this.

Starting with great retailer on slide 22. At the start of the year, I set out our top three priorities, which were to differentiate our brands further, to improve our customer experience, and to enhance our trading capabilities. In 2015, we strengthened our Direct Line offering and launched a really smart range of propositions which customers can only get by coming direct to us. Mike will tell you more in a minute. The results of our actions is that Direct Line is now once again the UK's most preferred brands for both Motor and Home insurance. We've also refreshed our famous Churchill brand, highlighting its dependability and appealing the customers who look for additional reassurance. Churchill is the second most preferred brand and is well placed to compete through price comparison sites.

Our focus has also been on improving our trading capabilities, in particular optimizing our pricing across different brands and channels. In addition to this, we continued to invest in digital initiatives and rolled out new quote and buy journeys for Home and Green Flag in 2015, building on the work we did in Motor in 2014.

We also invested in training and developing our customer-facing teams, helping them to interact with our customers in a new and refreshing way. This has resonated well with our customers and contributed to rising net promoter scores. The great things our people have been doing for customers has been recognized externally with multiple awards. The metrics you can see on this slide are what you'd expect to see from a great retailer. The two most preferred brands in the market, improved net promoter scores and strong and improved retention rates.

Moving now to smart and efficient manufacturer on slide 23. In 2015, we delivered better pricing and improved our claims propositions, all at lower cost. The Direct Line seven day repair service we launched in 2015 is just one example of how we've combined our accident repair center ownership, supply chain management and digital technology to offer our customers something unique, whilst at the same time improving our efficiency.

The combination of an online portal, which allows us to review customers' photos early to identify which parts to order before the car arrives with us, together with the latest techniques such as new paint system has made the seven day service possible. We've increased productivity per technician in the garages at the same time reducing the number of non-value added calls by allowing customers to track their repairs for themselves online. Better for customers and also better for us. We're rolling out this thinking to other areas of claims. You'll have heard me talk about our smartphone technology to assess home claims before and now we manage over thirds of eligible home claims this way. For these it means that half of these customers are now seen the same day or the next day compared with about seven days previously. We're now using this technology as part of Motor, Home, pet and travel claims journeys.

Over in pricing, we continued to evolve our pricing sophistication and completed number of projects in 2015, which aim to broaden our competitive quote footprint. We're also becoming smarter and more efficient at deploying pricing capabilities across the portfolio, for example, sharing pricing insights between personal lines and Commercial lines, means that we can compete better in the Van market.

Our people are the key to us being a smart and efficient manufacturer. In the second half of 2015, we launched what we referred to internally as Ideas Lab. This is a new initiative that gives our people the chance to share in the cost savings from their ideas. And to date, we've had over 4,000 entries. Putting all this together, you can see how we've reduced our cost again in 2015.

Our final strategic pillar is about leading and disrupting the market. We believe change is a good thing and we'll be increasingly challenging industry norms. There's a lot of innovation in the market as a whole. And in order to remain competitive and relevant, we must continually adapt the changing needs of our customers.

Starting with telematics, where we ended 2015 with more than double the number of telematics policies we had at the start. Telematics gives us a rich and valuable data source, with pricing insights that traditional rating factors simply can't reach. We've achieved this through further evolving our offering, whilst broadening our distribution reach and we now have over 78,000 policies. We believe this gives us a real advantage in the market and Mike's going to tell us more about some of the developments and insights we've made in this area.

Over in Commercial, we believe we're well placed to take advantage of the changes to distribution in the SME market. The Direct Line brand continues to drive growth in Commercial and we now have a real scale in the direct market with over 400,000 IFPs. Within that we saw double-digit growth in our award-winning Landlord product.

Our focus in eTrading continued and we launched more products in this platform in 2015. Not only did we grow, but we also were recognized as a number one eTrading provider in a recent broker survey. Together, Direct Line for Business on eTrade now make up over 80% of our Commercial policies.

We also developed new propositions and expanded our distribution reach. We launched a new professional indemnity product for our Direct Line customers and cyber cover for NIG customers, both of which are fully reinsured. On the distribution side, customers can now buy Churchill's business insurance direct from churchill.com or through two price comparison sites.

Finally, turning to Green Flag, we've implemented a number of digital initiatives, which drove 8% policy growth in 2015. We rolled out our new cleaner web journey, with web chat functionality and this delivered an immediate uplift in revenue compared with the previous site. Behind the scenes, we've been busy working on a big pipeline of future initiatives with a focus on digital. These initiatives are designed to improve the service we offer to our customers, whilst retaining the value for money that Green Flag offers versus its peers.

To go a bit deeper, let me hand over to Mike.

Mike Holliday-Williams {BIO 17467410 <GO>}

Thanks, Paul. And at the start of 2015, Paul talked about our increasingly external focus and willingness to start challenging some of the norms of the industry and innovate in this marketplace. Well, that's exactly what we've been doing in Direct Line.

2015 was a particularly strong year for the Direct Line brand. We launched a number of unique propositions throughout the year. We removed mid-term administration fees, we introduced a seven-day car repair service, we delivered a guaranteed hire car proposition for all of our current and new customers and we promised to have essential household replacement goods ready within eight hours.

Having launched a new quote and buy journey in 2014, we continued to see improved metrics across mobile and tablets with a 17% increase in usage in 2015. We've also improved our web and social media capability and offered 24x7 customer service through our web chat teams. The Fixer campaign with Harvey Keitel continued to perform well. All adverts have outperformed industry benchmarks. And as the campaign becomes even more familiar, scores are increasing with each subsequent advert.

We've also delivered some great content to influence our social media audience, from helping people during tube strikes to recruiting Stuart Pearce for the worst football team in the UK. Our Fixer campaign reach has been going from strength to strength.

Indeed, we were delighted to have been voted the most empathetic UK and U.S. company on Twitter within a recent 2015 Harvard Business Review Study. The results of this is that we've seen an improvement across all our key metrics including double-digit growth in awareness and consideration. Direct quotes grew by 6% in 2015 and new business sales grew by 4.5%. Brand NPS was up as our customers are now more willing to recommend us. In addition, we increased our already strong retention rates.

Direct Line is once again the most preferred brand in both Motor and Home insurance. And it's fair to say we have no plans to put our famous brand on an aggregator any time soon. Indeed, we are positively encouraged by the numbers of customers that are cutting out the middle man once again. In the words of Winston Wolf, we're on it.

Now, I'm going to just move to telematics. We said at the beginning of the year that we aim to double our telematics policy counts that you've heard and I'm glad to say we've achieved that, ending the year with 78,000 policies. Telematics is now very much established in the young drivers market. Nearly 60% of under 21s on Direct Line's new business are taking up telematics.

Where we particularly improved our distribution in the last few months is on price comparison websites. Young drivers used to have to click through to get the telematics discount, whereas for Privilege, we now lead with a lower-price DriveXpert telematics policy.

We've also made progress this year on our proposition for motor manufacturers, including the launch for Peugeot of a version of their Just Add Fuel proposition with telematics. Claims performance continues to be excellent and more than pays for the telematics discounts.

Our aim is for this increasingly to go beyond self selection and for our telematics offer to lead to better driving. In 2015, we've launched new feedback initiatives, including regular feedback on driving behavior through bespoke email and outbound phone calls to the worst drivers. This is all going well and we're starting to see improvements, but there's much more to come.

The big question is whether and how telematics is going to move beyond the young driver market and into the mainstream. In 2015 we've launched a pilot Cashback proposition delivered through a smartphone app, offering quarterly Cashback rewards to customers for good driving. We're seeing a good degree of interest in this now.

We've also been looking beyond telematics to the development of in-car technology. For example, today, we've launched Green Flag Alert Me, which offers battery health and vehicle fault alerts via an onboard diagnostic device and a smartphone app. Safety technology is also an area of focus for us. And we've recently introduced discounts for vehicles with autonomous emergency braking fitted as standard.

Beyond that, we're looking at more fundamental changes through autonomous vehicle technology. DLG became a member of Move UK, a newly formed collaborative R&D consortium being led by Bosch, which also includes Jaguar Land Rover. This consortium secured £5.5 million of government funding to develop testing and validation tools for automated driving technologies of the future. Our intent is to stay at the forefront of technological developments that are clearly going to have a benefit for our customers.

Finally, just a few words about the floods. Steve and his team have really focused this year on making it much easier for our customers every time they make a claim. We were really able to demonstrate our customer focus during the floods caused by the storms Desmond, Eva and Frank in December. These three events generated just a short of 5,000 claims.

So, how did we help our customers? Well, first, we were proactive and took a number of actions before the storms hit. We deployed our field teams in various locations, carrying tablets with customer details. They were proactively knocking on doors, providing advice and assistance to our customers, such as helping them to move items upstairs. We also sourced a considerable amount of alternative accommodation in advance, such as hotels, flats and holiday homes.

Once the storms had hit, we were there to ready and ready to help our customers. Our mobile response center, which we called CHARLIE, was set up in Carlisle and later on in York to enable customers to get advice, Internet access or indeed just a cup of tea. We also deployed our off-road vehicles in Cumbria, which meant we could get to areas that were inaccessible to many others. More than 80% of our flooded customers were visited within seven days of reporting their claims to us, 51% of properties had work commencing within a week of notifying their claim, and about 20% of content-only claims were settled on the spot.

You've heard how we're using video and photo evidence to enable us to assess, plan and start work sooner and settle claims faster, but this is a really huge benefit in bad weather, when claims volumes are high, because these images help us to prioritize face-to-face visits and minimize inconvenience and distress for our customers.

The response from our customers has been really positive and our NPS scores have increased significantly at this key moment of truth. We've had lots of positive feedback from our flooded customers, which is a really good reminder to us of why we do what we do every day.

And with that, Paul, I hand back to you.

Paul Robert Geddes {BIO 2474781 <GO>}

Thanks, Mike. So our strategy is delivering results with benefits coming through in multiple areas, yet we still see significant opportunities to improve. As is traditional now, we set out on this slide our stretching priorities for the year ahead. Many of these will be familiar themes, which we've already covered in depth today; customers, costs, claims, pricing and telematics, but I'd like to pull out three specific areas.

Starting with partners. Over the last few years, we've been focusing on improving our capability in respect of claims, pricing, digital experience and customer propositions. And you can now see the benefits of this across our own brands portfolio. But the news on partners hasn't been so positive. You already know about Nationwide and you'll see today that we're announcing an update on Sainsbury's. This is disappointing but comes with the territory of being in this channel where partners do occasionally want to change or review how they approach the market.

Looking forward, partnerships very much remain a key part of the distribution strategy for us and we will leverage the excellent manufacturing base we're building to deliver market-leading partnership propositions. And the great example here is NatWest/RBS, where we supported them with the changes to their product suite, including a three-year fixed-price Home policy. We're in discussions with them over a three-year extension to this Home partnership, which will continue to include both the RBS and NatWest brands.

The second priority I want to point out is how we're getting ready to launch the next generation of customer systems. This is a big piece of work for us over the coming years with multiple systems and multiple releases and we're looking to make significant progress this year. As you can see from our current trading, we're doing well. So, we're taking our time to get this launch right.

And finally, the piece of the jigsaw that makes it all happen are people. In 2015, we saw a 15 percentage point improvement in our full engagement from our people compared with 2014. We need to sustain this high level of engagement and performance in 2016. And to recognize the ongoing commitment to our people, today we've announced a third grant of free shares to each of our employees.

So, let me turn now to the outlook for 2016 on slide 29. The markets in which we operate have remained competitive in 2015 and into early 2016. And the increase in IPT has led to more customers shopping around. Taking the divisions in turn, Motor premiums have increased, but this should be viewed in the context of rising claims cost, which John discussed earlier.

In Home, the market deflated during 2015, although underlying market pricing was broadly stable in the fourth quarter, excluding IPT. In the Rescue and Commercial markets, we've observed increased competitor activity during 2015, and in particular in Commercial, which accelerated during the year and into the first quarter of 2016.

Against this backdrop, the group will continue to adopt a flexible but disciplined approach to managing the trade-off between margin and volumes. Our reserves are strong and we expect prior year releases to remain a significant feature of our results, albeit at a lower level than in 2015.

Furthermore, we expect total costs to be lower in 2016, although with a smaller reduction than in 2015, in part due to the cost of the Flood Re levy. We'll continue to invest in building future capability, as I've just taken you through.

Taking all this together, our COR guidance for 2016 is to aim for COR in the range of 93% to 95%, which, of course, assumes normal annual major weather claims for Home and Commercial. Finally, of course, our 15% RoTE target remains ongoing.

So, before I finish, a few brief key messages. In 2015, we delivered a strong performance by delivering better service for our customers. Our multi-year investment program is delivering improved competitiveness, but there's still plenty of opportunity for us in the future. At the same time, we've maintained our focus on improving our efficiency and reducing our cost base. We're also increasingly challenging the market norms and aim to be at the forefront of evolving trends.

Finally, we continue to offer good returns for our shareholders, having grown the dividends by around 5% and announced another special dividend.

Thank you, ladies and gentlemen. We'll now take your questions, initially in the room, and then latterly on the phone. Starting from here.

Q&A

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Good morning. Three questions. Dhruv Gahlaut from HSBC. Firstly, on the legacy portfolio, could you quantify how much reserves are tied in into the legacy portfolio and the capital which is against that book? Secondly, could you also talk about margin booking for 2016 year as in post what you've done in 2015? And thirdly, on Solvency II, you mentioned about required capital being broadly unchanged. Could you talk about what happens to the available financial resources?

A - Anthony Jonathan Reizenstein

Thanks, Dhruv. Can you just repeat the third question?

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Under Solvency II, you've talked about having a required capital, which is broadly unchanged, once you do the transition to the external model. Can you talk about what happens to the financial resources as well?

A - Anthony Jonathan Reizenstein

Sure. Well, let's start with the run-off book. There's £350 million of net reserves in that book, it's actually in the premium somewhere, and about £100 million of capital allocated to it.

On margin, so just to be clear, I think you were talking about current year margin, so as we talked about at the half year and, in fact, at the beginning of the year, we had decided not to automatically put a margin on the current year for Motor. And that has been a part - or part of the driver of getting our attritional loss ratio down by about 3.5%, it's about 2% of the 3.5%. And we expect we'll maintain that policy this year. So we said it'd be a one-off improvement in 2015. And so, if we maintain that policy, it will have been a one-off improvement in 2015 of 2%.

The third question, and the reason I asked you to repeat it is because I think the words I used were our capital position. Don't expect a step-change in capital position, which obviously reflects both the resources and the requirements. So I'm combining both of those together really because we - obviously on the internal model, we haven't said either today. And I'm asking you to be a little bit patient because we'll know - hopefully everything there is to know about that in six months from now or a bit less than six months from now, but we just make a very broad statement about the total position taking both of those into account.

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

Okay. Yes.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. Andy Hughes from Macquarie. A couple of questions, if I could. The first one is about small bodily injury claims, I think you said your frequency is up, but when I look at the slide in the charts, it shows that everybody else's frequency isn't really up on slide 36. So is this a deterioration of you relative to your peer group? And on reserve releases, obviously, the 2014 year, obviously you've strengthened the reserves there during the course of this year. Does that mean you've strengthened the actuarial best estimate? And are you kind of - obviously in your reserve release comments, your reserve release in future is going to be coming from 2013 and prior, or is there still lots of fat in 2014 and 2015 years? Thank you.

A - Anthony Jonathan Reizenstein

Yes. So, small bodily injury, against our expectation for the year, our current view is that it's been slightly elevated, but it's not a huge amount. So, there's nothing we're too worried about. The trends on that, the portal trends, yeah, we're still think we are outperforming, but obviously we have a sort of an advanced view on how we'll do and we're just saying - and that's built into our inflation estimate and our pricing. And what we're saying is on that particular peril, we haven't done quite as well as we thought at the beginning of the year. It doesn't mean we - that s consistent with either doing better or worse than the market I think. Because obviously when we look at our own pricing and look at our own claims statistics and what we expect to happen in claims, it reflects our actions and our portfolio and not the market as a whole.

On the second one, which is reserves, yeah, so we strengthened 2014. It was actually both ABE and margin strengthened for 2014. We do think we're going to get releases from 2014, or I do, and in 2015 or potentially in subsequent years, and we think 2015 we've been prudent as usual. And obviously you've seen a hit, on those graphs you can see what's tended to happen in prior years and bodily injury is one where we're particularly conservative, so you might expect to see some of that, too.

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

Okay. We'll stay this side, Ravi?

Q - Ravi Tanna {BIO 16926941 <GO>}

Morning. It's Ravi here from Goldman Sachs. I've three questions please. The first one was on the combined ratio guidance. If I look at the normalized level of your combined ratio this year is 93% and obviously, the guidance is for 93% to 95%. I appreciate there's going to be a kind of headwind in terms of lower reserve releases going forward, but I was just wondering if you could kind of walk us through how to think about that target in that context.

The second question was on the – going back to the Motor attritional loss ratios. 2 points was due to the reserve margin change I understand and then there's another 1.5 points. How much of that 1.5 points is due to Motor excess bodily injury, if you could share that with us that'd be great?

And then the third one was just on price comparison website distribution. You've made a comment in one of your previous quarters that sales via that channel was starting to slow. I was just looking for an update on that, please.

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

Sure. Shall I do one and three, John, might you do two? So on the COR walk, start at 93%, headwind from lower prior year partially offset by hopefully some improvement in combined – in current year and expense ratio. And as John says, our efforts to reduce our expenses in absolute terms obviously have been offsetting a reducing NEP, which hopefully will at least stabilize. So that's the walk.

I'll do PCWs. So, yeah, we – it's slightly different trends between Motor and Home. Home price comparison websites continue to grow, largely at the expense of the bank branch channel, and in Motor, it's pretty stable with kind of – not a fight back, but certainly maintenance of the direct channel. Partly because of what Direct Line's doing, I think respect to what Aviva's doing, so the direct people are giving customers reasons to come direct.

A - Anthony Jonathan Reizenstein

And on the 1.5%, the attritional loss ratio improvement that's not the margin. Yeah, BI excess is a big part of that, but it's not all of it. There is some improvement from pricing, but BI excess is a big part.

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

Great. Okay, let's do these two. Gordon.

Q - Gordon Aitken {BIO 3846728 <GO>}

Yeah. So, Gordon Aitken from RBC. So, three questions, please. On the 2014 accident year, I mean, I can understand very few claims are probably settled there, but more time has elapsed. Just wondering, I mean, you mentioned before more cyclists, more over 75. I mean, is there anything that you can sort of take from that year, that things you would do, or things you wouldn't do? That's the first question. Second one is, I mean, you've introduced lots of new initiatives and lots of them very, very helpful for customers, things like the smartphone technology, I was just wondering where the gains come from. I mean, is that cost of claims efficiency, retention, new business, is it all of those or is it one area in particular where you really get the gains coming through? And just finally, the Stuart Pearce thing, I heard the story and I knew you were behind it. I heard his game was cancelled. I don't know what happened when he actually played that match.

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

Okay. Mike, do you want to do the last one first?

A - Mike Holliday-Williams {BIO 17467410 <GO>}

He's not played yet.

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

He did a training session at Bisham Abbey though I think, so I think the team are in good shape. But, listen, we're doing stuff with bloggers and everything. I mean, I think people asked us why aren't we on TV talking about telematics? It's because at the moment our telematics offer is aimed at younger people, and younger people, social media is where it's about and we've got a cracking team doing initiative after initiative on it. And it's - so we're really proud of what they're doing.

I mean, I think the initiatives and, in fact, our generation - next generation systems is fantastic, the synergistic benefit of the same things which are better for customers save us costs, a better customer experience makes customers more likely to stay with us and buy more things from us. So it's not in one area. The nature of the business case for all this stuff is pretty widely spread.

Sometimes we also do things, of course, we do business case, but we do things because we think it's just the right thing to do in our market and for our customers. So guaranteed hire car was an investment which took us ahead of the market, the business case was, we could get it to a bit positive, but actually we had a conviction in it and actually it's come through with stronger results than we'd thought, really differentiating ourselves from the market.

And you saw a comparison table in there which looks at what retailers or people do to compare what they do with competitors. So, I think it's fantastic for us to be as a great retailer really into that space. So these things have multiple benefits.

A - Anthony Jonathan Reizenstein

yeah. On the other question on 2014, are we taking any action? Well, I think Mike may want to add, but certainly for older drivers, we did take some action in terms of pricing. So there was an action there. I'm not sure whether we've done anything on cyclists, that we've found anything we can do on cyclists.

A - Mike Holliday-Williams {BIO 17467410 <GO>}

I'm not sure if there's anything that we would learn. I don't think there is much on cyclists yet that we've seen more pedestrian – individual pedestrian accidents, but I think it's random, I still think we wouldn't take anything forward, didn't do anything differently 2015.

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

One thing about 2014 is we said we had a theory, some of it was just faster recognition in our claims processes and it's looking like that is still going to be a bad relative year. But that is a reason to give us some confidence that, as John said, it will develop favorably in future. Okay. We'll go and then we'll go on to the other side of the room. Yeah, James?

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

Can you hear me? This thing's miles away. James Shuck from UBS. I had three questions, please. Firstly, I mean if I look at the loss mix you show on slide 13, it looks like 2015 is around 92% and you're booking at a slightly lower level of conservatism. I appreciate that number will run off positively, but if I look at your expense ratio, 24%, that's adding up to 116%. So even if I allow for that 15 points or so, you're still writing at 100%. So could you just sort of give me some insight into what you think the fully developed kind of combined ratio is on Motor, please? That's my first question.

Secondly, on claims trends in the second half of the year, well, in the first half really, I suppose I'm keen to understand what the market is doing. You mentioned your own claims inflation is around 3% to 5%, pricing for the market is probably up 7% or so, so you're doing slightly better than the market. Would you say that actually the industry margin and the outlook is actually turning or are pricing just keeping track with claims inflation across the industry?

And then thirdly, I'd welcome any insight you can give around the impact of net promoter scores because it's one thing to focus on better customer servicing and another thing seeing all these feedback things. But have you actually done any research that actually points to what it means in terms of revenues and cross-sale please?

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

Right. Let me do the last one first and Mike can build on this. The reason we've been winning awards on customer service isn't just we do it speculatively, we can absolutely correlate net promoter scores and retention rates and we think it's that money well spent. And we do it all the way from training the people, people get instant feedback, which is linked to how we reward them, and we can see all these things kind of cross-tabbing. We can actually cross-tab employee engagement. So those are real signs and the reason we win awards is we can make those calls and links, so think it's money well spent. Our retention rates are really good and they've gone up. So...

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

You can't share information on that.

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

We'll give you some more of our award entries, if you want, because it's pretty – yeah, honestly, it's really impressive. So we can pull that out and share that.

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

I take your word for the net promoter score's increasing, but I'm interested to know in the work you've done behind the scenes that actually shows that revenue is increasing.

A - Mike Holliday-Williams {BIO 17467410 <GO>}

Yeah. Well, in fact, obviously we do net promoter score by individual person, so which is we're able to really strengthen it. So what we can then correlate is what's the feedback from that customer as a result of that net promoter score and what the complaints are by net promoter score, so then you get a correlation between those with highest net promoter scores delivering a better level of satisfaction and delivering a better level of retention, getting reduced levels of complaints, et cetera, et cetera. So on an individual level, it makes a real powerful difference and then clearly we're trying to shift the whole spectrum of that up. So, it is really powerful. And the biggest correlation was back to people engagement as well, needless to say, the people with the highest engagement themselves have got higher NPS scores, which makes the business a brilliant culture to work in.

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

Yeah. And the board is all over this, we have retailers on the board, we've got Seb James on the board who gives – challenges all our targets and ambitions all the time to just keep doing better on this. But we don't do it from a charitable motive, we do it from a – yeah, we think it's good business as well, it's also nice.

A - Anthony Jonathan Reizenstein

Just on the first point, I think obviously we do require to make a profit on an ultimate basis, that's how we run our business and that is what we believe we are making. Obviously, it comes out in different ways and lots of it comes out from PY, but we do believe we're making a profit on an ultimate basis and we believe we can improve that profit through what we do on expenses, on claims and on pricing. So it's our intention to make that – to improve that as we go forward. So the answer is, yes, we can make good money on that basis, if you put aside all the prior year accounting.

On the pricing and claims environment, I don't know whether you want to talk about that, what we're saying is claims for the industry has returned to more like normal levels and pricing seems to be reflecting that broadly. We've been able, partly because of the proposition stuff you've heard about, to get our pricing a little better than that, which we've needed to do because we had a bit of a – we needed to catch up a bit on what happened in 2014. So we're reasonably comfortable with that and our ability to get those prices through and we think that's due to all the work we've done.

Looking forward, I mean we don't look forward on pricing, but we're saying the conditions in the first few weeks aren't that different. I mean usually you get a bit of volatility because Q4 is quite a patchy quarter and then Q1 some people have big price cuts and there's been a few of those, maybe not as much as last year. There's still IPT and there's lots of shopping happening, so it's quite – it's a little bit uncertain as to how things are going to.

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

Our call centers have never been busier. I think the other thing we've said, we've said we think Solvency II has been, as hoped, a leveler playing field between jurisdictions as well as players. So, I think that's potentially a positive for having a very functioning marketplace, level playing field.

Yeah, as we said, I think Q1 started off pretty much as the second half did on Motor and actually slightly more positive, a bit of a respite from deflation in the Home marketplace, but loads of shopping, our call center was never busier. And actually, with the extra shopping, we're doing pretty well because we're competitive, we've got good brands, we've got good propositions. So, yes, that's enough about the market. Yes.

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

Jon Hocking from Morgan Stanley. I've got three questions, please. Going back to the Solvency II point, is that a sort of backtracking from where we were at the first half? I seem to remember the first half, there's a little bit of a stronger statement that maybe there's some excess that's obviously going to come back at the interims. So first question.

Second question, on Flood Re, is this just something for you that increases costs or is there an opportunity here in terms of the addressable market increasing of uninsurable claims, which are certainly insurable?

And then just finally, on the partnerships, I accept the fact you're still committed to that segment, but how does that square with the additional functionality you're building into your product here? And does it make sense to supply that on a white label basis or is there something you're going to with the less attractive product through the partnership channel? Thank you.

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

So I think the news on partnerships, and let me deal with the fact that we've lost two, I think one of them we lost for reasons not of our - entirely of our making, there was a different approach being pursued. I think the other one is, the degree to which we lost it is a reflection of our proposition, it was a reflection of our proposition probably two to three years ago, and the proposition as of today, I think we're really competitive, because we do allow partners to benefit form a lot of things we're good at, which is a reason to kind of come to us. So all our stuff we're doing on digital, the customer experience stuff we do share with partners, albeit our propositions on Direct Line go further. But our different partners want it tuned to different things, so we're developing quite differentiated propositions for RBS/NatWest to do what they're trying to do.

The gestation period for partners is quite long. So, it takes quite a long time to lose them. It also takes quite a long time to gain them. So, as we're now in the market saying we've got a good partnership proposition, which will only strengthen, that's not going to immediately turn into brand new partners, but we're really encouraged by the progress we're making on the new deal with RBS/NatWest. It's not signed, sealed and delivered, but good progress.

And in the future I'd love to win partners, either conventional partners or actually the next generation of partners, anyone with customer data, customer access, brand, could be a good partner in insurance. So, we want to be the go-to people for the next generation of partners that really value slick digital interaction and all the things that we're good at.

The Flood Re, so the certainty of Flood Re is the levy, the £24 million. That's just math on our GWP. The amount of premiums we play to Floor Re is our calculation of how many homes flood costs is more than the £250 to £600-ish charges, which are driven by council tax. So we would only put in kind of - and that's quite high flood risk, right. So, that's not millions of homes that have a floods component of their risk costs of £250 to £600. So it'll be quite restricted to pretty high history of flooding and pretty close to rivers and all that stuff, it's not going to be mass, mass, mass.

But what that does do, I mean we can go back into the Henley market probably because we have been a little bit - all our flood modeling means, probably people in this room, posh homes by rivers, we have - we needn't be shy of that for the reason of flooding. So I think, yes, there are some upsides, so definitely a cost downside. There's levy. Whether the market prices saw that? I don't know. It's a free market, very competitive and I don't make any forward-looking pricing statements. How much we recover depends on the floods and how many homes we put in. And then, I think a relatively modest opportunity I'd say to get back into certain places that we've been a bit shy of underwriting.

A - Anthony Jonathan Reizenstein

Solvency II. Yes, so let's just unpick that a bit. The internal model that we have obviously has a lower requirement than the standard formula, otherwise we wouldn't be doing it, and it's a much more accurate portrayal of our risk. So that's a positive. On the other hand, it hasn't been validated by the regulator yet and then we haven't yet set our risk appetite around it. So, our risk appetite on the old system was 125 to 150. I don't think there are many companies who have come out with a bottom end on the new system as low as 125, there may be some. So that could be a bit higher and I think the range could be wider because it's a bit more volatile. So that's another aspect of it.

And then the next aspect is the risk environment isn't changing because of Brussels or even because of London. The risk environment is the risk environment and we can't hold the capital we need for the risk environment. The one bit of the risk environment that will be improved when we get our internal model approved, assuming we do, is that we won't be uncertain about that anymore because at the moment we've been holding a bit of excess capital against that uncertainty, so we hope that's going to be released, if you like, that part of the risk will be released.

And then, obviously, I think you have the experience that we don't hoard and we tend to be transparent and we have paid quite a lot of dividends, including special dividends, so I think – and obviously in most periods we generate more than our regular dividend of retained earnings. So I think putting all that together, there's ground to be a little bit optimistic about the half year if that all comes through, but there's a lot to go through. And therefore, we think overall, given the risk environment hasn't really changed, there probably isn't going to be a step change. We're basically asking people to be a bit patient and we'll know much, much more then. So I hope that kind of answers it.

Have we backtracked? Well, I'm sorry if we have, you'll probably be able to quote me, but I don't think we have. But if we have, I apologize.

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

Okay. Yes.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi. It's Farooq Hanif from Citigroup. I want to go back to that point about Solvency II, so you've kind of partially answered the question, but you seem to be suggesting that obviously uncertainly about Solvency II generally has required you to hold capital at the upper end of your RBC range, even with the special so. We don't know what the new capital range will be, but are you suggesting you'd be more willing to move to a middle point of that range as part of your internal model?

A - Anthony Jonathan Reizenstein

I think really that's – I've probably said all I can say. I mean, there's lot to play for here, even without Stuart Pearce, and we'll – that's all work we've got to do essentially.

Q - Farooq Hanif {BIO 4780978 <GO>}

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A - Anthony Jonathan Reizenstein

No, I wouldn't want to – I certainly wouldn't want over many, many periods to hold the top end of the range and then make it a perpetual thing, but then we haven't set the range yet so.

Q - Farooq Hanif {BIO 4780978 <GO>}

portfolio changes you're making. Am I correct in thinking it's going to be quite a modest increase in SCR for that? And the last question was actually going back to the propositional changes that you talked about. Are you suggesting that there is a clear combined ratio profit improvement from what you're doing or is it really about retention and volume? So, for example, the guaranteed car, et cetera. So, are you going for actual combined operating ratio improvement from your initiatives or is it really about proposition and just keeping volume?

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

So I think it's a bit hard to take the sugar out the tea, frankly, and our COR guidance is our COR guidance, which puts everything together. I think we don't – it's very hard to know if you hadn't done stuff what exactly would have happened. And for me, rewarding our Direct Line customers for free with enhanced propositions is a good long-term business thing to do and we see some immediate benefits. We see some immediate deficits, if we give something free that we gave before. I think so far we've been validated in our assumptions we've made on Direct Line and hence us pulling it out as a positive narrative and I think we'll continue to do things like that in the future. But I think...

A - Anthony Jonathan Reizenstein

We have a customer value model, so we look at the long term over what a customer will deliver us, taking into account their retention behavior, our pricing behavior and so on. So it's on that basis, yes, I think we're doing it on a positive note, because there's a positive cash flow from it, but it may not come through in one year's COR.

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

John, on the...

A - Anthony Jonathan Reizenstein

Yes, on the investment portfolio, there will be some capital used, but when we do an investment portfolio change, we want to make sure we get a return on capital on that that's not dilutive to our overall return on capital.

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

Yeah.

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

Andreas van Embden at Peel Hunt. Just coming back to the cost savings and the potential for cost savings in the next three years. You were reluctant to give us sort of absolute number, but when you think about the potential, is that mainly coming from claims handling, is that mainly distribution and distribution mix, or is it actually the retention? And have you calculated for every 1 percentage point improvement in retention how much that saves in sterling million?

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

Yeah. So, cost savings, I think I feel validated in not giving an actual specific pound target by the fact that, A, our costs have come down 4.6%, £200 million since the IPO, our engagement has gone up so significantly at the same time, and we've improved our brands. I think one of the dangers of pound cost savings is that you get through September or October, you're not going to make your external target, what do you cut, training, overtime, brand investment. And that's precisely what we haven't done by having the wriggle room of you trusting us a little bit on when we're going to get there.

I think all of the big headings, to get big cost savings in the future, you need to tackle your big headings. IT is a big cost, for instance, you need to be vigilant about. We continue to drive efficiency through our people, digital channels, robotics. We are judiciously users of offshoring, which is an initiative we do very, very carefully. We always check that the quality and the customer service is okay. We've been doing a bit more of that in India and South Africa. So we've got a number of drivers.

I mean, ultimately, probably more in the kind of, the outer years of the plan, self-service is kind of the biggest probably concept we have in further cost savings because, as I've always said to you, when was the last time you phoned British Airways or you probably wouldn't even get a number for Uber. We're in a world now where low involvement transactions, customers want to do it and are happy to do it for themselves. There's always a role of our people in more complicated things, where customer knowledge is needed, handling emotional claims, et cetera, et cetera, but we do think probably as a medium to long-term opportunity self-service is a concept. Yes.

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

Hi. I'm Alan Devlin from Barclays. A couple of questions. If Flood Re had been in place for the winter storms, would you have had any material recoveries from this? And then just secondly on your investment income, if you hadn't been re-risking the portfolio, what would have been the portfolio yield, how much would that have been declining, given the low rate environment? Thanks.

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

There's some, but by no means not all because as I said, it's the really, really high risk ones that definitely you'd put in and kind of the rule of thumb is at least £250 to £600 is the premium we pay to cede that risk. And that's only one part of the multiple peril. So, if someone's paying an overall cost, I won't give you a rule of thumb, but you can kind of work it out. So it would have given us some, but by no means all. It's a relatively small part of that. Still worth doing.

A - Anthony Jonathan Reizenstein

Yeah. On the – I mean, one way to think about the second question on the counterfactual on investment. I mean we just talked about some of the reinvestment rates at the moment, so infrastructure is about 2.5%, high yield's about 4%, the typical IG credit would be about 2%, gilts would be about 1%, so you get a sense of that and I'm sure you can model better than I can what would happen, but it would make quite a significant difference, property as well, obviously quite a big – it's our biggest yielding element.

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

Andrew?

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

Good morning. It's Andrew Crean from Autonomous. Could I ask three questions? Firstly, as you re-risk the investment portfolio, do you think it is still right to carry unrealized and realized gains through the P&L account, having them capitalized at 15 times? Secondly, could you say whether you're happy with the capital stack that you've got or might you consider increasing the debt and returning equity?

And thirdly, if we go to slide 44, I think the move between your IFRS equity and the capital available was about a £203 million positive benefit, I'm assuming from moving the reserves from an IFRS conservative basis to a best estimate basis, is it fair to say that that £203 million is a good view of the amount of conservatism you've currently built into your IFRS reserves?

A - Anthony Jonathan Reizenstein

Investment portfolio, I think your question was about the market valuation of our profits, I think. Let me disclose what our gains are...

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

basis you don't have to carry those through the P&L. They could go through OCI.

A - Anthony Jonathan Reizenstein

Well, I think we're pretty clear about what we do and it's down to you experts to decide what value to put on them. Secondly, on the debt, obviously we look at that often and I think my response is the same as it's been, which is we clearly do have some debt capacity. I would rather have that as rainy day money and there may be an opportunity that comes up where that would be extremely useful to have. If we paid it out – if we geared up and paid it out that would be a one-off, people might be grateful that day, but then I wouldn't have that capacity for some future opportunity. And I think we do like to reward shareholders with cash and I think we've been decent at doing that.

In terms of the – what can you read into that bridge there on the IFRS to Solvency II standard formula capital, obviously you're right, I mean reserves is an aspect, but it's not the only aspect. There are other things going on to do with, for example, the risk margin, which is quite formulaic, understanding the formula, there are elements to do with our actuarial best estimate and margin and there's [ENIDs] coming in the other way. So there's quite a lot of moving parts. And it sounds like we should probably explore that further when we see you next at Q2.

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

Good. Second round.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi. Thanks very much. Andy Hughes from Macquarie. A couple of follow-up questions. The first one is on other income, I think you mentioned in your presentation that some of the changes you've made to the proposition were going to impact other income, but I think other income grew last year. So could you give us a view on that? And so coming back on Andrew's point on the reserve margin, if I understand it correctly, the reserve margin you're talking about when you give guidance on prior year profits is mainly margin the actuarial best estimate right, so it wouldn't be shown in this slide because this takes you down to actuarial best estimate. Is that right?

A - Anthony Jonathan Reizenstein

Just in terms of other income, what I said was that I think I called it – what – the income we lost by giving away the – by free admin charges and so on is not part of – part of our premium line. It wouldn't affect the other income line. So it's additional income, but it's not technically other income. And in terms of margin and ABE, let's deal with that when we've got the data.

Q - Andy Hughes {BIO 15036395 <GO>}

And a final question on the RBC deal, it sounds like you're fairly confident about renewing that deal and presumably that would be a margin reduction from where we are currently.

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

Okay. So you wouldn't expect me to reveal the commercial terms. We are in the middle of conversations with them. Obviously, they're going well enough for me to say we're having the conversation, but we haven't closed that deal. We've got probably a few more months of conversation with them to tie it up. So at that stage obviously what they're happy for us to disclose about the nature of the arrangement will be – we'll think about. So at a future date, when we've got that inked, we'll tell you what we're going to do.

Q - Andy Hughes {BIO 15036395 <GO>}

deal, so you're saying on the other deal it was the perception of what IT services you were prepared to offer and this one you presumably would be preferred to offer them.

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

I think that's what I'm saying is these things are – take a long time to bake. If there was an extent of the NBS being a judgment on the proposition in the wider sense that was an assessment probably when that decision was just dated probably two years ago. I'm saying as of today, our proposition I think is absolutely stands with comparison in the market and is very good, I'm saying that's on the basis obviously – and evidence to that is the potential RBS deal and evidence of it going – will also be hopefully over time we can win new partnerships, which is a stated ambition of ours. And then the commercial terms probably will stay shrouded in commercial sensitivity, but we haven't even – we still need to finalize the deal.

Thank you. Right. Can we just check with the phones and then we'll do any others. Yes, we've got one on the phone.

Operator

Yes. We got one question on the phone line from the line of Greig Paterson from KBW. Please go ahead.

<: Hey, Greig.

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

Good morning, gentlemen. You thought you'd got rid of me, but it's not the case. I've actually got four quick questions. One is, previously you speak about the stock of margin in the IFRS balance sheet, you talk about 7%. I wonder where we are now, if you can give us an update on that? Second thing is I wonder if you can just talk about the inflation, the year-on-year rate on the earn basis in the Home book. Third thing, for RBS, I wonder if you can just give us an idea of what its current contribution is to net written premium.

And the fourth and probably most important, we saw a spike – we've seen a spike in Motor premium rates in the fourth quarter. I'm trying to figure out to what extent that's because we have one or two players that have been very aggressive in finding themselves in trouble now and backing off, or if it's been a sort of uniform right across the market pain and everybody is backing off. I was just wondering if there's sort of any indication of the health or where the market's going to go or we might see some people exit the market, these spikes we saw in the fourth quarter.

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

On your most important question, we're probably going to be least helpful. Q4 is always a slightly unreliable guide for the rest of the year. What we're saying is kind of Q4 into Q1 is kind of in line with the trends which we saw in the second half. The new news is the extra shopping driven by the price increases, which we think is a catch-up on claims inflation plus IPT. So kinds of that's the new news, but we're not calling out any kind of brand new trends. But we are saying, the other thing I said was, of course, the Solvency II point and the level playing field across jurisdictions, which may be helping as well.

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

So there's no player that's – you haven't seen one or two players that's backed off dramatically. It's been an across the market sort of phenomena in terms of the rate increases.

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

Yeah, it ebbs and flows, Greig. If you saw the chart, it looks a bit like the London tube map. So it moves around, but I wouldn't say we're calling anything in particular out, either in that or in Home. RBS is roughly the same share of GWP as Nationwide was, roughly, a little bit less. Stock of margin is higher than 7%.

A - Anthony Jonathan Reizenstein

Yes, that's about it, that's what we're saying.

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

What do you mean inflation in Home, Greig? Claims inflation?

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

Yes, claims inflation year-on-year. You basically say 3% to 5% in – or the high end of 3% to 5% in...

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

I mean, the good news on Home is that the attritional claims was actually really good in the year, if you look back, there was a very bad set of one-off weather, but actually through the year, it was a very, very benign attritional claims environment. And that explains why we've got such a good loss ratio despite competitive pricing. And also, claims handling costs were also as a result of that frequency of claims was down, so that helps our claims handling costs.

A - Anthony Jonathan Reizenstein

Long-term, we still think that – we plan for Home inflation as well as Motor inflation.

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

Yeah, a little bit, yeah.

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

So what is that, 1% or 2%? I mean what is your -

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

Yeah.

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

And where are you relative to that 1% or 2%?

A - Anthony Jonathan Reizenstein

Well, a bit more, we plan for about...

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

2% to 3% maybe.

A - Anthony Jonathan Reizenstein

2% to 3%.

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

And then, where are you relative to that now, ignoring the bad weather?

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

2015 was better, but it was – you've seen all sorts of records being broken. It was the warmest winter and all that sort of stuff. So, all I'm saying, day-to-day, week-to-week, we didn't have any burst pipes, we obviously had 5,000 big claims at the end of the year.

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

Perfect. Thank you.

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

Very good. Can we do it in...

Operator

We have a question now from the line of Olivia Brindle from Bank of America. Please, go ahead.

Q - Olivia Brindle {BIO 17273762 <GO>}

Hi there. Good morning. I've just got two small questions left. The first one I was just clarifying some of your comments that you made on the Motor attritional. So I think, John, you said 1.5 percentage points when we exclude the lower reserve margin that's being put in and some of that being down to improved pricing. But you were also saying that rates were up 5.8%, claim inflation probably around 5%, so it's not obvious that you should have a benefit in your combined ratio from pricing. I think at the half year, you said there was a negative of 0.9 percentage points because you still had that catch up to make for last year. So if you could maybe just clarify what that 0.9 percentage points would be for the full year.

And then secondly, just you mentioned some write-offs on software, property, et cetera. How much was that and is that a pure one-off or can we expect anything more of that nature going forward? Thank you.

A - Anthony Jonathan Reizenstein

Well, on the costing, I think we said we ended the year at about £20 million run rate. It can be bumpy between quarters, but year-end you look at some of these things, but £880 million for the year is kind of where we start the new year, the year that's already started.

On the first point, I think we just said - so it's an improvement over where we were at the half year because we were worse by 0.9 percentage point underlying and now we're saying we're better by 1.5 percentage point, but, as I said most of that is due to improvements in bodily injury excess, now we've had a proper look at 2015. And there is some other improvement in there, but the main thing is the bodily injury excess.

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

Andrew, do you want to be quick?

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

When does the Sainsbury's premium drop out? And should we expect £80 million of weather losses, now you've got Flood Re in?

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

We'll come back to the Flood Re because we haven't decided what premiums to put in yet, we're still working that out I think, Kate?

as we work our way through.

Yeah, but handful of million?

Yeah.

Not huge.

Q - Olivia Brindle {BIO 17273762 <GO>}

So one down 2017, 2018, yeah, it's not huge.

A - Anthony Jonathan Reizenstein

And Sainsbury's, we're talking 2017

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

So the wind down, it's 2017, 2018. Yeah, it's not huge.

Good. So I'm just going to end, if there's no more on the phone, slightly unusually with a thank you to somebody. As many of you know, Neil, to embarrass you a little bit, is off to do a proper job, running NIG. I'm glad we didn't get any questions on NIG, but I think that underlines how important the Commercial market is that we're putting one of our stars into that. But I just want to thank Neil. Hopefully, he's provided you with good service over the last five years. He's been invaluable to us getting through the IPO and getting to where we are today. So just to embarrass him a little bit, just a round of applause for Neil.

And coffee outside, I hope you'll join us. Thank you.

Operator

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