Q3 2021 Sales and Revenue Call

Company Participants

- Neil Manser, Chief Financial Officer
- Penny James, Chief Executive Officer

Other Participants

- Alan Devlin, Analyst
- Alex Evans, Analyst
- Faizan Lakhani, Analyst
- Freya Kong, Analyst
- Gordon Aitken, Analyst
- Greig Paterson, Analyst
- Ivan Bokhmat, Analyst
- James Pearse, Analyst
- James Shuck, Analyst
- Ming Zhu, Analyst
- Rhea Shah, Analyst
- Thomas Bateman, Analyst
- Will Hardcastle, Analyst

Presentation

Operator

Hello, and welcome to the DLG Third Quarter Trading Update Conference Call. My name is Juan, and I will be coordinating your call today. (Operator Instructions)

I will now hand over to our CEO, Penny James to begin. Please, Penny go ahead.

Penny James {BIO 15157212 <GO>}

Thanks, Juan. Good morning, everybody. Now, I'm sure you have all read through the results and I'm conscious they're not that long. So, really this is about giving you a chance to ask any questions.

Just for gathering your thoughts, what I thought I'd do is briefly pull out a few key headlines from the quarter for you. I think the -- I'd best summarize that is we continue to do the right things and remain disciplined, while making good progress on the transformation and positioning ourselves well as we look ahead.

So the first thing I'd highlight is that despite challenging market conditions, we've continued to grow own brand policies. So, we were really pleased to have maintained a strong growth in both Commercial and Green Flag that we delivered through the first half of the year. In Home, as we expected, and I think highlighted at the half year, the market has got more challenging in the second half. I'd say, whilst we continue to grow, the rate of growth has slowed. And finally, Motor, our own brand policy count stabilized reflecting our improved competitiveness as we began seeing some of the benefits of our new system coming through.

The second point I was going to make is that having been at COP26 last week, it would be remiss of me not to mention the progress we're making on climate strategy, which is one part of how we're positioning the business for the future. So, we've committed, as we told you before, to the Race to Zero and we are working to set Science-Based Targets covering Scopes 1, 2 and 3 emissions. But also I'm really clear that for all the talk of commitments, which is important, we've also got to keep it simple for customers to go green themselves.

And that's why we are excited to launch our new electric vehicle proposition for Direct Line. It makes the switch to electric easier for customers and builds on our already strong position in the growing EV market. so alongside the benefits that we're seeing coming through from our new Motor platform, there's a real sense of momentum in the business as we head into the New Year.

And the third point I was going to draw out is that we are on track for the full implementation of the FCA's pricing practices review having successfully met the product governance deadline in the third quarter. Now as with any large regulatory change, we expect there to be volatility in the market in the first few months of next year as the new rules bat in. However, over the medium term, there will be no changes in the attributes required to be successful in this market such as strong brands, great customer service, and so on and so forth. So, we remain confident in our outlook.

So, summing up our transformation progress, delivery of new propositions and improved competitiveness, combined with our focus on disciplined underwriting, means we're well placed as we look ahead. And that's why we've reiterated our combined operating ratio guidance of 93% to 95% over the medium term, normalized for weather, of course, and to be between 90% and 92% in 2021.

Now just before I pass back to Juan to open the lines for Q&A, I just want to remind everybody of our Investor Insight Session that we'll be holding our commercial business on 17th November. As I've told you before, it's an area of our business that service through its transformation and that's driven the strong growth that you've seen in today's results and throughout this year. So we're really looking forward to giving you a bit more color and insight as to how we've achieved it.

So I will pause there, and I will pass back to Juan to see whether you've got any questions on the lines. Thank you.

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Bloomberg Transcript

Questions And Answers

Operator

Thank you. (Operator Instructions) And our first question comes from James Pearse from Jefferies. Please, James, your line is now open.

A - Penny James {BIO 15157212 <GO>}

Hi, James.

Q - James Pearse {BIO 21233776 <GO>}

Yes, thanks. Hey, guys. Hey. I hope you're all well. Just two questions from me please. So another strong quarter for Commercial. How sustainable are those, and those levels of growth in that business going forward?

And then the second question is, can you give us an idea of the percentage point benefit the claims repair network gives you in terms of claims severity inflation? Or I guess put another way, what is the difference between the level of severity on claims that go through your garage network and severity inflation outside of your network? Thank you.

A - Penny James {BIO 15157212 <GO>}

Yes, sure. So Commercial, I think the first thing is what's driving the growth. And I think there are probably three things underpinning that growth. The first is that we've invested in technology that's enabled us to really support customer service over the last few years. So we won another award for kind of broker hub electronic hub last week. And you can see both in the broker side and the customer side, the service levels and flexibility that people have is ahead of most of the markets. So that's the first big win. And I think alongside that that held up through COVID unlike some of the competitors. So that's been a real advantage.

The second thing that's driving it is we've got pricing models in there, we've had Radar Live in for some time, so first part of the business that's done that, which has enabled us to really start refining the pricing in those areas and that in itself has given us benefits through this year as well, and it's driven some of that growth.

And the third thing is that the market has hardened throughout this year in commercial, to some extent in the SME space, less than other parts of the market. But what that's meant is kind of more business has been coming to market than usual. So when I look forward, I think the momentum that drives the first two of those continues. I think we'd expect to see the market get more competitive again as it does in its sort of natural cycle as we move into '22 and beyond. So what does that mean? So when we look at this business, we don't see something that's probably growing at 15 -- 12%, 15% per annum as it has done this year. We think that's probably a bit rich because it's had the additional tailwind of the market. But we do see a business that can grow upper -- mid to upper single-digits going forward on a continuing basis and that's how we view it. So we're pretty proud of what it's done this year.

The second one on kind of the benefit of network and severity inflation generally. I'll give you a feel for what's happening in severity. I think the first thing is, we know we have an advantage because there is benchmarking done across the industry and so on, so we can very literally see that. We don't give that detail out, James, because it's clearly very commercially sensitive in terms of the points differential and so on. But to give you a flavor of what's going on in severity generally, I think we've been kind of -- I think we flagged at Q1, we're probably slightly above our usual 3% to 5% range. At Q2, we said it was sort of coming in just inside. Broadly, it's running around somewhere at the top of that 3% to 5% range and maybe slightly outside that if you include some of the real COVID factors that are still having a little bit of effect. So people driving premium cars, for instance, cleaning costs, those sorts of things are still knocking around. But the biggest driver at the moment, that's putting kind of upward pressure in there will be around, I suspect, for a little while is second-hand car costs, where you've seen a big spike because of consumer demand and lack of availability in the new car market. So I think we kind of expect to see some continued inflation probably somewhere around the top-end of that range as we have through this year, driven by that effect and to see that for some months, yes, I think.

What does having a network do for us in that, gyuys? Certainly we have been able to manage some of those costs in a different way. We've been able to be more flexible in certain areas, we've been flex [ph] what we do on the repair side. So we know that there are benefits from having the repair networks that come through, especially when things spike. But I can't give you the numbers for competitive reasons, I'm afraid.

Q - James Pearse {BIO 21233776 <GO>}

That's fair enough. That's very clear. Thank you very much.

Operator

Thank you. The next question comes from Greig Paterson from KBW. Please, Greig. Your line is now open.

Q - Greig Paterson

Hello, everybody. Can you hear me?

A - Penny James {BIO 15157212 <GO>}

Hi, Greig. How are you?

Q - Greig Paterson

(inaudible) The -- two quick questions. One is, wonder in Home due to the FCA pricing review, you've consistently said that you're moving renewal rates down in a steady way to achieve the pricing rules by the first of next year. I was wondering in percentage terms, how much further you still need to go to achieve that on the renewal pricing?

And the second thing, in Commercial lines, in the third quarter, I was -- including NIG and SME area (inaudible) business, what is the net rate that you are carrying year-on-year sort of premium rate minus claims inflation? Thank you.

A - Penny James {BIO 15157212 <GO>}

Brilliant. And thanks, Greig. So FCA pricing, and where are we? So I guess, and in particular kind of focused on Home, well, first thing to say is, we're on track because I think that matters. Second thing is, we've delivered all the product fairness elements, which I think is relevance to your question. And kind of we're set for year-end, if you like.

What's happened on renewals? Now, we've said over the last three years that we've been progressively tightening, setting margins in the book with which we're comfortable and bringing those in, and we set those basically in the 5-year, 10-year points primarily. So as we come into this year, we've been kind of dealing with those tails each year. We've done a bit more today -- so a bit more over the course of this year, which we can sort of see in the AVP numbers. So even though I think the AVP on Home overall is pretty flat even though we've been putting inflation through and as we go, and that's because we have a side that is we've done a little more tightening in those margins at the end of 10-year [ph]. So when we actually put the sort of product fairness elements and the product governance elements of the rules in September, we didn't make a step change for that because we have been doing that incrementally over a number of years is perhaps best indicator I can give you.

I think the remaining bit, therefore, where the pricing rules come in is, is the leveling up of the 10 years and that's kind of the process that will happen in the early part of next year. So perhaps that gives you a feel for what's happened in that space.

I think on Commercial --

Q - Greig Paterson

Sorry Penny. Is there going to be dramatic -- I'm just trying to -- is it something we need to be shocked by or is it going to be fairly second order? That's what I'm trying to figure out.

A - Penny James {BIO 15157212 <GO>}

I'm not going to make predictions. It's legal for me to price indicate, so I try it [ph] with a little bit of caution. But if you look back to even the kind of the FCA original business case and so on, you can see that there is a not insignificant correction in the numbers, in the new business numbers in the Home book when they did that modeling. So I don't think it's unreasonable if I got that modeling right to expect something. And I think the other thing that people will have to think about is what's coming through in inflation and inflation in Home has been running top-end of 3% to 5% and really with one eye on what's happening, construction cost and so on, so actually, there is some inflation out there. So I'm not sure it's about. The other thing I'd say is, it will vary, but from segment to segment, brand to brand, channel to channel.

So when I say that we expect some volatility at the beginning of next year, I think people will put their rates into the market on Day 1, and then that'll be a process. Remember, it takes six weeks or so -- the renewal notices go out about six weeks ahead of renewal dates, so there'll be will be some time before it's clear, what all effects are on both new business and renewals, and we -- you should expect, I think the market to make adjustments as all those data points become clear. So I think we'll be and we've kind of flagging that there'll be volatility in Q1. And I wouldn't over read any particular direction, you're seeing that for any particular player because I think that will all kind of even out across that quarter, if that helps at all. I think the important thing when you stand back is we have the levers we need, we've got experience in this market. We're comfortable with our position in coming in, and we've been very careful in Home to take our volumes early in the year before it got too competitive. We've backed off a little bit as things have got competitive in the second half. So, we're very comfortable with where we're coming into that process, and we've got the levers to deal with it and we will all see kind of what the best route through the early weeks is when everybody's prices are in the market.

Sorry. You asked a question on Commercial as well, about rate carry. Yes, I don't think we've given the rate carry numbers in here, but we are carrying ahead of inflation around 6 points something like that inflation running in the 3%, 4% somewhere around there.

Q - Greig Paterson

Thank you. Cheers.

A - Penny James {BIO 15157212 <GO>}

Thanks, Greig.

Operator

Thank you. The next question comes from Freya Kong from Bank of America. Please, Freya, your line is now open.

Q - Freya Kong {BIO 20097488 <GO>}

Hi, good morning. Two questions, please. So firstly, given that you've talked about severity sort of getting worse since H1 driven by used car prices and market pricing remaining quite stubborn, how comfortable are you in being able to price the severity inflation going into next year?

And secondly, could you comment a bit more about the competitive dynamics that you're seeing in Home? Given the slowdown in growth that we've seen in Q3, do you think this will continue into 2022 or is it very dependent on the FCA trading volatility? Thanks.

A - Penny James {BIO 15157212 <GO>}

Brilliant. Hi, good morning, Freya. On Motor first, I think the punch line is if you look at the ABI data, the market is down about 7% year-on-year. For us, we're pretty flat. So, what's going on there? Well, the reality is that the market adjusted in January to lower frequency and that hasn't really risen since, and there's lots of good reasons. But that might be the case, so whiplash and so on and so forth, that could be driving that. But however it got there, it's kind of reduced for lower frequency, and hasn't really risen as a whole, the variation within it, but as a whole. We've reduced the shallower amount and we've been passing inflation through to your point, throughout the second half of the year. So, we lost share in the first half, because we've taken a shallower route and we started pricing inflation towards the end of the first half. But actually as we've come through the second half, we've improved our competitiveness, if I could say the word, as we started to see the pricing benefits coming from the new platform launch. And so even though we've been putting inflation through, we're still seeing benefits, and that's why we've kind of stabilized the policy counts regardless of putting inflation through. So, it's very clear that our aim is to continue place pricing severity through, and we wait with curiosity to see where the rest of the market -- when the rest of the market will stop pushing.

And on Home, yes, you're right, the shape -- I mean, Home has done -- I'd like to say, we've got a crystal ball, but that's not the case. But Home has done kind of exactly what we predicted it would do. We -- it was -- it's been pretty flat with relatively low inflation and relatively low premium inflation for the last few years. And it kind of remains low at start of the year. We pushed pretty hard and actually we have some, good [ph] manufacturing benefits coming through, strong claims management and so on, that enabled us to grow and improve our loss ratio through the first half, which is a magic you always want to replicate.

Now as we moved into the second part -- second half, it's got more competitive. We think by September again, it was something like 7% off year-on-year, the Home market. Now our read on that and our -- what did we expect, because logically, long term customer values increase in a post pricing practices world. So, our belief is that that is driven by pricing practices and people's entry points into pricing practices trying to drive share as we go into that. If that's the case then logically people will adjust that thinking as they get into the post pricing practices world what they do -- what that does to price for them to judge rather than us. But as I say, we are pretty comfortable on Home with where we're coming in, the pricing practices to be able to kind of hold rate coming through and still be holding the book flat growing slightly after strong growth in the first half feeling pretty positive for that. Yes, I pulled [ph] that.

Q - Freya Kong {BIO 20097488 <GO>}

Okay. Thank you.

A - Penny James {BIO 15157212 <GO>}

Thanks, Freya.

Operator

Thank you. The next question comes from Thomas Bateman from Berenberg. Please, Thomas, your line is now open.

Q - Thomas Bateman {BIO 21707516 <GO>}

Hi, good morning.

A - Penny James {BIO 15157212 <GO>}

Hi, Thomas. Good morning.

Q - Thomas Bateman {BIO 21707516 <GO>}

Just on the Motor pricing, I think investors checking from the outside are seeing pricing down 7%, claims inflation 5%, and there's a big kind of 12 point gap there. And I think there's lots of moving parts in between, driving behavior, whiplash, new cars et cetera. But I don't know, can you help us give us the numbers to bridge the gap as to why -- it's not a 12-point gap for the rest of the market.

And the second question is just on the transformation changes, there's a lot of good talk about improving accuracy in the pricing. But when do we -- should we expect to see sort of the changes are -- actually travel for both Motor and Home or more material change in the direction of travel policy count on both Motor and Home?

A - Penny James {BIO 15157212 <GO>}

Okay. Look the challenging tone of the second question, I will come back to that. Okay. I mean, I can only do so much to tell you why other people are pricing, what they're pricing, that's for them to tell you. But let me give you -- if I can fill in some components, if you like that might be the case. So, I think you're right that the answer lies between claims frequency, severity and including whiplash and preparation for pricing practices, and any other people can tell you how they're drawing those lines.

But what's happening on frequency, I think we said at half year driving miles are pretty much up where they were pre-COVID and that's obviously continued. Frequency remains below 2009 levels. For us, they're still trickling upwards. For us they're kind of close to still approaching the pricing assumptions that we've been running with. So that's good. But it is a critical assumption, so there may be some variation with a few points there in people's positions, don't know. But broadly, there is a benefit relative to 2019 levels at the moment.

In terms of severity, people are calling out -- sometimes we call out lower numbers than competitors because I think what James asked, we have some benefits from the repair centers. But yes, you've got to say that it's been somewhere around the upper end of 3% to 5% for the last couple of years, and those two years where the claims inflation haven't been priced yet by the market, because they've been offsetting them in some sense against frequency benefits. So you think you've got that plus whatever is ahead still to come in some shape or form.

And then offsetting that you've got whiplash few points depending on who you are and whether you use the government numbers, very unclear at the moment what the benefits of -- it's just too early to know where the whiplash reform benefits are going to land. So again, you've got an assumption in the mix. So I think all of that kind of point you to the market is 7% down, which means they really haven't priced a couple of years of inflation. So if you take -- if you assume that it's logical because frequency is down, it's still -- there's still a gap there, whether 5 or 10 or whatever will depend on some of those assumptions, but there's clearly a gap.

So I think that's where the market really is and people may be making choices. I think as a practical point with PPR [ph], that's the only other thing that I would sort of flag, that if you make a pricing change now, you've only got a few weeks benefit from it. So, there comes a point where you kind of apply most of your pricing resource to what could 2022 look like rather than what 2021 look like. So, I'm not sure now, I'd be over-reading movements in the back end of this year because just because the volume of resource that we'll be focused on post '22 well than anything you do now has little validity or is only valid for a few weeks. So, so sort of -- I think the story from here, it was not very exciting in 2021 whatever direction it goes and because most advantage is going on 2022. But a shorthand answer to all of that is the market hasn't priced all of inflation. We've been pricing inflation. We got more of the kit bags to come as we can kind of put resources back on to delivering benefits that's currently focused on getting us over the line for pricing practices.

So we're feeling pretty positive actually as we go into next year, which leads us on to transformation, which is your second question. So, what's -- kind of what are the benefits and so on. So I think why we got more competitive through this year, through the second half, really because I think and I probably flagged it way back when -- when you move over to the new platform, before you even do anything with it, you gain some increase sort of fidelity in the pricing because you're no longer translating languages, pricing languages into the deployment languages and so on. So you keep some granularity in that, that you didn't before, and we always thought there'll be some benefit attached to that. So that's part of I think what's improving competitiveness.

We've also started the process of bringing in more external data sources. At this stage, it will be bringing us up to some of the better players in the market rather than taking us way ahead of anywhere. So we have a list that we are working through of model improvements that are backed up behind that, which bring in other sources, new different -- use different techniques and so on and so forth. At the moment, we are not putting many of those through because we're focused on getting pricing practices safely over the line. But those are sort of in the wings and building ready to go, which is why we're quite optimistic about the deployment opportunities as we go through 2022. And then on top of that, there are expense benefits, which are attributable to platform, which come as the book migrates over which will be over the next 12 to 18 months we'll build and really that's around customer self-service levels. So it enables self-service in a way that we couldn't have done on the previous platform. If I give you an example, so 100% of claims can be done self-service, now probably around 20% or something like that. So, and there are similar effect on the sales and service side. So, it enables us to start evolving that as the book goes over and migrate over. So that's the other area to look for over time. So feeling pretty positive about the pricing position coming in relative to the markets and lots on the kit bags come through yet from the transformation.

Q - Thomas Bateman {BIO 21707516 <GO>}

That's really hood to hear. Thank you, Penny. Appreciate the comments.

Operator

Thank you. The next question comes from Alex Evans from Credit Suisse. Please, Alex, your line is now open.

A - Penny James {BIO 15157212 <GO>}

Hi, Penny. Good morning, Alex.

Q - Alex Evans {BIO 22496014 <GO>}

Good morning, Penny. Thanks for taking my questions. I just wanted to have a little bit more color on when you say pricing in line with severity claims inflation, you're meaning sort of across the total, but -- because when I look on a new business perspective at least, it looks like pricing for Churchill is more in line with the market and you're essentially saying pricing for the market is not taking into account inflation. So is it fair to assume that you're sort of quite materially ahead in the Direct Line brand there?

And then, I just wondered if it's possible to give a bit of color of where the key drivers of growth is coming in Motor at the moment? Is that sort of more Churchill based relative to sort of the existing Direct Line?

A - Penny James {BIO 15157212 <GO>}

I think you're right that it will vary because when I say that sort of portfolio levels, there will be some variation underneath it. But philosophically, it's going in everywhere where we make some trading choices around that as well. So it's going in on new business as well. I think the key drivers of growth, certainly we have seen PCW come back faster than direct as we've pulled out of the pandemic. I think there's all sorts of reasons for that and the offset is we've seen renewals on direct hold up really, really well and strengthen. So as a book, probably not much story, but the new business story is definitely versus renewal story has definitely kind of differed between the two channels, I think is the essence of the picture.

So yes, pricing going through everywhere, but we do make different choices in different segments and different channels. So it's difficult to say it necessarily, and through this year, PCW stronger than Direct on new business, but not so on renewals.

Q - Alex Evans {BIO 22496014 <GO>}

Okay. Thank you.

Operator

And our next question comes from Will Hardcastle from UBS. Please, Will, your line is now open.

A - Penny James {BIO 15157212 <GO>}

Good morning.

Q - Will Hardcastle {BIO 22230376 <GO>}

Hi, good morning, everyone. Quick question on home insurance actually, just thinking about the inflation levels and whether these have changed at all as the year has gone on. I think you mentioned you're running at the top end of 3% to 5% in Home as well. I guess, do you have any procurement contracts that help to mitigate inflation risk here or would you say you're equally exposed as to wider market, things like labor cost, material inflation et cetera?

A - Penny James {BIO 15157212 <GO>}

Great question. So I think, look, we're somewhere around the upper zone there. I wouldn't over read that. I think we get quite granular on whether it's 3% or 4%, it's somewhere around the top. And I think over the course of the year, I think it's fair to say that it's been pretty -- it's run fine all the way through. We're still kind of -- it's running pretty fine inflation. We're conscious of though as we look at construction costs it's only a relatively small part of the book, it's the first thing to say. So a lot of Home claims are jewelry and electrical goods and carpets and so on and so forth, and although we are seeing supply chain glitches, in some of those places, this thing that's really changing that you can't maneuver around for want of a better description that's changing the face of things and lots of things cash -- are cash anyway. Really the drive -- the questionnaire is more around sort of construction costs where clearly there is inflationary pressure across the markets, not just in insurance. And our sense is that we've kept it tight through this year and we've been able to manage it within that zone. But if that pressure keeps building then there is kind of some inflationary pressure because we are not immune.

And in terms of contracts, you're right, we have contracts with suppliers that roll at certain date. So, you do get some protection for a spell [ph] that may not be there forever, and I suspect that's the same with other significant players as well. So our sense is that there is a kind of building pressure in the market that might lift off slightly and that we're kind of monitoring that very closely, which is why I say we're sort of actually around the top of the range, yes.

Q - Will Hardcastle {BIO 22230376 <GO>}

That's really helpful. I guess just -- this is probably my naivete, but construction as a percentage of Home claims, are we talking 10%, 20% by the sounds of what you're saying, is it in that range?

A - Penny James {BIO 15157212 <GO>}

It's in that, Will, and it's quite difficult to peel apart because even within a -- even within a claim it depends if you have an [ph]escape of water claim, it depends on what component of that is, so it's not even as simple as escape of water claims we will be doing and so on and so forth. But it will be that's fair rather than higher.

Q - Will Hardcastle {BIO 22230376 <GO>}

Brilliant. Thanks, Penny.

Operator

Thank you. And the next question comes from Rhea Shah from Deutsche Bank. Rhea, please your line is now open.

Q - Rhea Shah {BIO 20971663 <GO>}

Thanks. Thank you very much. And two questions please. For the first one -- good morning, Penny. The first one is on Motor mix. How has the mix been developing over the last few months? And just looking forward into the FCA's reforms, is there any danger that more established players or insurers like yourself could lose out on new and younger drivers in the first few months of the year if there's kind of continued competition?

And then my second question, which is slightly different around [ph] the theme of today, but how should we be thinking about investments and income guidance looking out over the next couple of years in a rising yield environment?

A - Penny James {BIO 15157212 <GO>}

Brilliant. And I'm really excited because it means that Neil got a question. So just on mix, I think the story on mix, it's really a COVID one rather than a pricing practices one at the moment. So -- because you saw through 2020 -- want to my years right 2020 and into 2021, there were less new drivers coming into the markets. We saw sort of AVP do some strange shapes through last year because of that and because of less new cars in the market. Now, although that's correcting, but not corrected, I would say, so there is still some mix shift in the market. I don't think our book is doing anything particularly drastic compared to anybody else's in that regard or not consciously so. So I think that's probably the story on mix still correcting if you like.

I think coming into next year, I don't know how -- I don't know that there is a particular feature of what will happen to young drivers versus anything else. But certainly, I expect, you will see people have more flexibility of pricing in segments that they don't have large back books in. So you may see some movement in that space or people creating sub-brands or targeting the different channels, or that's kind of what will happen. So I don't think there is a clear outcome of automatically X, Y, and Z will happen. I still think the big players have dominant forces in this market, so you may see some nimble players doing specific things, don't know, but I wouldn't over-read at this stage what will happen to any one particular player. I think we'll let it settle out, of course, in the next few months. Neil?

A - Neil Manser {BIO 5571223 <GO>}

So I'll take investments and income. So thanks for the question. So, yes, so you pretty well remember, we ticked up the investment income guidance for this year from 1.5% to 1.6% at the half-year. If I look at what's happened since then you've clearly got rise in risk free rates through to now, but you've seen a kind of a consistent slight tightening on credit as you go through the second half of the year. So net-net, I think I said at the half year, the 1.6% for this year is pretty much a good platform for next year.

If you look longer term, the impact of rates will start to feed through the book, but obviously, we only -- the maturity profile is that we are kind of reinvesting a third of the portfolio each year. So it takes a while to work through the book. So I think underpin -- so I think, the good thing it basically underpins where we are today. I think it needs to move a bit further when we start to see credit markets moving to get a lot more upside.

Q - Rhea Shah {BIO 20971663 <GO>}

Great. Thank you.

Operator

Thank you. And the next question comes from Ivan Bokhmat from Barclays. Please, Ivan, your line is now open.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi, good morning. I've got a couple of questions please. So the first one is back to the guidance and combined ratio. So for this year, you're talking about 90% to 95%, and if my math is correct, that means that for the second half, you'll be at the top end of your mid-term range or possibly slightly above it. So I was just wondering if you could maybe try to outline the main drivers combined ratio to return back into the range for 2022, is it mainly expenses? Do you have any particular assumptions on pricing, et cetera?

And the second question is actually on capital. So maybe also for Neil, maybe you could give us an update on the capital generation second half. And just related to your comments about first quarter being very uncertain, do you think it will be appropriate to expect to return to 160% solvency ratio with your capital distribution at the year-end? Thanks.

A - Neil Manser {BIO 5571223 <GO>}

Excellent. Thanks for the question. On the core, the simplest way to think through is the 90% to 92% with a 3-point benefit versus the 93% to 95% is all down to Motor frequency in the first half. So, that was about -- when you size that's about 3-point kind of in a vertical [ph] is one-off benefit, that's what's flowed through into the 90% to 92%. Clearly between first half and the second half, there's always a split between when reserve releases come through and don't forget, in the first half, there is no weather as well, although all these numbers are normalized. So things in part [ph] is the one-off benefits from low frequency in the first half. It shouldn't -- you shouldn't take anything from that guidance. They've been consistent with the medium term 92% to 95%. That's the first point.

And second point on capital, we -- as I said at the half-year, we're looking to move back down to the mid of the range. So the 160% still a position today. Of course, any uncertainty, we will generally take into account within the SCR for that type of risk rather than within the range. But let's see when we get there, we'll be excited to. We're still pretty confident on the capital position January [ph].

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Maybe one follow up. Would you consider another buyback, if you're well above the range?

A - Neil Manser {BIO 5571223 <GO>}

So, of course, any decision we take on that will be done year-end. You know our track record, which is, if we've got -- if we think we have excess capital, we have consistently returned to shareholders. And I think given where we are today, we're buying back stock, we think is a very attractive price in the marketplace.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Ming Zhu from Panmure Gordon. Please, Ming, your line is now open.

Q - Ming Zhu {BIO 17001429 <GO>}

Thank you. Good morning. Thank you for taking my call. Two questions please. First question is around whiplash. What have you seen so far? I think, Pen, you had a comment earlier saying it's still early days to see where it will land. So I'm just wondering whether you could give some color on this and also when do you suppose this should settle at some point? And second is on share buyback. And I think you've always commented on you're buying back the share at quite attractive price, good ROE. But if I look at your buyback program, which started on the 9th of March, your share price was GBP3.20, and then if I look at the share price now, even at just the interim dividend, it just shows your buyback hasn't really done anything to the share price. I mean, at the full year, would you reconsider going back to the special dividend because that seems to be the preferred way to income holders? Thank you.

A - Penny James {BIO 15157212 <GO>}

Whiplash, I mean, not much to add really. I think whilst -- so when it was effective 31st of May, I think whilst the industry was ready, I'm not sure that all these first [ph] claims management firms and so on had got their heads around the process. So we saw a sort of slowdown through the summer while things work through the system, if you like. So I think at this stage, nothing that meaningfully, we would flag out. And we'll give a little bit more color at year-end, by hopefully which time, it will be clear on what's happening, whether there are any trends of note in that.

A - Neil Manser {BIO 5571223 <GO>}

And on the share buyback, this special dividend question, I guess we're open minded. We don't have a kind of we have to do one or the other. We look at the position at the time with the evidence we've got. At the moment we think a buyback is the best approach. I'm not sure that either necessarily will be driving the share price today. And the return of capital is a long-term game. We're returning capital because it's the right thing to do to create value in the long term. So I'm not sure it's necessarily such a driver of short-term share price, of course.

Q - Ming Zhu {BIO 17001429 <GO>}

Thank you.

Operator

Thank you. The next question comes from Gordon Aitken from RBC. Please Gordon, your line is now open.

A - Penny James {BIO 15157212 <GO>}

Good morning. Hi, Gordon. Are you there?

Q - Gordon Aitken {BIO 3846728 <GO>}

Hey, Penny. How are you doing? Yeah, so couple of questions please. First, what do you think happens to the price comparison channel post January 1, 2022, and maybe you can talk about next year, but also talk about over the medium term, given that it's going to take customers a while to change what they do?

And also another question on the pricing review. From what you've said, my sense is that you think you've repriced your back book, probably maybe to a slightly greater extent than others, if you can say if that's right. And if it is, do you then need to -- or the beauty of it, you don't need to raise new business rates as fast as others. So is this an opportunity to either gain share or to gain margin? Thanks.

A - Penny James {BIO 15157212 <GO>}

Thanks, Gordon. So PCW, I think perhaps the way -- if the FCA achieved what they set out to do, it will reduce the amount of movement in the market. So in that sense, you may -- you would -- actually, some of the things that you are seeing in the market now around Home pricing and people trying to take share, and so would again suggest that customer -- people believe that customers will stay around for longer in this set of scenarios, in which case, you would see less volume moving logically through -- well, any acquisition channel, including the PCW. So that said, I think there are many things that drive people to move insurance products, service, changes in lifestyle and so on and so forth, so I think there's still plenty of ammunition left in the PCW channel as well. So it's not the only thing driving it. That's probably the position on PCW.

In terms of pricing review, I'm not going to predict or tell you what I think our pricing will do versus other people's. But we have, yes, taken the action that we think we need to take on the tail, so we are not coming into 1st of January, trying to make those adjustments. Those have already kind of gone through the book, if you like. I would imagine that others with large books have been making moves as well, but that's a question for them rather than for me. I would say that a lot of those players sit around the ABI table, which had long before pricing practices came onto the horizon had set themselves some guidance as to how it addresses. So I'd be pretty confident that people have been moving that books. You'd have to ask them how fast and to what degree. So you're right that 1st of January is much more about leveling up pricing in the early 10 years of then kind of dealing with any tail issues. So that's where the focus will be. I don't have a crystal ball as to where others sit in that path, so whether our movements will differ from theirs and to what degree.

Q - Gordon Aitken {BIO 3846728 <GO>}

Great, thanks.

Operator

Thank you. Our next question comes from James Shuck from Citi. Please James, your line is now open.

Q - James Shuck {BIO 3680082 <GO>}

Thanks. Good morning.

A - Penny James {BIO 15157212 <GO>}

Good morning, James.

Q - James Shuck {BIO 3680082 <GO>}

Good morning. Just on frequency, I think lots of comments about the 2021 experience. Just interested to get your take on how much of the frequency improvement is actually sustainable. People are using cars in different ways, different times of the day. Do you think we're going to remain below 2019 levels? If so, how much?

And then kind of same theme of claims inflation, are you seeing any trends to kind of repairing cars rather than titling them, and hence putting more people through your garage networks, but then maybe that is leading to a bit more of a backlog because then you have to fix the cars and that might be affecting that promoter scores. Just any comments around that might help.

And then secondly, lots of commentary again around FCA reforms and pricing practice. Interested to get your take around the duty of care, which I believe has led us a timeline now from Parliament seeking to get your thoughts around add-ons and any other things we should be considering around that. Thank you.

A - Penny James {BIO 15157212 <GO>}

I love that. I'm sure that's three questions than two. So frequency, I think we said -- I think we said at half year and is still the case that driving miles definitely back up to pre-pandemic levels. Frequency, still below, and I think we are assuming that it remains below. I won't give you the exact number. But why are we assuming that? Because when we look at -- the different kind of mileage is largely commuter traffic changing shape. And when we look at our business and other businesses, we think the mix model ways of working and so on will continue in some shape or form. That thing is difficult to predict is exactly what -- where that point will end up. So that could use still judgments in that. But that movement, although still increasing, is kind of -- the frequency levels, although increasing, are kind of trickling up rather than having stock moving or shooting up. So it feels as though we're starting to move into the sort of endpoint territory, so -- and that will be a little below what it was in 2019. But you're still susceptible to increase -- lockdowns or actually on the other side, increasing confidence over time. But when we look at -- when we look at this from an operational perspective rather than a frequency perspective, and we look to our people, there really is a move to hold on to a sort of mix model way of working and I think lots of businesses are seeing at that. So I think it's reasonable to assume that there is a structural long-term benefit there. The exact amount to that, we will all zero in on over time. So I think that claims frequency.

The second part of the question was the severity, yes, so it was around what are we doing in the repair centers and what opportunities and what risks are there. So you know, there's a number of factors kind of evolved in a kind of the severity question. So supply chains, for instance, we're seeing bits and pieces, sometimes there are delivery issue, sometimes there are particular parts issues. All of them at the moment seem to be kind of smoothable out rather than crisis levels, if you like, rather than creating real constraint with the exception of the one, which is second-hand car prices. You're right that we can flex in the repair centers, especially with frequency down. So there are some -- like everywhere, there are skill shortages at the moment. You're seeing that across pretty much every industry. So there is some of that happening in the repair network beyond that, not just ours. But actually, with the frequency levels that they are, we're able to do a greater proportion in house and so that gives us a benefit overall. So I think it's fair to say that having a repair network is an advantage, especially when severity is spiking, especially when it's spiking for the reasons it is. So certainly the case. What all that works out to in terms of our inflation relative to others? Too early to tell. So we would say we're at the top end of the range, somewhere around there, and (inaudible) what they're seeing separately.

And the third question was duty of care question. So it's a completely different, I think duty of care, so a few things I rounded [ph] on the call maybe it's close to a few, but -- so, yes, definitely the FCA will do something to bring a duty of care or something of that, make sure legislation requires them to do so I think over the course of next year, next summer, I think. When you talk to the FCA how do they think about it, they think about it as they consider NGI that they have done a lot of things that they want to do. So they say, duty of care raising the bar across all kinds of areas of financial services. So the fact that they've done pricing practices, vulnerable customers and in our industry and they've done IDT before that on the distribution side that kind of saying or literally saying actually we think we've covered the bases in GI. So until you see the detail and then due to consulting [ph] until December, no one will know exactly what that means. But I'm confident that it's not aimed at TI, if you like, and I'm confident that we'll be less impacted than some other industry areas and we'll wait and see. I've got a long way to go before we know what the exact path that is.

Q - James Shuck {BIO 3680082 <GO>}

Okay, that's very helpful, Penny. Just one point of clarification. Are you -- because of the price of second-hand cars, are you repairing them more than you are pricing them off, and is that not that -- it's not leading to any backlog in your repair networks?

A - Penny James {BIO 15157212 <GO>}

So you did ask that question, and I forgot to answer it. So we will be. It will change the points of that judgment absolutely. No, we're not seeing more backlog of repairs, and yes, NPS scores are holding up and customer services is fair.

Q - James Shuck {BIO 3680082 <GO>}

Wonderful, very clear. Thank you.

Operator

Thank you. Our next question comes from Faizan Lakhani from HSBC. Please, Faizan, your line is now open.

A - Penny James {BIO 15157212 <GO>}

Good morning.

Q - Faizan Lakhani {BIO 20034558 <GO>}

I just had a few questions. Could you potentially look to run-off your most profitable distribution channels to maintain the margins on your back book? That was question one.

Question two, if you chose to further that inflation in household, some commentators have pointed to a benefit from COVID from lower levels of burglaries and being more aware at home, could you potentially quantify what benefit if any, you had from COVID over the past nine months?

And the final one is a small question. Could you provide a split between the businesses that are in the short tenure versus with the tail that you've already dealt with? Thank you.

A - Penny James {BIO 15157212 <GO>}

I didn't quite catch the last one. But let me just start the first. Run-off is an extreme work, so not planning to put any parts of the business into run-off, if that's the question. I think the real essence of this is, when we look at our book segment by segment, cohort by cohort, we can make choices about where we hold prices and in areas where it's sensible to do so, we will seek to -- we will make the choice basically to protect shareholder value within the bounds of being comfortable that it delivers fair outcomes for customers. As I said, we've already been through the latter question, so our focus will be on what delivers the most value for shareholders and we will dial in and out of segments with different brands and different channels as appropriate, to get that. But you know -- but we're not putting any parts of the book into run-off.

Inflation in Home, I think was the second one, where broadly what -- I think it's all very muted now, and pretty much back to COVID levels. There are some mix differential. So, you're getting, (inaudible) costs are lower, because people identify them faster, largely because they're in the homes. We possibly think some increase in things like drains, which might be the key with the number of houses having surveys, because the housing market has been more buoyancy, we're seeing more claims on things like sort of damage in the home because there are more people in there. So mix shifting overall pretty much dialing where it was pre-COVID.

And I didn't catch all of the cheeky third question.

Q - Faizan Lakhani {BIO 20034558 <GO>}

You mentioned that you've done a lot of work around the tail in terms of sorting out the issues regards to the FCA pricing review and there is still some work to be done on the short of 10 years, that will probably happen in in January. Could you potentially provide a split in terms of what you categorize as tail and actually what's tail in your back book, roughly a percentage?

A - Penny James {BIO 15157212 <GO>}

No, the way we think about it is over a five-year, 10-year, we check every customer policy price so that's way we think about it. So, I don't think it's really -- I don't have the number, but I don't, -- because I don't think it's relevant to say if X% or Y%. It's more the path every journey goes -- every customer goes on.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Great. Thank you very much.

A - Penny James {BIO 15157212 <GO>}

Thanks.

Operator

Thank you. And our last question comes from Alan Devlin from Goldman Sachs. Please, Alan, your line is now open.

Q - Alan Devlin {BIO 5936254 <GO>}

Hi, guys. Thank you very much.

A - Penny James {BIO 15157212 <GO>}

Good morning, Alan.

Q - Alan Devlin {BIO 5936254 <GO>}

Morning, a couple of questions from me. First of all, just a follow-up from the answer to Gordon's question. If the FCA is successful in increasing retentions, lowering churn, how does that change your kind of view on -- your view of marketing? How much money you spend marketing, which is kind of the acquisition cost for the Direct Line brand going into next year?

And then the second question on your EV proposition. I wonder if you can give some more color on what you're doing there? And what -- is your market share of the EV new business, higher than the overall business? And what kind of advantage does your claims network give you in the EV given you spend a lot of money training people to fix these vehicles? Thanks.

A - Penny James {BIO 15157212 <GO>}

Brilliant. So I'm not going to give you a direct answer on marketing or what we're going to do on marketing, because that's in the competitive side now, Alan. But I'll say this, over time, the way we think about the amount of marketing spend that we do is linked to the amount of value that we see in customers. So we will -- as we see what customer behavior does through there and what retention levels do we will reassess the overall long-term value equation for each customer and that will set the parameters on the acquisition costs we're prepared to pay. So, it kind of works the other way round. So, we do have a view as to what we'll do on Day 1, but really it's much less important than overriding point that it will flex over time, dependent on how that -- how customer behavior settles in the new market.

EV, yes fantastic. So we believe there are [ph] published market share numbers on EV segment, so proving something is different, but we believe we punch beyond our weight in terms of share, partly because the customer introduction -- to introduce the relationships with someone that we have and we traditionally have done, and we've got good insights because for some years, we've been doing that. And so that's given us insight on repair around EVs over a number of years.

What are we doing for customers? So obviously, we're offering an insurance product, but we're also offering a package of things around that to help customers make the transition, including access to various charging network, discounts on that, help with getting subsidies, education online to different cars ranges, different attributes, so we've teamed up with it with a startup called Electrifying who do a lot of that research content and are super engaging around that, access to people to come and set up charging points when you drive and so on and so forth. So the full kind of package of things that an individual customer will have to go through to move to an EV and the aim is just to make it in line with the brand as easy as we can for people to make that transition. So that's really kind of the aim. We continue, as you say, to invest in the training of our mechanics and our engineers to get them all EV. And it's not just EV, it's actually a lot of the technology that goes in cars, modern cars around that as well so that we can be leading edge. And as time moves on and our pricing capabilities improve, then we'll seek to bring those. Today, there's not much ability for us to use that knowledge in our pricing. But at the time, we see that as a real opportunity as well. So there's a package of reasons why we think we kind of have the right to be successful in EV building on our start that we already have. And this proposition for customers is one piece of that tick [ph]

Q - Alan Devlin {BIO 5936254 <GO>}

Excellent. Thanks for the answer.

A - Penny James {BIO 15157212 <GO>}

Brilliant. So is that the last question, Juan?

Operator

Yes, we currently have no further questions. I will now turn over to you Penny James for any final remarks.

A - Penny James {BIO 15157212 <GO>}

Yeah. Thank you. I would thank you. Wow. Well so questions of 1.5 times release, but look, I'd just leave you with, I think we feel well positioned in the markets at the moment, we're on track for pricing practices with positive about how we position both in the mark to market given its challenges and in Home coming into PPR and we know we've got a number of levers up partly, some of which you are already aware of and some of the transformation will bring us beyond that. So, we feel positive about how we're set as we look ahead. And the final thing I will do is a plug, for November 17, for anyone who wants to understand a little bit more about our commercial business and what's been driving the growth there. But other than that I should stop there and thank you all for joining us. Have a good day.

Operator

This concludes today's call. Thank you so much for joining. You may now disconnect your lines. And enjoy the rest of your day.

A - Penny James {BIO 15157212 <GO>}

Thanks, Juan.
