Q4 2015 Earnings Call

Company Participants

- Inga Kristine Beale, Chief Executive Officer & Director
- John Parry, Director of Finance
- Thomas Allen Bolt, Director-Performance Management
- Unverified Participant

Other Participants

- Bill Cooper, Managing Director & Head of Insurance
- Joanna T. Parsons, Analyst
- Kamran Hossain, Analyst

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Good morning, ladies and gentlemen and welcome to the Lloyd's 2015 Annual Results Presentation. Thank you to those in attendance at our London office this morning and to those who have joined us on the webcast.

Joining us today is Inga Beale, Lloyd's Chief Executive Officer; John Parry, Director of Finance; and Tom Bolt, Director of Performance Management.

We will start the presentation by outlining the financial and market results. John Parry will then talk you through the financial results for the year ending December 31, 2015. We will conclude by looking ahead to the focus and challenges in 2016. At the end of the presentation, you are invited to ask questions. Questions will be answered at the end of the presentation.

I would now like to invite Inga Beale, Chief Executive Officer, to start the presentation.

Inga Kristine Beale

Thank you very much and welcome, everybody. As everyone knows, 2015 has presented the market – and the market globally, not just the Lloyd's market – with a number of challenges. We've got pressure on premiums, exceptionally low investment returns, additional capital still coming into the sector and an exceptionally competitive market because of that. So, the market had to show some resilience and certainly an ability to adapt and be quick-thinking. And it's a hard work actually for everybody involved in the market, not just on the underwriting side where margins are being squeezed, but also on the broking side where margins are also being squeezed. And for those of you familiar with Lloyd's will know that we are a fully intermediated market and we rely very much on our broker partners.

So, it's certainly hard work, but we do know that it's a global market phenomenon that's going at the moment. So we know that we are not alone, and I suppose in that context, the market has produced, I think a very creditable result. £2.1 billion of profit, albeit down on the prior year, still producing what some investors might look at as a very healthy return at the moment, 9.1% return on capital. Again, albeit from some of the macro things I mentioned, there's certainly been pressure downwards on that.

The combined ratio of 90% still outperforming the average of our competitor group. And I really, really think this is a creditable result for the entire market. And I know that the market and the underwriters have been working very hard to make sure that we're going out with new ideas, with new product and that Lloyd's is going to certainly remain a very, very healthy and sustainable market well into the future.

Now, moving on, let's just look at the combined ratio as against our competitor groups. So moving on to the next slide, slide 3. Here we show the usual group of competitors, those 11 companies, and we've listed them on the slide here. And that group has been constructed to reflect on aggregate, Lloyd's mix of business, whether it's how much we write, how much insurance we write, reinsurance we write, whether it reflects the geographies that the Lloyd's market plays in. So, it also goes on a regular scrutiny I would say by our credit rating agencies, so it's not something we are doing in isolation and just plucking these companies for no reason. It's been quite a consistent group now, and as I said, we do check it out with our rating agency friends.

Now, the competitor group average, it's an average combined ratio. It's weighted by premium, as is of course the Lloyd's own combined ratio when we look at the market as a whole. And the slide here quite clearly shows that we - the Lloyd's market continues to perform very well. So, outperforming the group average by 4.7% last year. And you'll see on the right-hand side, as we look over the past five years that that is a consistent outperformance with the exception of 2011 when we were hit by a series of those natural catastrophes that you can remember back in those days.

If we were of course to remove one of the, perhaps, worst performing companies from the group, it would improve the group average ratio. And I'm sure you can all do the math yourself on that. But even so, despite that, Lloyd's would still be ahead of the competitor group. So, very, very healthy position despite a challenging market.

Now, I'm just going to move on to the next slide and just talk a little bit about some of the strategic highlights and some of the great progress that we've been making towards Vision 2025. And despite all the difficulties around the operating environment, we're still very, very keen to make sure we're focusing on these things. We fundamentally believe these are exactly the right things for Lloyd's market to focus on.

So, last year, under the capital heading, the PRA approved our Solvency II model. So, we were very pleased of that outcome obviously. A landmark achievement after years of a lot of work, a lot of collaborative effort across the corporation and indeed all the syndicates and managing agents in the market and we are very, very pleased to have got through that.

We're also pleased with how the capital base is expanding and getting more diverse by geography and sort of type of capital, so we have some new entrants coming into Lloyd's last year. And they also contributed to the overall growth in the capital base.

On the global market access front, again, great progress opening two new offices last year, one in Beijing where we were awarded an insurance license and also in Dubai: we opened up a platform in Dubai in the DIFC there.

We also got approval for rep offices both in Mexico and Colombia: so moving over to another continent where we've seen some progress. And as I mentioned earlier, broker's key, key source – key distribution partners for the Lloyd's market. And we saw 20 new brokers being registered at the Lloyd's and 11 of those were actually outside of the UK. So very pleased with progress on that one.

Moving on to ease of doing business, this is where TOM fits, our Target Operating Model TOM that is, and this is the market modernization effort that is being driven collaboratively across the entire London insurance market. So, the brokers are involved, their company market is involved, as well as of course the Lloyd's market. There was a whole discovery phase and a lot of market engagement happening last year. We had something like 28 different events throughout the second half of last year, engaging over 1,200 people from the market to get them to understand what's happening around modernization, and also importantly, to get their input and feedback to make sure that we are not just modernizing some old process and we're actually thinking in a really new and innovative way.

We honed down the priorities for this year in terms of modernization. There are three key initiatives. One is around electronic placing, and there's a PPL board just called who are driving that for the market. We've got a Central Services Refresh Programme which is looking at automating processing of premium and claims after binding the business, and we're also looking at delegating authority. Coverholder model for Lloyd's is very, very important, so we want to make sure that we are always looking to improve and make it easier to do business with Lloyd's in that space.

And we must not forget data. So, enabling all of this, we have to consider data and how we can grapple with data across the market. As we move towards digitizing processes, there's going to be an abundance of data. We want to make sure that we're eliminating any duplicate data entry and our ideal is to have one single entry point for any piece of data whenever it hits the underwriting and processing process. So, we've got to look at that data as well as an enabler to all of the modernization we are doing.

Market oversight, key part I believe of the Lloyd's market success. And we produced a new and fully comprehensive market oversight plan. There has been some increased focus in various areas, whether it's on the conduct side, whether it's on the capital side, on the regulatory capital side, whatever. We've pooled all of that together and made it clear what our oversized objectives are for this year. And we've issued for the first time ever a plan for the entire market to see.

We also were proud that there were no new members who had to access the Central Fund at Lloyd's last year. So again, I think a success of the oversized activity that's been taking place.

Moving on to the last bullet point here, M&A mentioned in there and indeed there were eight different Lloyd's businesses affected by M&A last year. Some of them are smaller, some of them are quite large, some of them I believe showing a real confidence in Lloyd's and where Lloyd's standing is right now in terms of reputation, professionalism, underwriting expertise, and access to specialty business. So, Lloyd's is very much seen particularly part of the London market is being still very much the center for specialty insurance and reinsurance from around the world.

And that may well continue, the M&A activity may well continue and we're also being seeing quite a bit of that in the distribution and the intermediary space as well, not just on the insurance carrier space.

So, then I'll just move on to the next slide, this is our sort of little partied history of some of the activities. The important activities that took place last year and they range from opening up new offices to having to get to grips with conduct standards and implementing new conduct standards across the market. But alongside all of this activity, I really think that we took a step forward as being very much seen as a hub for innovation.

So, the innovation focus, while Lloyd's has traditionally been seen as very innovative, we particularly wanted to keep moving ahead on that front, doing a lot of emerging risks analysis and coming at with some really meaningful work that everyone can benefit from. And one of those was the City Risk Index that we launched last year, which was evaluating 18 threats against 301 cities across the entire globe and of course, one of the most interesting things that came out of that was how important those man-made threats are now versus some of those natural catastrophe events that we used to think as always being so threatening. The man-made ones are becoming ever more relevant, which of course also plays into Lloyd's sweet spot of about being innovative and grasping new risks.

We also launched the Innovation Awards and this was not anything about somebody sponsoring an event and having a glamorous dinner, this was about truly recognizing innovation in the market. So, this was the first time we've run that and we ran those alongside our Science of Risk Awards that we'd always being giving out or we have done for some time, reflecting great work that's done in the world of science.

But the Innovation Awards is sort of taking what's happening out there and actually then converting it into either new products or new non-products, new innovation around distribution or anything perhaps using digitization or whatever. So, that was I think a great reflection of stepping up on innovation and also of course, we announced our plans last year to launch our Insurance Index in the middle of this year. And that again is responding very much to the environment that we're all faced with. And plans for that are progressing very well. So, you'll hear more about that later in the year.

Now, at this point, I know many of you are very keen to dig into the results. So, I will hand over to John Parry.

John Parry {BIO 18896198 <GO>}

Thank you, Inga. Good morning, everyone. So I'm John Parry, the Director of Finance. It's my pleasure to walk you through some more of the detail behind the 2015 annual results for the Lloyd's market.

So, on slide 6, we've got this sort of table of the key numbers. We're going to talk about each of those in time. So, we'll just move pass that, that's sort of a reference point for you for the figures in one place.

So, we'll move straight to slide 7 on the overall income statement. So, gross written premiums for Lloyd's increased by 6% year-on-year to £26.7 billion and the breakdown of the movement of that I'll cover on the next slide. We've also seen net earned premiums track that up 5% and then both expenses and total claims very similar picture and increasing by 7% year-on-year. That gives us a very creditable underwriting result of just over £2 billion. And as we will see, the make-up of that is substantially from the strong balance sheet and realizing surpluses on our prior claims reserves. That gives rise to the overall combined ratio of 90% and I think Inga said very pleased to see that outperforming the average of our competitor group.

The biggest reason behind the fall in profits year-on-year, remember we are comparing against the 2014 result of over £3 billion, is the fall in investment returns. And we'll cover that as well later in the presentation.

Other expenses are the cost of the Corporation and one of the biggest drivers behind the increased year-on-year is a very successful debt issue that we made in the back end of 2014 and the annual interest payments coming through during 2015, giving an overall profit before tax of £2.1 billion.

So, I said, we just talk about the movement in the gross written premiums for the whole of Lloyd's during 2015. So £25.3 billion last year, we have seen a reduction in prices adjusted for changes in terms and conditions of about 5% across the whole book. The note of caution there is that is on our renewal business, that's where we capture the data. That's over 70% of the book but clearly there was a balance of business that moves either between syndicates or in and out of Lloyd's where the rates change may actually differ from that sort of straight-forward renewal price.

There is a mix, certain lines of business have suffered more rate reductions than others, particularly energy and property reinsurance while others, the rate of decline has been less particularly in casualty business. We are presenting our numbers in converted sterling and with a stronger U.S. dollar during 2015 compared to 2014, you get an increase when you translate that business that we write worldwide of about 5% year-on-year an increase.

Then we have growth, so there have been new syndicates added to the Lloyd's platform during 2013, 2014 and 2015. These businesses do start small, they will recognize difficult market conditions there are and they've added about 1%. But there remains a strong pipeline of interest in the Lloyd's platform.

Existing syndicates have been able to benefit from our strong distribution chain and diverse business mix and they've been able to increase our premium writings by 5% in a controlled manner during 2015, giving total income of £26.7 billion. I think a point I would make there is that syndicates have written within their approved business plans. So, where there are (00:17:45) difficult market conditions that's been recognized and the actual premium written is lower than the amount approved, and importantly, we capitalized the maximum amount that syndicates have committed to write.

Next slide shows the mix of business. It's a mix of reinsurance and insurance business across a whole wide range of classes of business. There has been a slight change in the mix. We do the property reinsurance. It suffers from the more higher price reductions versus slight change in the business mix overall but as we enter difficult market conditions, having a broad, diverse mix of business by line, by distribution chain and by territory gives the Lloyd's market the flexibility to be able to select the lines with the greatest prospect to profit going forward.

The next slide is the breakdown of the combined ratio, 2015 compared to 2014. Very similar story across all of the bars. The first one is the accident years, so excellent performance (00:18:52) during 2015 excluding major events and we have seen that increase into 2015 to 94.4% and we are seeing that both on the expenses side, cost of distribution, and the cost of running and controlling our business in the managing agents and also the attritional loss ratio. This trend is something that we're acutely aware of going forward into the difficult market conditions ahead.

Major claims added just 3.5% to the combined ratio in 2015, very much in line with 2014. I think we're all aware of the lack of natural catastrophes causing large insurance losses during the year and we'll come back to that in a moment.

Prior year reserves, we hold over £30 billion of the reserves for future claims, and what we have seen during 2015 is actual claims experience (00:19:49) much better than projected. And we've been able to release approximately £1.6 billion from reserves, reducing the combined ratio by 7.9% in 2015.

From the initial analysis that we've done centrally, we're pretty confident that that's justified by the performance during the year and isn't a reduction in the balance sheet strength of the market. Overall combined then of 90%.

The next slide just shows some of those numbers to show the consistency of a time (00:20:23), particularly on the reserve release. So, you got two lines there. The one that ends with 5.5% is the release expressed as a percentage of the net claims reserves brought forward. And that's been 5.5% for the last three years more or less. The bottom line is also that percentage is a reduction against the net earned premiums , so (00:20:44) the contribution to the combined ratio.

The other line we show is the major claims impact on the combined ratio from 2011 to 2015. Lloyd's does write a substantial book of property reinsurance and property that is exposed to natural catastrophe risk and clearly, you can see that with 2011 where it added over 25 points to the combined ratio. But in the last three years, we have seen a marked reduction in natural catastrophes well below the long-term average. And in fact, we just show that on the next slide. So £724 million worth of claims net of reinsurance from major events $1.1 billion and you can see that's considerably lower than the long-term 15-year average of $2.7 billion.

The largest claims for 2015 are listed there, headed by the warehouse explosions in Tianjin in China, which is a net loss to Lloyd's after reinsurance of just over £200 million. Then there are some energy losses, but in fact, the largest natural catastrophe is storm Desmond. It's certainly (00:21:54) a loss to Lloyd's of about £50 million. In fact, (00:21:57) total natural catastrophes added less than £100 million to the claims in 2015.

Turning to the class of business performance during 2015. You've got three bars there. You've got the performance in 2014 and 2015 on an accident-year basis. And then the third bar brings in the performance on prior-year claims reserves to give you the combined ratio by class.

It's ordered (00:22:26) by net earned premiums. So the powerhouses of the drivers of profitability are, from the left, reinsurance, property and casualty. Reinsurance and property clearly benefiting from the lack of natural catastrophe activity.

All of the classes have got a prior year surplus, and that remains the pattern across the vast majority of our syndicates. So still a strong reserving position across the market. Casualty is one class which is broken even overall in 2015. And actually, we're comfortable with the initial loss picked that syndicates have made as of December 2015 for recent business. Clearly, it's an area of high inherent risk when it comes to reserving and that will be a focus of our market oversight going forward.

Turning to investments on slide 14. So this is the aggregate asset disposition across syndicate assets, members capital put up these funds (00:23:24) at Lloyd's and the assets of the Central Fund, central assets. So, a total asset base of £56.9 billion.

As we can see overall, it is a portfolio conservatively set up asset mix (00:23:41) high proportion of investment grade bonds both governments' and corporates' and cash and cash equivalents including letters of credit. The return is low that is positive. It's £402 million, but at 0.7%. It's clearly indicative of the challenging low yield environment that we're in and seems pretty sure to continue in 2016 (00:24:05) forward-looking statement but I'm pretty confident about that one.

There are a mix of growth assets. So here, we break out (00:24:16) into the three separate asset pools. And just wanted to turn to the bars on the right, we see some mix of equity and risk assets, so that could be hedge funds, structured loans, emerging markets (00:24:26) global equity portfolio. A vast majority of the assets are held at syndicate level, held in trust ready to pay future claims. And there, that is usually – that is a short-dated, short-duration, high-quality investment grade bond portfolio with a limited number of equity and risk assets.

Slightly more risk is taken by members on their (00:24:48) capital to approximately 11% of members' funds at Lloyd's put up in more growth assets and then the central fund which can take a longer term horizon view. We have a strategic asset disposition of approximately 71% in fixed income, high quality fixed income and 29% across the range of different managers. And from that, some of the (00:25:12) generated 1.5% or £43 million during 2015.

Looking at the overall balance sheet, this is a highly liquid, very strong conservative balance sheet. £56.9 billion of cash in investments. We have seen member capital and central assets go up. Now, some of this is foreign exchange-driven. So much of our assets are now put up in U.S. dollars to match the potential exposures that we have, good currency matching. And clearly, with a stronger U.S. dollar in December 2015 than a year ago, you get the numbers going up in converted sterling.

But we are pleased that we've transitioned into the Solvency II world without any impact on member capital, so we continue to set capital based on regulatory minimum surplus and uplift of 35%. (00:26:09) increase in central assets through the annual subscriptions syndicates pay on their premiums. And importantly, no new members requiring support from the central funds and no new insolvent members in 2015.

I'm just going to close if I (00:26:25) looking back over the last five years of the Lloyd's market performance. So, profits realized of over £10 billion across that five years with a average return on capital just over 10%. Combined ratio performing very well (00:26:42) compared to our competitors and net resources increasing from £19 billion to over £25 billion. So, as we enter difficult market conditions, we're in excellent financial strength going forward supported by the strong ratings provided by A.M. Best, S&P and Fitch.

Thank you, and I'll just pass back to Inga to close the presentation.

Inga Kristine Beale

Thanks, John. So, I'm just going to finish with a few words on the last slide 18 here. John has mentioned quite a few times about how we don't see much change in this year versus last year in terms of a challenging environment. So, pricing is going to continue to be a challenge for the underwriting community. The investment return is going to continue to be a challenge for the asset managers. So we don't really see much change there.

So it's going to continue to be a challenging environment. However, at Lloyd's, we are in an incredibly strong position. We've got a fantastic franchise, an incredibly strong brand that is best in class. We've just completed a bi-annual survey, which confirms that best-in-class brands globally. So Lloyd's overall is in a very strong position, with a very strong balance sheet.

So we will continue our focus on innovation, looking at new products, looking up those new emerging risks where Lloyd's can play a meaningful part in providing solutions around the world. We'll also be continuing to look at underinsurance around the world and the opportunities that arises out of that. We have to keep going on our modernization piece, we need to embrace technology, we need to start digitizing and making the market more efficient, and taking some cost out wherever possible.

So we believe we're absolutely on the right track with what we've set out as our (00:28:40) strategic priorities, continuing to drive towards our Vision 2025. One thing that wasn't in the 2025 vision when it was launched was the EU referendum this year. So we've put that on, it is a distraction certainly at the moment, not only for us here at Lloyd's, but for the entire population of this country and also further afield across the world.

We don't know what the outcome will be. And we've got a few months to go before we will have any idea, and I'm sure there's going to be endless conversations and interviews and discussions and debates about this topic. But at Lloyd's, we have made our position clear, we believe it's much better for the UK to remain in the EU. We're very much in favor of the (00:29:36) campaign to be part of the largest trading block in the world. The EU overtook the U.S. as the largest trading block in the world some time ago. It has negotiated trade agreements that every small business – and some of the businesses are quite small here and Lloyd's benefit from by being able to access the world's largest insurance market in an efficient and smooth way. So, we see very advantageous to stay in. However, we're in the risk business, so rest assured we've got contingency planning well under way if the vote goes the other way in June.

So, I don't want to leave you on that (00:30:20) thought. I want to lead (00:30:22) you with a thought that actually Lloyd's is in an extremely robust and healthy position, and we are still looking ahead with a great enthusiasm in terms of taking Lloyd's more broadly across the world and in continuing to improve the market access that we provide to every single participant in the Lloyd's market.

So, thank you very much for listening today.

Unverified Participant

Thank you to Inga and John for taking us through the results. I would now like to invite our audience to pose your questions to our CEO, Director of Finance, and Director of Performance Management.

Q&A

Q - Kamran Hossain {BIO 17666412 <GO>}

Morning. It's Kamran Hossain from RBC. I've got three questions. The first one, I didn't hear, unless I missed it, much mention of solvency II. Will you disclose the ratio for Lloyd's market or can you just give us an indication of kind of how happy you are with the balance sheet on that basis?

Second question on the return on capital say hit 9% this year, could you just walk us through what that might look like if all syndicates had hit their (00:31:38) business plan? And what is the kind of direction (00:31:43) for 2016? And the third question, just on reserve margins, I know it's in your annual report, (00:31:51) got a number of syndicates having (00:31:53) prudent on the way in on reserves. Do you have any idea how much that might add to the accident year combined ratio? Thanks.

A - Inga Kristine Beale

Okay, thanks. So, I will let John handle those, but just to say on Solvency II is perhaps we didn't talk enough about it considering how much work has gone on and how much effort has gone on because it really did and we're very, very pleased we got there. But yes, I'll hand over to John in terms of are we (00:32:19) going to disclose the ratio (00:32:21) balance sheet as it is.

A - John Parry {BIO 18896198 <GO>}

Yeah. Obviously (00:32:25) half-day with you on Solvency II, Kamran, if you want a bit more. Yeah. So (00:32:31) yeah, internal model was approved. We think it's early days and comparison between companies isn't going to be helpful at the moment whether they're on an internal model or on a standard formula. I think our plan over time is to whether (00:32:46) to which regulators or jurisdiction were harder with companies that are going to lead up, run up to it. In terms of public disclosure, we'll see what the others do and see what comes out.

At the moment, we put some of the rating agents commenting that they don't see it as a sensible comparator (00:33:00) vital for the Lloyd's market to achieve model approval, but in terms of building into their capital models, they're not taking it in or comparing it between entities. (00:33:11) to disclose I think in May 2017 and we'll see how (00:33:17) commentary develops around that. Your second question, return on capital 9%, (00:33:25) regarding the future.

A - Inga Kristine Beale

Backward forward-looking statements.

Q - Kamran Hossain {BIO 17666412 <GO>}

Yeah.

A - John Parry {BIO 18896198 <GO>}

Yeah. In terms of the future, it may well be single-digit returns or something that investors need to understand that that may be the case going forward. I mean the 15% return over the last five years, you've had that combination of some low catastrophe years, very strong performance on reserves at a fairly mild claims experience. (00:33:52) their plans, it would have been better. But really you've also got that benefit of the prior year reserve leases. So when we approve syndicate business plans, we are taking account of what they are going to underwrite rather than, yeah, taking credit for what, yeah, might come out of (00:34:10) prior year reserves. (00:34:11) stand on its merits of that forward-looking plan and the realistic expectation of making money.

A - Inga Kristine Beale

What we do have to think about will this be the new norm. And the discussions we've had with some of the alternative as we – which we refer to as (00:34:27) capital and the required return or desired return that they're looking for is still somewhat lower than this.

A - John Parry {BIO 18896198 <GO>}

Yeah.

A - Inga Kristine Beale

So it is something that has to be seriously considered by, I think, the entire insurance sector as to what is going to be the medium-term level to be expected.

A - John Parry {BIO 18896198 <GO>}

So I think coming to the third point regarding the (00:34:49) impact it has on the published accident year ratio for 2015. We're not in a position to be able to comment on how strong that is. We will do more research when we get more granular data from the market in the next couple of months. What we can say is it has been consistent that managing agents have a pretty consistent reserving methodology. Those that require – everybody is required to put up their best estimate and we got audit and actuarial controls around that. Some do choose to reserve inherently prudently because of the uncertainty early on. And that has been seen when we had releases come through sort of systemically.

So, if we hit expected claims projections, that would normally produce a reserve surplus. But to get to this level, you do need actual experience to be better than those projections. So, the moment we say, (00:35:40) there is some impact in there but we would need to do the analysis before we, yeah, could be sure.

Q - Bill Cooper {BIO 16162509 <GO>}

Morning. Bill Cooper, Lloyds Bank. I got two questions. One is a sort of strategic type question and then the other one is an attempt to get you into the forward-looking statement again. So, the first one is on, I suppose, diversity of capital providers. So, we've seen with this M&A activity and also some of the new entrants more sort of diverse ownership base for the Lloyd's market. I think (00:36:11) about 70% is now owned by overseas sort of investors one way or another which shows is a big contrast to, say, 10 years ago. So, I guess the question is have you think about that? Is that okay, is that good, is it bad? (00:36:26) crisis situation, could that be a problem for the market?

Second question, looking at the results in a slightly different way, given a sort of softening market and, therefore, thinning profit margins, does that make you more worried about the weaker performance? And I suppose the detailed question behind that is have you got a wider diversity of performance by syndicate than you've had, say, in a harder market? So those were two.

A - Inga Kristine Beale

Okay.

Q - Bill Cooper {BIO 16162509 <GO>}

Thanks.

A - Inga Kristine Beale

On the diversity of capital, it is actually part of our desire to diversify capital. And very much it fits in with the desire to get capital from some of those new or high growth markets. So, that was a specific strategic intention. And when we look at anyone who is actually coming new into the market versus those that make acquisitions which obviously is a different way of coming in, they have to be bringing something new to the table. And part of that was very much (00:37:24) China investing, you've got to (00:37:26) some Chinese business in with you. So, there was a definite strategic attempt to go after new capital, new diversified capital. I think we haven't set ourselves a target per se. So, (00:37:39) 70% is good or not, I mean 16.5% is Japanese, which I think is quite a big shift I would say.

And obviously, they're seeking diversification of their own portfolios, which tend to be very heavily domestic, and access to Lloyd's licensing and brand and reputation and expertise importantly. So, I see it actually as positive. In the crisis, we're actually going to be doing – we're going to be part of – I think it's actually been reported in the press as well that the PRA is going to be doing some disaster recoveries sort of situation. And we're going to be very much part of that, to think about what would happen if there was a big catastrophe with capital to suddenly flow and how would that operate. So, we're going to be very much be part of that this year.

And then, you were asking if we're more worried about some of the weaker performance and that is a much dispersion of results (00:38:36) syndicate. Maybe, I don't know, John or perhaps even Tom might want to...

A - John Parry {BIO 18896198 <GO>}

Yeah.

A - Inga Kristine Beale

...give a view on that (00:38:41)?

A - John Parry {BIO 18896198 <GO>}

(00:38:41). In the market there's over 80 market-facing syndicates (00:38:47) special purpose syndicate. There's always going to be syndicate-specific issues. (00:38:52) time, 2007 and 2010, the market overall was making a lot of money, but they were one syndicate 2007, one syndicate 2010 that had their syndicate-specific issues.

There's always a wide dispersion, yeah, across the market. I don't think it's only particularly different now, compared to – and with a profitability from prior years, there's been a consistent theme (00:39:16) 11 years of prior reserve releases. They do tend to come from the same syndicates year-after-year. So, there is some consistency between them. So, 2015 isn't particularly a different year.

A - Thomas Allen Bolt {BIO 20535299 <GO>}

The interesting thing is on our weaker performers, oftentimes someone seeking entrance into the Lloyd's market, thinks they're an attractive partner. And so, they buy them. So, while you might argue we should have every once a while a well-publicized hanging, we oftentimes find that people come in and buy those syndicates as opportunities to move forward.

We did have one syndicate shutdown in 2011 which is my favorite kind of outcome, because we wounded up and it didn't cost anything to the Central Fund. And in fact, the capital providers got back a lot more of their capital than they ever expected. So, if we do see a problem, we do move quickly to try and address it and make sure we minimize the losses involved.

Q - Bill Cooper {BIO 16162509 <GO>}

Okay.

Q - Joanna T. Parsons {BIO 1558226 <GO>}

Thank you. Joanna Parsons from Stockdale. Two questions please. Firstly, if we could just chat a little bit more about cyber. I know you've been making a few comments about it over the last year or so. And it's obviously a topic that everybody likes to talk about is perhaps a scenario where we are actually seeing some growth in rates going up. So, I know Lloyd's has been analyzing what it means. A little bit more comment and color on that, please.

And secondly, the move to actually improve the systems at Lloyd's, digitalization, et cetera, et cetera, very welcome. Having covered the Lloyd's market for a few years, I know it's been tried a few times. Could you tell me what do you think is different now which will enable you to be more successful than some of the projects that have been in the past? Thank you.

A - Inga Kristine Beale

Yeah, okay. So I'll ask Tom specifically to talk about the cyber aggregation work that we're doing, which is trying to come up with some scenario and some way of aggregating exposures. Because before he leaves, but he's going to get that done for the market, which I think is going to be a great service, in fact, not just to Lloyd's but to the entire insurance sector globally.

But let me just touch on the actual insurance side first. So, I mean, Lloyd's is definitely being a pioneer in this area, it's still predominantly bought by U.S. businesses. We're doing as much as we can to raise awareness around the rest of the world, particularly across Europe. We're holding many seminars and events all around the side but wherever we go.

We think Lloyd's may have as much as 20% market share globally, a cyber – specific cyber insurance. And we are actually pleased with that, because that's exactly what we should be doing going after these new risks. But the aggregation piece is an important part, so I'll just hand over to Tom to give you more color on that.

A - Thomas Allen Bolt {BIO 20535299 <GO>}

We're very pleased with what the syndicates at Lloyd's who sell cyber insurance written as such, do in terms of managing their aggregates and staying on top of new risks and new features. What you have is an exposure to the whole industry is where you have cyber coverage that might be inferred from the way your policy is worded, where it is not written as such.

So, we thought it was pretty important to get our arms around aggregations of that non-cyber written as such exposure, and embarked on a lengthy exercise with the LMA's help over the period of the time in the fall and looked at realistic sort of scenarios by class of business, 32 classes of business actually that we brokered into.

And what I wanted was not the 1 in 200 event, because you'll come up with a level of aggregation that when somebody looks at that, they say, well, if that happens, we're all out of business. And the board of management of the syndicate wouldn't engage but I wanted scenarios where they can say, actually, we could see that happening. And so, they do engage and they do participate very actively.

And by the end of March, we will have there three scenarios from each syndicate, so we'll get 84 syndicates times three scenarios on different classes of business and the Board of Directors understanding and agreement to what they say the risk appetite is. We'll review that during April, come up with a statement sometime in April about where we think we're going and also where we're headed in terms of what we want people to use as the aggregated different scenarios for your different lines of business. Because, I think we – the biggest risk we have if you look back at pollution, you look at other systemic risks across the portfolio, it's not Lloyd's particularly, it's the insurance business generally needs to have a handle when you have something new like this on what you're aggregated risk position is because I – the big thing is, one, guys come to us for a business plan approval for a new cyber line of business.

We're quite keen to give it to them but I also want to make sure you're managing it and running it in a way that doesn't jeopardize your other promises to pay across the whole portfolio. And that's what we're trying to do with this aggregation study. And I think given the interest from other markets, other major carriers that there's a lot of interest in the work we've done because we have a pretty interesting sort of lab to look at all these things. I'd like to think that, that gets picked up and built on in the rest of the world as well because the cyber exposures are going to affect every line of business, everything we do. So, in a few years, we'll think that (00:44:59) what you've been talking about, we'll have figured out how to adopt and incorporate cyber exposures into the way we sell risk policies.

But until we get that done and with the uncertainty of how courts will rule, we've had a few very favorable court rulings in the U.S. but I don't know that I want to count on that until we - without knowing how much we have. So we think this is a very important measure. So, it isn't scare the living daylights out of anyone, it's really to make sure that we can meet the promises to pay that we're making to our customers, both the overt ones and maybe some of the ones we didn't know we are making.

A - Inga Kristine Beale

And on to the other TOM, the target operating model and the modernization, we did look at - we try to identify all the reasons why it didn't work in the prior attempts and it has been going on for some time. A lot of it was around engagement, the lack of engagement with people who are actually going to be affected by it. We also felt that it wasn't actually done in a collaborative fashion. It was being sort of pushed through without actually engaging with the people who are going to be part of that and that was very much the broker community that we weren't really collaborating with them in terms of modernizing.

And also, because the London market is such a market in itself, we wanted to include the company market as well, and I think that's being the real trick. And what that stunned is, I mean, we've raised this up to the London Market Group which is that collective group which brings all of those different stakeholders together and we're doing it collectively and I think that's a massive change on prior attempts.

We've also looked at, well, how this is going to be funded. And so there were question marks over funding and maybe that was one of the reasons it didn't work. We've got now mechanism for getting that funded by the Lloyd's market and in some of the other tools that are being rolled out at the (00:46:58) electronic placing, funding has been agreed, how that's placed amongst the various stakeholders.

So we feel that we've really addressed those and most recently, we put a new Steering Board, a market Steering Board together to oversee this. And we've made sure that we've got some very, very senior people on that Steering Board who have a very, very vested interest, and importantly can make the decisions whether to go or not. So, we've got CEOs on that board now who are going to be making decisions to their own businesses.

So, I think it's all set up in a very, very different way to what it was before. And things seem to be progressing well. And we're going – there will be some releases of some of the new systems this year.

One at the back.

Q - Unverified Participant

(00:47:49). Two questions, please. First of all, could you maybe talk about your strategy for the coverholder business, the binding authority you mentioned in your presentation. How does it compare now in terms of underwriting quality versus the open market business? How much of the market is it today? And what is your strategy to stimulate the growth of the coverholder business? And do you think there are enough checks and balances in place to make sure that development of the coverholder business is kept in check and is disciplined, particularly in a softening market?

Second question is really on risk management. Has the market de-risked in 2015 and will it or should it de-risk further in 2016? Because if I look at the accident year combined ratios by business line, I just wonder whether there's enough diversification in the market today with a lot of lines of business, class of business writing above 100 (00:48:46) to absorb losses in a year where you've got major cat losses and possibly man-made losses as well. Are you happy with the diversification across business lines? And should the market actually start thinking about reducing its time capacity and becoming more disciplined as the market softens? Thank you.

A - Inga Kristine Beale

Okay. I'll ask John to comment on the diversification aspect because that is a key part of what goes therefore into the capital modeling. So, I'll ask John to do that I'll ask Tom to touch on the Coverholder piece, particularly around the controls we've got for discipline and all of that. But just on the most strategic element of the Coverholder stream, we engage very regularly with the associations that represent that body, particularly the U.S. because that's a big part of it.

We have been and will continue to take action around that. So, some of the action we took was, well, we were hearing – there was a feedback that actually competitors are offering agreements on a longer term basis: they don't have an annual renewable agreement that you demand in Lloyd's. So, last year we changed that and we introduced the ability to have three-year contracts, which was a new change and we were reacting to competitor activity around that.

Because we operate in a subscription market, we also had feedback around – as we've seen, the cut is (00:50:13) going in, doing its due diligence separately, doing all of its auditing separately. That's a huge burden on each NGA or Coverholder. Can we do something about that centrally? So, we streamlined that and we are doing central audit work now on behalf of all of the syndicates that are participating with an individual Coverholder.

So we are very aware that we must make Lloyd's easy to do business with. And any barriers that we learn about that make Lloyd's less competitive with others in that area, we would take very, very seriously.

The other thing that's impacting Delicated Authority business is the requirement to understand the underlying exposures much more. So, we piloted last year data feeds coming from our Australian coverholders directly into the syndicate's books and that means they've got policyholder information, they've got aggregate information in a much more streamlined and up-to-date fashion. So that was a big piece of work. That has been successful. So, we're looking to roll that out this year across other geographies and other coverholders. So that will mean we are keeping Lloyd's regulation oversight activity happy that we've got that data, but also some of the regulators here in the UK and local regulators around the world who are demanding that we have much more transparency.

So, that – those are things that we're doing in terms of making it easier to do business with Lloyd's, and I will ask Tom just to touch on profitability and any concerns over lack of discipline.

A - Thomas Allen Bolt {BIO 20535299 <GO>}

Like, anything you see in a marketplace, it – to use as a classic answer, it depends. And it depends – in some cases, I can show you where the binding authority Coverholder book is actually more profitable than the open market book. And then they have other classes where it's exactly the opposite. And things move around. Over the six years I've been here, things have moved around in terms of which things did better or worse.

But the important thing you should know is, we do monitor and watch for it and look for signals or signs that tell us to be worried. And when I arrived here in 2009, we had not really begun the efforts on audit, so the – Peter Montanaro hired two more people to not do the audits, but supervise the syndicates who have the responsibility to audit their coverholders.

We then suggested that they work together to have joint audits, which Inga mentioned, and after giving the market a couple years to get its act together, we have now taken over that role on their behalf to offer – and we have quite a growing number of coordinated audits where the managing – delegated authority managing agent is pretty happy to see us once on a more thorough basis than all the quick, superficial things they used to see.

And in agreeing the three-year agreement, that doesn't mean we're writing three-year policies: it means we're writing a three-year authority agreement with the binding authority Coverholder. And the trade we made with the marketplaces, as long as you keep your monitoring of his financial statements, his compliance statements, all the other things you have to do every year anyway, then we're not going to force them to go for a re-filing or all the other administrative traps that go with that. And we think it's working pretty well, but we're going to continue to monitor, and if an underwriter doesn't do a good job of that, we'll take away his right to issue three-year agreements. So, we will stay on top of it. And the amount of audits has increased, the amount of auditors that do the work has increased, and the goal is not necessarily to be more invasive but to be more effective when we're doing the audits and when we have given away the authority.

There's about 20 – you ask a question – there's – about 20% of the premium at Lloyd's is from third party Delegated Authority underwriters, and then another 11% to 13% is Delegated Authority underwriting agreements with service companies: and these are operations that are owned by the managing agents themselves.

So, if you look at it, about 31%, 32% would be the amount that is through Delegated Authority agreements and we monitor the service companies just as actively and as thoroughly as we do (00:54:43).

A - Inga Kristine Beale

They are the underwriters who are employed by the syndicates based in – somewhere other than London. So, it's quite different to the third-party Delegated Authority. The coverholder book – that Delegated Authority book actually is particularly attractive and is very, very sticky business. It's very loyal. It doesn't really move around, a lot of affinity products in there. So, we like it as a context. And John, on diversification.

A - John Parry {BIO 18896198 <GO>}

Yeah. I mean, you're right. Diversification only works if you are – each line of business is – got realistic expectation and that's where we start. That is the test that the syndicate business planning review process starts with that each line has a realistic expectation of profit on a gross basis.

Then there are the two mitigants of it: there's arbitrary insurance; and as prices fall, Lloyd's is a major purchaser of arbitrary insurance and you can often extend the cover for the similar sort of spend, so there is some mitigant with reinsurance. And then the second thing is capital. And our capital base responds – we introduced ICAs back in 2006 and we've transitioned well into the Solvency II well with Solvency Capital Requirement. The amount of capital every syndicate or every member puts up is directly tied to the expected profitability and the chance of downside.

And we have seen our capital increase as prices have come down. So we're in a good position to manage it. But nobody here is unaware that some of these classes are around about that 100% ratio in a low cat year. And that's why market oversight and our data is such a powerful tool for us in maintaining Lloyd's competitive position versus the peer group.

Q - Unverified Participant

Should the market derisk then going into 2016, given where we ended in 2015? Or are you happy with the risk profile of the market today, the PMLs et cetera?

A - John Parry {BIO 18896198 <GO>}

Again, when we do the business planning process, they don't come in with sort of a rate added foresee (00:56:47) warranty. They come in with an expected loss ratio, which we challenge and come to some sense of the capital needed if you're going to write at that loss ratio. And if you look at some of the players in the market, they have reduced their exposure. If you look more broadly, our reinsurance percentage, when I started in 2009 was 38%: we are down to 34% of premium as reinsurance. And of the decrease, almost all of it is in property catastrophe, excess or loss, where you've seen an erosion in the rates in the last few years.

So, in a sense I think that's getting at what you are talking about in terms of derisking. And that's the real challenge: this is when we'll separate the really good operators from the not so good operators is, they will look across classes, they will look across customers and they'll differentiate who they want to work with, given they are in a thinner rate environment than they may have been in the past.

So, that's what we look for is, who's making informed choices and trying to decide whether they grow or if they don't. If, in the business planning process we see that you're just a me-too syndicate that's growing with everybody else, you probably will find you don't get your business plan approved as easily. And we saw that in the feedback that the syndicates were given last fall. And that will get more and more as you see the market hover around that 100 level.

A - Unverified Participant

Two questions have been submitted by Mr. Marcus Rivaldi of Twelve Capital. His first question: You flag in the Annual Report, but oversight of casualty reserves remains a focus especially in relation to more recent underwriting years (00:58:31) future results may vary considerably from the significant surplus observed in 2015. How concerned are you about the trajectory of reserve releases?

A - Inga Kristine Beale

Was there another one or...?

A - Unverified Participant

Second question. Could you elaborate on what Brexit contingency plans might look like?

A - Inga Kristine Beale

Okay. I'll just take that one first. So, we are looking at alternatives. We are a market: as you know, it's not as simple as just sort of thinking about, well, we'll just set up a subsidiary somewhere. So, we are looking at what it would take – for each country, what sort of trading rights we could negotiate. So we are having to do it country-by-country. So that's basically what we are doing. We've done the priority countries, as you might imagine, first. And we are working through all of that. And it is possible obviously to do this, but the main thing is that there's so much uncertainty if there were an exit and you would have years to sort it out that you don't actually know what the outcome would be in terms of what the UK as a whole negotiates something or would we have to go with each one of our individual plans to each country.

I think there's – one thing is for certain: it seems as though nothing would be quite as smooth and easy as it is now. Though that's the certainty, but actually there is so much uncertainty as to how much specific negotiation would have to go on with each country. John, casualty reserves.

A - John Parry {BIO 18896198 <GO>}

Yeah. So casualty reserves, it was an area of focus for it. We did write to a number of managing agents in the summer of last year, having analyzed the December 2014 casualty position. We are very pleased with the response: we can understand it regarding sort of re-underwriting of the book after the financial crisis, 2008, and why they were going forward with their reserving practice. Particular thematic focus for us is on claims inflation. There hasn't been any significant real claims inflation in the last two years or three years, so – but that is a specific consideration for the independent actuarial review of syndicate reserves of how they have accounted for inflation when setting syndicate claims reserves going forward. So that remains a threat, and it remains an area of focus for us.

In terms of the trajectory of future claims reserves, it has been a consistent theme of the results for the last few years. We are comfortable there remains a surplus within the balance sheet in aggregate across Lloyd's. But to get to these level of figures, you do need that actual experience to be better than projections and that is what we have seen. But remember, it could easily revert to being as expected or worst. There is a lot of uncertainty in there and that's why our market oversight role is so important.

A - Unverified Participant

As there are no further questions, we will now conclude today's presentation. Thank you for listening.