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Q4 2016 Earnings Call

Company Participants

- Martin Lindsay Bride, Executive Director & Group Finance Director
- Neil Patrick Maidment, Executive Director & Chief Underwriting Officer

Other Participants

- Andrew J. Ritchie, Analyst
- Ben Cohen, Analyst
- Eamonn M. Flanagan, Analyst
- Faizan Lakhani, Analyst
- John A. Borgars, Analyst
- Kamran Hossain, Analyst
- Nick Johnson, Analyst
- Robert Haim, Analyst

MANAGEMENT DISCUSSION SECTION

[Abrupt Start]

I'm slightly worried about this year's presentation, this year's results presentation, because several of you told me what I'm going to say in advance of me saying it regarding these results can't last, margins are going to come down, and so on, but I am going to be making some comments like that. So, apologies to anybody who's heard me say that, the previous 10 presentations that we've given since 2012.

Let's look at what we're going to do. So, I'm going to give you an overview of what's going on during 2016; Martin is then going to take us through the financials, the performance, the investments, reserves and capital; then Neil will talk about underwriting, what's going on in the underwriting; and then I'll come back and look at our vision and the outlook for 2017.

So, let's look at the highlights of the results. So, the profits were up a bit, which we're really pleased about. What's driven that? The combined ratio remains just around the 90% market, 89% of the underwriting is good, although it's down a bit on 2015. So, investment income up quite considerably over 2015, up to $93 million. So, the investment income is the main driver. Return on equity, slightly down from 19% to 18%. We're using more capital as we continue to grow the business line. Pleased with the increase in gross premiums written. That's mainly driven by our growth in the U.S. on mid and small businesses, particularly within specialty lines. We're growing that 6%, which is just under £2.2 billion.

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Rates continue to hedge down, and Neil will be showing us a rating chart later on. So, it's another 2% reduction on top of the 2% reduction in 2015. And on the back of all that, we have announced our increase in the second interim dividend, up about 6%, and because our profits are good, a special dividend of £0.10, which is down on 2015.

Our aim, just to touch on the special dividend front, is that we would like to use the profits to grow, if we can going, forward. And if we do believe and we do that margins are going to come down in 2017, once we paid the base dividend, want to continue to grow our book. There may not be a lot capital left for special dividends. Well, that depends on the actual results, which we'll know towards the end of 2017 rather than the beginning.

We highlighted this one a busy year. There has been a lot going on within the company. In 2016, hired a record number of underwriters. There has been some stress in the system as some our competitors pull out of certainly lines of business, and we have benefited from that, some M&A that took place over the past one or two years, and we benefited being able to recruit some of the underwriters from those companies We also acquired a couple of things, Leviathan is a two-men subsea insurers, submersibles, and the Marketform team did mislaid medical, so Marketform, true, mislaid the medical business and we acquired their team, open or expanded offices in a number of places around the world, in the U.S. and Paris. We're opening an office in Birmingham in the UK.

We thought, for the half year, we're going to be launching an international initiative within specialty lines. Specialty lines has been historically about 85% to 90% U.S. I'm again, try to replicate the success we've had in the U.S. of writing business internationally, and internationally in this term, means everything outside the U.S. including the UK. So, everything outside the U.S., building a team around Gerard Bloom and starting right premiums at the beginning of 2017.

On the back of that, we're converting our reinsurance company in Ireland to an insurance company, because Gerard wants to be able to write both on the Lloyd's platform and also on company paper. So, in that process, we are dependent on the CBI approving. That submission went in towards the end of last year.

Touch on the fact the U.S. premiums continue to grow strongly, expecting similar, maybe a bit less growth than that in 2017. And we announced this partnership with Munich Re during the year. We write a lot of mid and small-sized cyber. Our book of larger cyber has generally been smaller. And in partnership with Munich Re, we are targeting some of the large-risked business, and we have a good pipeline within that going forward.

Some good business last year, and Martin has been very busy, as well as everybody else on the corporate finance side. So, the debt issue, successfully launched. That's one of the reasons our capital surplus is higher at this point in time and we've changed the group down south from Ireland to the UK. So, a lot going on.

Looking at the charts over five years, I think a great chart, left-hand side, showing growth each year, which is good, about 16% growth over that five-year period. The chart in the right-hand side, for a volatile industry, we're really pleased with how the lack of volatility in

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both of those. So, combined ratio on the right-hand side close to 90% for the past five years and return on equity stubbornly holding out in that high teens ROE. And then, the bottom left showing the base of earning growth of 5% to 10%, around 6% over that period of time. And this infamous special dividends, which are supposed to be special and not happen all the time. Unfortunately, on this chart now, because 2011 has dropped off, it didn't happen in 2011. There was no special dividend in 2011, so they can't be used where they're on as special dividends. But as we have excess capital, enough capital to support our growth, we hand it back to our shareholders.

Final chart for me before Martin, is looking at our total shareholder return, which is the weekly chart, showing a 22% compound total shareholder return since the end of 2009. Why is this important? Beginning of 2010, it was when we brought in our long-term incentive plan, and the grey bar show where the long-term incentive plan starts and where it stops.

So, we top out if we have grow net asset value by about 175% over the past six years. We've actually managed to grow the net asset value by over 200%, which is where the red diamond is. Net asset value, from our point of view, is a key driver for growth. So, if we can grow the net asset value, our view is the share price will follow that, and we can see the share prices more than follow that over this period of time.

Over to you, Martin.

Martin Lindsay Bride {BIO 15458196 <GO>}

Thank you, Andrew. Good morning, everyone. I'm Martin Bride, the Group Finance Director. I'm going to talk to you about the overview of the financials, and then the habitual three subjects of investments, reserves and capital.

So, on the overall financials, Andrew just talked about the 6% growth, net of reinsurance, we actually achieved slightly stronger growth than that, and Neil will go in a little bit into why that was possible. As an earned premium level, there's always a lag between written and earned. So, the NEP growth has not yet fully caught up with that good written premium growth of 8%, which we're very encouraged by.

Per share metrics, I think one of the big changes since this time last year is the sterling-dollar exchange rate. We are essentially a dollar earnings generating company. We carry our capital in dollars. And so, the per share metrics in pence have moved forward very strongly.

So, net assets per share up nearly £40, and shareholders have also £0.285 of dividends during that period of time. So, there's really been very strong sterling generation per share during the period, which is we're very pleased with. As far as the dividends are concerned, board remains committed to the 5% to 10% dividend growth.

So, on investments, our highest ever dollar investment income, we were obviously pleased to achieve that. Remains to be seen as other companies published how the investment return stacks up, but we are certainly, in terms of the level of risk that we take, which is not high, we are very satisfied with the 2% return that we achieved. And indeed, eking out a positive albeit a very small positive return in the fourth quarter when U.S. interest rates went up very sharply.

In terms of the portfolio construction, the overall level of risk is unchanged year on year. As those of you who follow Beazley, every half year, we'll see there has been a move, which is already visible at the half year, out of treasuries into credit. In the core portfolio, we would view that as pretty much complete now, and don't expect in the short term for there to be any significant changes in the portfolio mix. And we will now continue to concentrate on trying to maximize the yield in what remains a relatively low yield environment, excuse me, with that possibility of interest rates going up in the U.S.

Reserve releases are an incredibly important part of Beazley's results. Philosophy, as a company, is reserved very prudently, and if you do that, then on average, you get releases from the reserves as we pay claims. What you can see in 2016 is reserve releases, very similar levels to 2015. Indeed, a very stable five-year patent with reserve releases averaging about 10% of net earned premiums in any one year.

The only other comments I would make, the top three blocks, the light blue, the pink and the white. The short tail CAT-related lines and what you can see over time there, is a reduction in the level of reserve release and as we have been saying to you, rates in those areas of business have been coming down in a cumulative fashion, quite substantially. And then that does have a mechanical effect on how much margin there is to release in those classes.

One of the strengths of the Beazley business model, different classes of business driven by different cycles compensating and quite a significantly increased reserve release from our specialty lines business in 2016 compared to previous year.

Just as important as the current year reserve releases, what is going to happen in the future. So, this chart is giving you our view of how the reserves we're carrying on our balance sheet, how much margin they have in them compared to our own internal actuarial estimate, which itself has an element of prudence in it. So, our view is that we are in our 5% to 10% corridor. So, our balance sheet is of the same strength as it has been over the previous few years. The chart does have some jagged edges to it moving up and down. This is an art, not a science. And so, we don't really view the small movements in the charts as being of any particular significance.

Moving on to capital, so we've now got through the £700 million mark in terms of capital returned to shareholders during the period. I was looking at the market cap this morning. The market cap is near £2.3 billion. It was £500 million when this chart started. So, we've managed to convert £500 million into £3 billion market capital and capital distributed. So, it's been an incredibly successful period that is very positive for the company and for the shareholders.

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In terms of the capital position, we said at the half year that we expected underwriting capital to support our 2017 business plan to be higher. I think we gave you a figure of $1.5 billion. You can see actually, it's remarkably close. So, our view that underwriting capital for 2017 would grow has been borne out. We have a good capital surplus at the year end. Post the dividend, we would expect it to be 36% of our Lloyd's ECR.

We continue to have our target corridor of 15% to 25%, but we did raise debt this year, and when you raise debt, you do it in, I'm going to call them big lumps. So, the fact that we are above our capital corridor at the end of the year, in which we raised debt is not something that concerns us. And again, as we said at the half year, we maintain a perspective that we have opportunities to grow in the high single digits and that underwriting capital and premiums will probably grow in tandem. And so, we are very comfortable to have the capital necessary to finance that growth, assuming we can indeed execute upon it.

Neil Patrick Maidment {BIO 5232207 <GO>}

Thank you, Martin, and good morning, ladies and gentlemen. So, in the next part of the presentation, I'm going to be looking at our underwriting performance, and that remains the main driver of the results that we're talking about today.

So, if I start with the highlights from 2016, we're very pleased to be reporting continued strong profitability with combined ratio at 89%. It was understood that was slightly better than where we were guiding in the third quarter IMS, and it also compares favorably to our five-year average, 90%. Also, really pleased to be talking about growth of 6% in gross written premiums. There were a number of drivers for that, but the main contributors was specialty lines, which grew by 14%. And also, further strong developments of our business written onshore in the U.S., which grew by another 20% to $780 million.

Those results were achieved against the background of a more competitive market. Overall, rates reduced on our portfolio by 2%. And I'll talk in a moment, in a little bit more depth, about market conditions. But what I would observe was that our ability to reach an increasing volume of business in the midmarket and SME markets in the U.S., has offset and balanced the more competitive market conditions that we're experiencing here in the large risk and wholesale market written in London.

Now, we've also benefited from a relatively benign claims environment, once again, and in particular, the natural catastrophes that we saw in 2016 were below the level, for which we budget. The largest event of the year was Hurricane Matthew, which I think is a market loss in the $5 billion range, which for an industry that's preparing itself one day for a hurricane affecting Miami, that's going to cost $250 billion, is relatively slight, and they were relatively insignificant events as well for Beazley. And as Martin has just covered, the reserves for prior liabilities continue to develop positively, and our consistent approach to the reserving process has maintained that surplus over our actuarial in the target range of 5% to 10%.

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So, if you dive into the numbers in a little bit more detail, top line growth, 6%. As Martin said, the net written premium actually grew by 8%, and the reason for that was that our dollar spend on reinsurance was relatively consistent despite the growth in top line, and that happened because we're still experiencing a fairly competitive reinsurance market. If I unpack the combined ratio, the claims ratio remain flat at 48%, but the expense ratio grew by 2 points, and there were two reasons for that. One was, we're seeing increased upwards pressure on brokerage. And the second driver, as Andrew has illustrated, is that we were fortunate to continue to invest into the business to drive growth in 2016 with hiring of those 63 underwriters. So, those were the two drivers of that increased expense ratio.

And at the bottom of this chart, we can see pricing, as I've mentioned, minus 2%. That was led by the large risk short tail catastrophe exposed lines of business. And if I was going to pull one out, I guess I would identify energy, where weak oil price below $60 leads to weak demand for insurance, and we saw prices fall by further 13% in the energy insurance market in 2016.

And if we look at rate changes more generally, this chart shows the cumulative risk adjusted rate change going back to 2008, and this dotted red line is the composite. This is the overall rate change for the business. We measure rate change on a risk adjusted basis, to take account of changes in terms of conditions and exposures, as well as price. What I would note about, at dotted red line, is it's relatively consistent across the period, and of course, that reflects the benefit of operating a diversified portfolio, and it evens out the ups and downs of any one particular line.

What we've seen in 2016 is that most of our divisions are experiencing a more competitive rating environment to a greater or lesser degree, with the largest decreases being those two at the bottom, the light blue line, which is marine, minus 7%, and that gray line, political and contingency group, minus 6%. That latter division includes our terrorism book of business. And I think I've said in the past that we've been fortunate since 2001 not to experience terrorism events, probably at the devastating scale that we saw at WTC, and consequently, the terrorism market has trended down ever since 2002.

Balancing those negative impacts, of course, we have our largest division, specialty lines, which continued in 2016 with a positive rating trend that we've experienced since 2012, an overall rate since specialty lines were up further 1% in 2016, which is the red line there.

And if I turn then to what's happening in 2017, broadly, we expect those similar market conditions to continue this year. So, supply of capital into the insurance industry continues to grow at a faster rate than demand for insurance products. And alongside that, this relatively benign catastrophe environment is encouraging further competition. And those two things are being reflected in the 1/1 renewals in our property reinsurance book, where we saw a further rate reduction of 3%. And as you know, that 1/1 renewal season tends to be a bellwether for market conditions for the rest of the year.

With rates expected to decline, and here, I'm at risk of heckling from the middle row, with rates expected to decline this year. Any return to a normalized claims level will lead to

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upwards pressure on our combined ratio, and we should expect margins to decline. Against this more challenging background, our 2017 business plan is targeting continued moderate growth in the 5% to 10% range that we've been looking to achieve over the last few years. And as Martin has already pointed out, we do benefit from operating a diversified portfolio, and one of the key benefits of that is that we can exercise cycle management. Cycle management is simply a clever term for pushing forward in the areas where we see more opportunity and pulling back and being disciplined in the areas where margins are under pressure.

So, in the 2017 plan, we plan to continue to reduce the volume of large risk short tail exposed lines business, such as energy and large risk property, and we will be focused on protecting our margin in those businesses. Alongside that, we will continue the trend of recent years and reduce our catastrophe risk appetite in 2017.

Balancing that of course, we have a number of opportunities for profitable growth, and the three that I just want to pick out. Cyber continues to grow strongly for Beazley, both within our core Beazley Breach Response product set that targets the SME and midmarket. And alongside that, as Andrew said, we're seeing see more opportunity in the large risk segment, and we did this partnership in 2016 with Munich Re to create $100 million of capacity to serve customers in that large risk segment. And finally, I think it's worth highlighting as well, we're seeing increasing demand in the international markets outside of the U.S., as awareness of the risk around cyber continues to grow.

Secondary opportunity is onshore in the U.S. We continue to benefit from this more focused distribution strategy that we've talked about previously, and also putting more underwriters, more product throughout our footprint, getting decision makers closer to the customer. In addition to that, in 2016, we've benefited somewhat from some market desiccation, for example, in the environmental sector, where the leading competitor actually withdrew from the market. We expect those opportunities also to continue to drive some growth in 2017.

And then, finally, we have Specialty Lines International. This is the major initiative to internationalize specialty lines, to diversify our U.S. strategy, and to take advantage of this increasing demand for cyber outside of the U.S. As Andrew mentioned, Gerard Bloom and the leadership team have already joined, and we are in process converting Beazley Re into being a fully licensed European insurer to provide that non-Lloyd's paper, alongside the Lloyd's paper.

Beazley is fortunate, I think, to have these opportunities for profitable growth in what is otherwise a relatively low growth environment. And the reason we're fortunate is that it allows us to be disciplined in the areas where we see most pricing pressure, and to protect margin in those areas.

With those thoughts, I'll hand it back to Andrew.

Great. Thanks, Neil. Let's have a quick reminder of our vision and our strategic priorities. For those of you who followed this chart very closely, which I assume is most of you, you

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will notice there were seven pillars on here rather than the six pillars we originally had. We've added data and analytics on the right-hand side. So, to quickly look at them, there are three geographic growth initiatives, growth in the U.S., in Asia and Europe. As you know, growth in the U.S. is much larger towards than Asia and Europe, but we continue to focus on those. The SL International, which Neil just talked about, will help us grow both in Europe and in Asia-Pacific. I think we have good businesses out there with good people, and they are starting to grow, but are smaller than the U.S., mainly because the U.S. market is so much larger.

Small and medium-sized enterprises, small enterprises, which Mr. Adrian Cox has been running for the past year, we've handed that over to Mark Bernacki to look at now. So, this is looking at how do we get more small business. Historically, Beazley has been a large risk underwriter, but we've found we've written more and more small business used to be written in a different way to the large risk, and we put a lot of focus on that.

Sales and service, really important in markets like this. The brokers need fast turnaround from a service point of view, and we're ensuring we continue to maintain and improve our levels of service on the sales front. Brokers also need help to think of new things to do and bring new business into the market, and that aligns quite nicely with our innovation and product development, where during the year, we continue to innovate, thinking of new products. Ideally, we think of the next five cyber lines that could all generate $200 million each. They may be smaller than that at this point in time, but there is a real innovation culture within the company.

The final one, which is the data and analytics, everybody keeps talking about big data and data wars going on, and we have focused on how do we get more out of our internal data, which historically, I think we've been very good at. But can we use external data to enhance our product offering and enhance what we actually do? And it sort of incorporates the insuretech world, which seems to be growing and growing, and we are approached by a number of opportunities on insuretech. Ian Fantozzi, our COO, is running a data and analytics initiative.

Time to get the crystal ball out, dust it down and have a go at determining what is going to happen in 2017. Unfortunately, that crystal ball has not told me anything about the political and economic landscape, which in my view, does remain somewhat uncertain. So, it's quite difficult to answer the question what is going to happen in the U.S. at this point in time. We don't know, nor what is going to happen in Brexit. I'm not trying to kill off those questions before we go to Q&A in a few minutes' time, but it's quite difficult to determine what is going to happen within Europe and the U.S.

We have a great business in the U.S., and as we've talked about, we are trying to focus on growing our European business, both at Lloyd's, supporting Lloyd's, as it thinks through how to get licenses. It loses its licenses in Europe, and also setting up our own licensed EU insurance company.

At risk of further heckling, although you didn't get any heckling at all, Neil, and I always say, within Beazley, I am the most repetitive man in the company. So, I want you to share in my

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repetitiveness, at this point in time, that premium rates continue to decline, margins do come under pressure. Our aim, and I think we've been very good at it, is trying to re-balance the portfolio, and we'll continue to re-balance the portfolio without withdrawing wholesale from anything, but there's a limit to what we can do when the whole portfolio continues to go down. And I believe, generally, is that claims have been below average, as we do think claims will take up a bit or could take up a bit in 2017. Of course, the aim of the company is to try to outperform the average of the industry, and I think we've done a good record or have a good record of that probably for 30 years, no matter past 5 years.

Last, going on, we are continuing to attract people, and our aim is to continue to invest in teams and individuals in 2017, maybe not quite the same rate as we did in 2016. At the beginning of 2016, we didn't know that all leasings we're going to happen in the market, and therefore, we didn't know these individuals we're going to be available. So, we probably recruited more than we thought in 2016, but our standard's in good stead for great opportunities in 2017 and beyond.

Specialty lines, we hope it's going to drive us to high single digit growth overall. That is going to use more capital, as we touched on before. Therefore, special dividends may not happen going forward. Returns pool, we have a lower ROE and we use a certain percentage for our base dividend, and then we want to grow our specialty lines business beyond 2017, and special dividends may not happen.

One thing the crystal ball has told us, because we need to be told by the crystal ball, is we are merging our PCG and LAH divisions together. Adrian Lewers is going to retire at the end of June, and we're merging two of our smaller divisions under Christian's leadership. There are some synergies, specifically between the Contingency and the PA business line. So, Christian has taken on that from the 1st of February. And as I touched on, we have this new strategic initiative on data, more of which we'll be able to talk about at further presentations.

On that, we are open to questions.

Q&A

Q - Kamran Hossain {BIO 17666412 <GO>}

Morning. It's Kamran Hossain from RBC. Two questions, one, on the performance in specialty lines, that combined ratio improved pretty dramatically year on year, so 96% this time last year, 93% this year. Some of that is reserve release, but some of that is mix change with cyber. If we think about the direction of that 93%, where should we think about that continuing to get - sorry, Andrew. Should we think about continuing to improve from the 93%, or how should we think about that? So, that's question one.

And the second question is just on reserving, obviously, continued growth going on in the business, with the track record of being super prudent on reserve setting. How does your attitude towards reserve setting for new business differ to that, which you apply to business that you've seen for a number of years? Any color on that would be really helpful. Thanks.

So, especially on, I mean, I think two drivers we've seen, one is the pricing trends since 2012. So, we've seen four years of price increases. The increase moderated during 2016. We're pleased to finish positive, and it moderates to 1%. And it I think with pricing trends in the market, generally, we'd expect that to go flat or even possibly slightly negative in 2017 this year. So, I'm not sure that I would expect, from a pricing point of view, continued improvement in combined ratio. On the other hand, we are seeing an increase in volume. We have written increase in volume of what we call, the short tail product set within specialty lines of the cyber business which, at this point, is carrying a lower loss ratio than the traditional medium tail specialty lines business. So, if we write a change in mix, and if that cyber business continues to grow more strongly than the medium tail business then we would see that effect. But with the pricing leveling out, I would say that 92%, 93% is where we would expect to continue.

(31:45) reserve comment, Martin?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Yeah. So, on the reserving side, I think we try and operate stable opening loss picks. So, we don't categorize our business by renewal business and new business in terms of focus groups. Our focus groups, which are the level at which we set our opening loss picks, are more type of business, where our whole pricing basis and our whole approach to a product that's completely new to us. Yes. We're very conservative, which is a slightly different question. So, no. We don't differentiate between new and renewal business on marine hull, for example, which is a class of business we know very well. Are we very conservative with loss picks on a completely new branch of insurance we're going into? Yes. Generally, my view would be we are.

Q - Ben Cohen {BIO 1541726 <GO>}

Hi. Ben Cohen at Canaccord. Can I ask three questions, firstly, just following up on the specialty reserve releases, I think you make mentioned that you had a particular benefit from post, what had been thought to be a recession in the U.S. How far are we through reckoning that full reckoning in terms of further releases?

And secondly, just in terms of life, accident and health that was loss making in the year, do you expect it to move to an underwriting profit this year?

And then thirdly, on the investment yield, could you give us any outlook, given where you are reinvesting at the moment, as to what you would look to achieve in 2017, given all the caveats around no one knows what's going to happen with yields? Thanks.

Let me have a go at the first two, maybe. The claims have been trending more positively in specialty lines since 2012. So, the recession periods, 2007 through 2011, is further in the rearview mirror, A, and B, we've been growing specialty lines against that the background of pricing strength, and we're starting to see that reserve development from 2012 and post. And the second thing I would observe about that is we have been growing cyber as a part of the specialty lines business, and because it is shorter tail in terms of the duration of its liability, we're starting to see releases from that increasing cyber book within the specialty lines business as well from 2012 through 2014. So, those are the two drivers I would observe on claim trend in specialty lines.

Accident and health continue to disappoint in 2016. Main driver for that was under performance in our Australian business. We had, and I think we've been talked about in the past, we had a number of large accounts those weren't profitable, we've separated with those accounts, and we're in progress building a more diversified portfolio, but that remains a challenge.

With the balance of the London business and also our investment in the U.S., which is designed to take advantage of growing or emerging demand for specialty health products. I hope that we would get towards profitability, but obviously, we're in progress there with our Australian remediation and the continued investment in the U.S. Whether that comes through come through in 2017 or beyond, we'll have to see.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

On the question of investment deals, Ben, I think if we compare where we stand today versus this time last year, one would expect to probably make 25 basis points more this year, than one would've expected this time last year to make. We didn't, this time last year, expect to make 2% in 2016, though. So, we're probably expecting to make about 1.5% last year. Risk assets had a very strong year last year. So, that would be how we would view herein. Most of that is just driven by the fact that the U.S. yield curve is about 20 bps higher across most durations today than it was a year ago.

Q - John A. Borgars {BIO 15015364 <GO>}

John Borgars. Two questions, firstly, Neil, could you tell us what you think the market rate of premiums have gone down, because you're quoting a 2% fall on renewal rates, which obviously understates the general fall because you've turned down one drop by half?

Secondly, I think Andrew talked about planning to arrange for other insurers to use several, are going to Beazley products? Will those be a reinsurance basis, to taking reinsurance on those companies way too like, and they presumably like? If so, will that reduce brokerage costs?

A - Neil Patrick Maidment {BIO 5232207 <GO>}

On the first one, I'd say, well, thanks for the question, John. We approach pricing on, under the old business in the same way, and I would say the 2% I gave is a relatively good indicator of where we see overall pricing on our portfolio. The thing I would just caution is that it doesn't necessarily reflect pricing trend in the market as a whole because it obviously reflects the mix that we have with specialty lines being slightly positive in 2016, balancing some quite significant negative pressures in those large risk short tail lines business. But I think if you read any of the press at the moment, you get a flavor of the individual markets pricing. And I think for the products we write, we're experiencing the pricing that you're reading down in the press.

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I think on the second point, what we do like is we have partners with reinsurers or reinsurers where we embed product with them, and they help us distribute it where we can't access distribution easily. So, overall, I guess it may reduce distribution cost, but it's just a different way of paying for rather than through the broker. Brokers do tend to be involved in those transactions as well.

Q - John A. Borgars {BIO 15015364 <GO>}

I think it's more of increasing your distribution?

We think that the aim is to increase distributions. How do we access plans we got access.

Q - John A. Borgars {BIO 15015364 <GO>}

Thank you.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

It's Andrew Ritchie from Autonomous. Four very short questions, I think. On cyber, there's been a proliferation of competitive launching products, quite a few people trying to launch higher limit products, not that many actually. And maybe just comment on where you see the differentiations at Beazley. Do you feel more challenged? I think a number of competitors are trying to offer similar types of brief services. And then, how successful has the early signs of the Munich Re JV and offering high limit there?

Secondly, just on specialty claims environment, there's been a tick up in transactions, some competitors talking about slightly tougher pressure in dormancy claims environment. Are you seeing that?

Thirdly, for a good deal of specialty, healthcare is an important segment for you in the U.S. You have, in the past, cited things, Obamacare actually I think generated some new business. So, maybe comment on any risks, if you see a rollback on that? Obviously, we don't know what the outcome is.

And finally, in the (39:25) report, thanks for providing us. It's the first time you talked about potentially cyber RDS scenario where you've talked about it as being less than your nat cat loss scenarios. Presumably, you're happy if that was to become bigger. You say it's growing. So, right now, the cyber worst case, I presume, of the seven scenarios that you talked about in the past is lower than the worst case one in 1 in 100 nat cat. Are you happy for that to go higher than that? What's the risk appetite? Thanks.

I'll have a go at some of those. So, differentiation. I still think we're experiencing the five of Beazley Breach Response remains differentiated products in the market. And the thing that is particularly distinctive is that we create a separate division and a separate team within Beazley to manage and handle the crisis response. And whilst many competitors bring some element of service provision. That coordination and the brand and reputation that we have for serving, what is now over 5,000 breaches, remains quite distinctive.

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In the large risk area, I mean, we have written some large risk business for a while. What we saw in 2014 and 2015, we saw some significant breach activity that was widely reported in the press. We took some time to think about how to serve that market. And I think the attractive thing about working with the company like Munich Re is of course they bring skills and knowledge that partners quite well with us. So, we know quite a lot, as I've just said, about data breach. They have quite good knowledge about, for example, physical damage or business interruption risk. And so, it's the ability to put these different elements together and provide significant capacities differentiating. We've got good pipeline, and with Adrian and his team, we've already written some good risk in that area.

We are seeing a heightened level of security class actions. They've been at relatively low levels in recent years. We've seen a recent uptick over 2016, M&A activity and what pump up actions have been a driver. I think, overall, that has been in line with our pricing expectations. So, if anything, the outcome in D&O management liability has been a bit flatted by the absence of those security class actions in recent years, but we definitely have seen that trend.

Healthcare, I agree, uncertainty. And I think the main challenge with that political uncertainty is it creates uncertainty in customers' minds. So, they don't know how to prepare, and therefore had to buy their reinsurance, whether they know what regulatory environment is.

Having said that, whatever happens with the ACA, the Affordable Care Act, I don't think the challenges in the underlying economics of the U.S. healthcare system are likely to change, and so we do see an increasing trend for the higher deductibles on core healthcare programs and that those higher deductibles, higher retentions, will create a demand for the products that we've expected out in the past.

And then finally, cyber RDS, the board, the PLC board, sets the risk budget on an annual basis and every year, just as the way we've been bringing down our catastrophe risk budget. As margins decreased, we evaluate the trade, the relationship between pricing strength and the risk that we want to run, and also the balance of our overall perspective earnings and our capital position with the risks we want to run. So, it's an annual exercise.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

I think I'll jump on that last point. I think it's incredibly difficult. We do have 100 years' worth of hurricane data or more than 100 years' worth of earthquake data, so it's incredibly difficult to make direct comparison between cyber and nat cats. On the cyber side, we clearly believe that events can occur, and we very carefully risk manage against them. At this stage, we have no data on cyber events, how often they occur and how large they might be. And so, as Neil has said, we approach it very cautiously and as presumably, will happen over the next 10 years, we will get some evidence. We will have to adapt to our approach as we see what emerges.

Q - Robert Haim {BIO 20636816 <GO>}

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It's Rob Haim from JPMorgan. Just a question on the expense ratio, you mentioned the two factors that drove it up. Have those two factors worked their way through in the sense that their pressures of increased brokerage potentially capping up? And the hiring sites, so are we going to see a reversion back to the 39%, 40% type levels?

I think you're not going to see a reversion back to 39% in 2017. I would expect to see the expense ratio in 2017 will disable to 2016. Looking over a 5- or 10-year time horizon, if we are able to get up to the high single-digit growth, there's potential for an improving expense ratio. But, and I think being realistic, the main expense within Beazley are people and that does inflate, and then the risk pressure on brokerage. So, the cost base is going to increase in the future, and the challenge for us as the management team is to try and find growth opportunities for the top line that allow us to in sync, which we've done quite successfully. Over the last three years, we've gone from 39% to 41%, which we think is a good outcome. But I think in the current environment, expectation of expense ratio reduction is, I think, been optimistic.

Hi, there. Johnny Irwin from UBS (46:17). Just a quick one on your traditional loss ratio, you obviously don't give us the losses by year. But if you did adjust for CAT, stripping them out alongside the reserve releases, what would your attrition will have done? I mean, would it have come back a bit given the 2 points of raising pressure across the book, or is that more than offset by mix change?

A - Martin Lindsay Bride {BIO 15458196 <GO>}

I think both of the last statements are true. So, we all see adjusting mix to allow for perspective profitability, as Andrew said during the presentation. So, there is some offsetting that happens. As I said in the press, though, we didn't use the catastrophe reserve that we've budgeted for in 2016. And I guess if add that back, if I normalized for that, the combined ratio would be up by a couple of points.

Thank you.

Q - Nick Johnson {BIO 1774629 <GO>}

Morning. Nick Johnson from Numis. Three questions, firstly, on cyber, there's been a bit of comment recently about potential misselling. I just wondered if you could give your thoughts on that topic and perhaps give us a feel for what controls you've got in place?

Secondly, I'm just wondering if you could possibly discuss the international specialty lines expansion a little bit in terms of how do those markets differ to the U.S., where are the opportunities and why are there opportunities internationally?

And thirdly, on political risk, to what extent is the combined ratio of 75% an anomaly? How much of that is down to low terror planes, and how much of it is down to the core political risk book? Thank you.

Well, sorry. I'm not sure what you're specifically talking about, Nick, on the cyber misselling. We sell all our products through brokers, professional advisers through our clients, and

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the development of that product really depended on our brokers getting a full understanding of the advantages of buying standalone cyber products alongside conventional coverage, which may also have some cyber exposure in it. So, my observation would be that saves us (48:34) somewhat from the misselling risk.

Political risk continues to experience relatively good run, I think. We have seen the increase in some terror activity, most of that tends to be focused on (48:55) although we have also experienced an increased frequency of physical damage losses. So, I would say that with pricing coming down in terror and an increased frequency, we should expect margin to be squeezed in that part of our political account. I'm sorry, what was the middle question?

Q - Nick Johnson {BIO 1774629 <GO>}

Question on national markets and differences to U.S.

Our approach in SL International, if I step back one, what are the drivers for this initiative right now, first one, I think I would identify is that a lot of agents, customers, are global customers, and those customers are looking for a globally relevant insurer. So, one that is equally relevant, equally prominent in the international markets, as well as the U.S. markets. So, I think that's one driver. The second driver, I think, is this opportunity that we see in cyber and being relevant across a product set, alongside cyber, I think will help us make the most of that opportunity. Our approach is going to be quite segmented and targeted, so we're going to focus on our preferred lines of business.

As you know from a few years, within specialty lines, we have focused on what we see as growth industries like healthcare, like technology, and we will continue with that in the international markets as well. And I think that will lead to us having a fairly distinctive portfolio relative to existing markets in international specialty lines.

In terms of geography, Europe, obviously, is a significant opportunity, but we're also looking at Miami, Singapore. So, it is a global initiative.

A - Martin Lindsay Bride {BIO 15458196 <GO>}

Anybody else, Eamonn?

Q - Eamonn M. Flanagan {BIO 14018002 <GO>}

It's Eamonn Flanagan with Shore Capital. Sorry, just a couple of questions. Firstly, Martin, going back to your comment about running yields. I see the duration of the book has dropped quite sharply and the bond portfolio. So, are you still comfortable with that guidance, 25 bps more this year than last year? And in that context, is that drop in the duration a market call?

And then, the other area question is going back to the expense ratio, is there anything you'd do to compete against the increase in brokerage? What are the dynamics there? And then we noted one of your peers have to change its policy on deferred acquisition cost, are they in line with you, or do you have to review yours, et cetera?

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A - Neil Patrick Maidment {BIO 5232207 <GO>}

I'll leave you brokerage, shall I? Yeah. So, I think, yes, I think I'm comfortable with, so this time last year, we would have expected a 1.5% for 2016. So, I'm comfortable guiding 1.75% for 2017. As you yourself said, Eamonn, I think the possible range of outcomes is wider than it's ever been because we could easily have a risk off year in 2017. I did actually put some extra words in the report accounts on deferred acquisition costs. The one big area of judgment is how you treat underwriters' costs, and we only deferred their base salary. So, our view of our approach to deferred acquisition costs is we are deferring towards the lower end of the recent judgment, and we defer towards a, what I call, the lower and therefore prudent, and we're not expecting to change our approach in any way.

Eamonn, on brokerage, there is pressure on brokerage, not surprisingly, because the brokers are under pressures, especially the largest business in London, where the rates have come down. They're often on commission-based revenue, and therefore, they look for other sources of revenue to counter that and the best way of doing that is increasing the brokerage, which means potentially, we get, possibly, get less. We don't tend to find the same pressure in the U.S. business as we do in the EU (53:30) business. How do we actually respond to that? Our aim is to deliver something of value to them, so that we can actually mitigate or reduce brokerage because the best way of generating more revenue, if everybody is actually generating more business for everybody.

Q - Eamonn M. Flanagan {BIO 14018002 <GO>}

Sorry. I just had a follow up question. I'm just trying to decide whether I need to concern myself with the direction of the surplus in reserves slide just coming back to that one, 6.6% at the end of 2016. I'm just thinking, the reason it's fallen, partly some of the surplus, that was recession uncertainties come out, I guess.

And secondly, as your specialty business grows, and particularly things like cyber, where there's a large degree of uncertainty and final loss outcome, there's probably a high degree of concern in the actuarial best estimate. Is that fair? I'm just trying to touch...

In my view, there's no reason why it's fallen, because we're not trying to work through an accurate number. This is the end game of a very detailed bottom up process. So, there's no reason why it's fallen, as long as it's within the 5% to 10% range when we've done the bottom up review of actuarial numbers (54:41)

Q - Eamonn M. Flanagan {BIO 14018002 <GO>}

So, it's more the peaks at eight (54:43) is slightly anomalous?

A - Neil Patrick Maidment {BIO 5232207 <GO>}

The whole process is an art rather than science, (54:48) is here, so maybe when the formal session is over, I'm sure she'd be happy to talk you through some of the challenges of the business.

Q - Eamonn M. Flanagan {BIO 14018002 <GO>}

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I'm sorry. When you say it's above, it's not above the midrange of your best estimate. It's above the upper end of your range of best estimates, is that?

A - Neil Patrick Maidment {BIO 5232207 <GO>}

Yeah. Well, I think if you look at, juts to emphasize, I think it's important, if you read the reported counts, the X axis of that chart is an actuarial estimate, which has prudence in it.

It's not the best asset.

A - Neil Patrick Maidment {BIO 5232207 <GO>}

It's not a margin over best asset. It is margin over an estimate that has some prudence in itself. So, Andrew, it's sort of higher, a 50-50 number is, no, only having 6% above the 50-50 number would be quite tight reserving.

Wendy (55:35), I think there's a question right down the end.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Hi, guys. I'm Faizan from Bernstein. I guess, more of an actuarial question. In terms of the reserved set or on a substitute technical vision basis, do you strip out that prudence from actuarial side? So, would you have a best estimate in that figure?

A - Neil Patrick Maidment {BIO 5232207 <GO>}

Yes. The way we do Solvency II reporting both to Lloyd's when we start the group, and Solvency II is quiet clear. You do best estimate reserves. And our view of our Solvency II balance sheet, it is precisely that true best estimate. Yeah.

Anything else? Great. Thank you for joining us. We're going to be around to address those questions. Please feel free to just ask.

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