S1 2020 Earnings Call

Company Participants

- Penny James, Chief Executive Officer and Executive Director
- Tim Harris, Chief Financial Officer and Executive Director

Other Participants

- Abid Hussain, Analyst
- Andreas van Embden, Analyst
- Andrew Crean, Analyst
- Dominic O'Mahony, Analyst
- Edward Morris, Analyst
- Freya Kong, Analyst
- Jon Denham, Analyst
- Kamran Hossain, Analyst
- Oliver Steel, Analyst
- Thomas Bateman, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to the Direct Line 2020 H1 Results. My name is Rachel and I'll be coordinating today's call. (Operator Instructions)

I will now hand over to your host Penny Wilson to begin. Penny, please go ahead.

Penny James {BIO 15157212 <GO>}

Good morning, everyone. Thank you for joining myself and Tim today for our half-year results presentation. I'd like to start by saying how incredibly proud I am of everything that we've achieved so far this year. Being in this position, given the unprecedented environments we've been trading in, it's a testament to our strategy and our people.

Starting with the highlights on Slide 3, we focused on being a force for good and have supported our customers, our people, key workers and local communities through the crisis. And we traded well. The momentum we saw at the end of 2019 and into Q1 has begun to return. We delivered 2% growth in our direct own brands policy count, operating profit of GBP265 million, and improved the quality of our earnings even before COVID effect. Our financial resilience in the face of COVID-19 disruption has enabled us to reward our shareholders' patience by paying a 2020 interim dividend, as well as the catch-up of our 2019 final dividend. And finally, our strategy helped us navigate testing first half whilst making great progress on our technology transformation.

Now, you may recall our vision, purpose, and strategy on Slide 4. I'll talk more to our strategy later. But it was designed to give us competitive advantage to how to change and adapt and be more resilient so that we can improve margins on the business we write and ultimately grow. Now, there's no doubt that this has been a testing period and our strategy hasn't just helped us through the crisis, it's enabled us to accelerate our plans in a way that we simply couldn't have entertained 18 months ago and consistent with the vision that has customers, people, and society at its heart, we've achieved the success by doing the right thing for each of our stakeholders.

Throughout the pandemic, we focused on the physical and financial well-being of our people, supporting our customers and contributing to the national assets. And by doing so, we believe that we are protecting the business for the long term. Repair centers aside, we moved almost all of our people to home working, that's around 9,000 of them and rather than access government support, we chose to protect everyone's salaries and roles through to the autumn.

For our customers in financial difficulty over the altered circumstances, we've reviewed cover, waived cancellation fees, offered the option to defer direct debit payments and refunded customers who are driving fewer miles due to lockdown restrictions. And that's in addition to plying 800 customers stuck abroad back home.

We played our past in the national effort by helping key workers with free Green Flag recovery and free home emergency cover. But we've also helped around 100,000 of society's most vulnerable households through our GBP3.5 million community fund and we've contributed a similar amount to the ABI's COVID support fund. In all, we expect to invest around GBP80 million to GBP90 million across 2020 on these initiatives and I believe it helps protect the business for the long term.

Now, we couldn't have done all this without our highly engaged people who have shown the commitment and flexibility to do what it takes for our customers, resulting in high levels of customer satisfaction. It's been a real 11,000 strong team achievement and I'd like to thank all of them for their contribution.

And with that, I'll hand over to Tim to talk you through the financials.

Tim Harris {BIO 16707496 <GO>}

Thanks, Penny, and good morning, everyone. This has been a very challenging first half and I believe the business can be justifiably proud of how we've traded through the period. I would like to start with the key messages before we explore the detail.

I'm starting my presentation on Slide 7. We came into the year with strong trading momentum and despite COVID-19 uncertainty in quarter two, we delivered a 2% growth in own brand policies in the first half. Today, we are reporting operating profit of GBP265 million. When we adjust for the storms experienced in Q1 and the change in the Ogden discount rate to minus 0.25% in 2019, our operating profit is GBP5 million higher than last year. Importantly, we continue to improve the quality of our earnings with current year operating profit estimated to represent 52% of total operating profit in the first six months of this year, excluding the impacts of COVID-19. Our expense ratio increased in the first half to 25.2%, reflecting the additional costs we incurred to support customers, people, and the national effort through the crisis.

However, we continue to target an expense ratio of 20% by 2023. These savings will be delivered through the benefits of our technological transformation and we took the first steps towards this through the office closures and redundancies we announced in February. Our combined operating ratio was 90.3%, below our 93% to 95% medium-term range, reflecting the claims frequency benefits coming through our Motor book due to COVID-19.

We recognize the importance of dividends to our shareholders and having taken steps to strengthen our capital and liquidity and observed a mass improvement in credit markets, as well as a greater confidence around travel and business interruption claims. We believe it's appropriate to catch up on the 2019 final dividend of 14.4p. Even after the dividend catch up and an interim dividend of 7.4p, our solvency is a very strong 192%.

Turning to the results summary, the shape of result reflects the consequences of COVID-19, including the significant reduction in motor claims frequency, the impacts on our investment returns and the additional costs that we incurred supporting our customers, our people, and society. Strong Q1 trading across our own brands offset the headwinds in Q2 and delivered modest premium growth of 0.4% in the first half. Although, we delivered strong growth in Q1, reduction in Q2 will have an impact on earned premiums in future periods.

Underwriting profit was GBP144 million, well ahead of H1 last year, largely due to the Motor frequency benefits we saw at the start of Q2 due to the COVID-19 lockdown. Installments and other income was lower in H1, which is largely due to lower written volumes in Q2 and lower claims-related income. Investment return reduced to GBP41 million in the first half due to a combination of lower income and higher realized losses mainly on our commercial property portfolio. That brings us down to operating profit of GBP265 million, marginally lower than prior year as the stronger underwriting results was more than offset by lower investment return and the Q1 weather events.

Turning to Slide 9, and here we have split-out the management estimates of the impacts of COVID-19 on the group's operating profit, which you can see was broadly neutral. This takes into account changes in the claims environment, costs associated with supporting customers, people and wider society and movements in our investment portfolio. As I've said, our headline operating profit was GBP265 million in the first half compared with GBP274 million in 2019. Last year, we had very benign weather and the results included a hit from Ogden. Adjusting for these, there was a modest growth in profit of GBP5 million.

We estimate the net impact of COVID-19 on the group to be around GBP7 million benefit, which you can see broken down in the table on the left hand side. We haven't seen much impact in Home at the moment, but that may change as claims develop in the second half of the year. That leaves us with a broadly flat underlying profit year-on-year, but there has been a real increase in quality with a GBP63 million growth in current year profits, offset by the continued reduction in prior year reserve releases. This is a good result and demonstrates the progress being made in increasing the sustainability of our earnings and we are well on track to deliver 50% of our operating profits from current year by 2021.

On Slide 10 is a summary of a breakdown of the 90.3% combined ratio. The group current year attritional loss ratio, which is the current year loss ratio excluding weather, improved by 8 points. We estimate the impacts of COVID-19 is around 4 points with the rest due to underlying improvements, some of which will come back in the second half. Our weather estimates from Q1 are unchanged at GBP30 million, which is around 2 points of loss ratio. The prior year loss ratio was 3 percentage points lower as Motor prior year continued to reduce in line with our expectations, alongside the timing of reserve reviews in Home. That gives us a group loss ratio of 59%, which is around 3 points lower than H1 last year.

Next, the expense ratio is higher due to actions taken on COVID-19 and the commission ratio is flat. Finally, the annualized return on tangible equity was a strong 19.9%, ahead of our 15% long-term target.

On Slide 11, we've split out the operating expense movements half-on-half which increased by GBP9 million. The expense ratio tends to be higher in the first half of the year. And the increase against H1 2019 was driven by higher levy costs alongside the actions taken to support our customers, people and wider society during the COVID-19 uncertainty, which Penny will share more on later. Other costs have reduced GBP3 million with lower staff costs and amortization and depreciation, partly offset by higher other operating expenses.

In terms of our outlook for operating expenses, we estimate we will incur a further GBP20 million to GBP25 million of COVID-19 related costs in H2. The additional costs we incurred to support our customers protect our people and society do mean we have delayed the downwards trajectory of our cost base. We remain committed to becoming a more efficient organization and reiterate our targets as outlined on the Capital Markets Day in November last year to move to a 20% expense ratio by 2023.

As I mentioned earlier, the key actions that deliver this reduction are linked to our investments in technology and changes to the way customers interact with us with a shift towards digital channels. This will also enable us to review our proxy footprint and you will remember that, in February, we announced the planned closure of two of our offices. Our new systems will help us to reduce costs further over the next year or two as they become embedded in our operations. And we will now look for additional savings that may arise from the changes in customer and workforce behavior following the pandemic.

Let's turn now to Slide 12, which shows performance across policy counts and premiums during the first half. From a trading perspective, the first half has really been a tale of two quarters. Starting with policies on the left hand side, which are split between own brands and partners. In the dark blue bar, you can see the 2% own brand growth versus June last year. If you look at the individual data points, the own brand's policy count grew quarter-on-quarter with a very strong Q1 and a slowdown in Q2. On the right hand side, our premiums, which is at group level, were broadly stable. In the darker blue sections, you can see growth across own brands was strong at 5.6% in Q1, but fell 2.9% in Q2 due to reduced Motor new business premium, following lower new car sales and new drivers to the market.

We now get into the segmental results starting with Motor on Slide 13. Operating profits in Motor of GBP221 million was well ahead of prior year, largely driven by the impact of COVID-19 lockdown restrictions on claims frequency, partially offset by higher average repair costs, lower instalments and other income and lower investment return.

On the ratios, you can see a really strong H1 current year performance. Of the 18 point reduction year-on-year, we believe approximately 10 points is COVID-19 related, which leaves around 8 points of underlying improvements. This was delivered by underwriting and counter fraud initiatives introduced throughout 2019. We started recognizing the benefits from these initiatives in the second half of 2019, meaning the 2020 full-year improvements in the underlying current year loss ratio will be lower than in the first half of this year, but we still aim to demonstrate year-on-year progress against the full year 2019 current year loss ratio of 81.2%.

On the next slide is more color on Motor trading. I'm not going to go through all of the moving parts as we've commented on the slide. A few points I would like to mention are, the strong positive growth was largely driven by Churchill and Darwin, which have both performed extremely well on price comparison websites. This demonstrates good progress on our PCW strategy, which Penny will talk about later.

As I mentioned before, the pricing environment in Motor has been somewhat distorted due to actions taken to help customers and the impacts of lockdown, driving a reduction in new car sales and young drivers entering the market. This has led to a 3.4% reduction in risk mix. We continue to price for our view of underlying claims inflation on new business, with some caps placed on the newer pricing increases in Q2 as the group focused on delivering strong retention. In addition, many of our customers have also taken the opportunity we provided to reduce their premium, reflecting their lower car use. Overall, risk-adjusted prices increased by 1.8%.

On the claims side, frequency has been increasing since the initial 70% reduction in claims notifications we called out in April while the impacts on claims severity is too early to assess as very few claims have been settled during this period. As a result, we continue to expect underlying claims inflation of 3% to 5%. In terms of the outlook for Motor, we expect some headwinds as the top line impacts begin to earn through.

Now turning to Home on Slide 15, Home profit was GBP35 million in H1, GBP36 million lower than H1 2019, but a strong result considering the weather events in Q1 and the exceptional performance in 2019. In terms of ratios, Home's current year attritional ratio, which excludes the impacts of weather, continued to improve following actions taken on escape of water claims in 2019. The combined ratio normalized for weather was around 5 points higher than prior year due to a reduction in prior releases, although, there are some timing differences here. So some of it should come back by the end of the year.

On to the Home trading slide, you can see the Q1, Q2 shape on the policy volumes and premiums. I'd just make a couple of observations. Overall, we are pleased that we grew own brand's policy count since the end of December and this was due to a strong performance by Churchill in the price comparison website channel and strong retention over the period. Gross written premium was broadly level, which reflects the continued shift towards price comparison websites. While PCW business attracts lower risk and lower average premiums, our team are making great progress on trading profitably through this channel.

Moving onto Rescue and other personal lines on Slide 17, let's start with the overall results for the segment, which was a GBP16 million loss. There are two main moving parts in this, namely Travel and Rescue. Starting with Travel, where we estimate the net impact of COVID on the book to be approximately GBP25 million. This assumption is based on the same criteria we set out at Q1, namely that the Foreign & Commonwealth Office restrictions on international travel remain in place until the end of September. As we now know, this is quite a conservative assumption. The main risk to this figure is around the financial failure of airlines or travel companies.

In Rescue, the H1 operating profit result was a very strong GBP24 million, GBP3 million higher than H1 2019, which helped partially offset losses in other personal lines. The growth was mainly due to lower claims frequency following the COVID-19 disruption which has since returned to normal levels. In terms of Rescue trading, you can see that Green Flag had a very strong Q1 as it continues to deliver double-digit premium growth before COVID-19 drove a material reduction in new business sales in Q2.

Finally, the commercial results on Slide 18. Commercial profit was GBP25 million in the first half, which is a strong result when you consider the GBP13 million of weather event costs. The net impact of COVID-19 in commercial was slightly positive, up GBP4 million or 0.1 points of loss ratio as the estimated impact on business interruption claims was more than offset by a reduction in claims frequency during lockdown. As outlined with our Q1 results, our standard business interruption policy wordings on which over 99.5% of policies are written, provide cover only for certain specified diseases and do not provide cover for losses due to the COVID-19 pandemic. For those policies not on our standard wordings, we continue to estimate claims costs of approximately GBP10 million.

As you can see from the ratios, commercial improved its current year attritional loss ratio which is the result of the investments in NIG pricing and underwriting initiatives beginning to come through with rate increases above 5%. This delivered a combined operating ratio normalized for weather that has improved around 5 points year-on-year.

Turning to commercial trading on Slide 19, here you can see the commercial group premiums and policy volumes in both Q1 and Q2 to end the first half 5.3% ahead of prior year.

Moving on from trading performance, let's now turn to investment return on Slide 20. The total return of GBP41.3 million in the first half was GBP34 million lower than prior year due to lower net investment income, some losses on our commercial property portfolio, and the non-repeat of gains recognized in the first half last year.

We've recognized GBP14 million of realized losses in the period of which the majority was due to revaluations of our commercial property portfolio. In the middle graph, you can see that our commercial property investments accounts for just 4.6% of the portfolio. The majority of our portfolio is held in either investment grade, credit securities, or cash. Our cash holdings have increased over the period as we took the prudent decision not to reinvest as debt securities came to maturity, although we have now begun reinvesting. We have seen no material deterioration in the quality of our credit securities during H1.

From a yield perspective, you can see that the realized losses reduced our investment return yield to 1.4% while net investment income yield reduced to 1.8%. At Q1, we updated the net investment income yield expectation for the year to 1.8% which we reiterate today.

Here on Slide 21, we have presented the capital ratio in a waterfall [ph] so you can see how our solvency ratio has progressed across half. On the far left, you can see the results of the prudent decision we took in order to maintain a strong solvency position. After those actions, our solvency ratio was above the top of our risk appetite range at 189%.

On to the bars in the middle of the waterfall. First, in order to help secure the long-term finance of the group, we issued GBP260 million of Tier 2 debt at a 4% coupon. I was pleased to see a strong appetite for the transaction which was 16 times oversubscribed. Our existing Tier 2 debt instrument issued in 2012 has a call date during the first half of 2022, but at least until then, this provides a useful capital and liquidity buffer. Importantly, the debt issue represents the first step in our work to secure the long-term capitalization of the business that I discussed at the Capital Markets Day last year.

You can see, capital generation is a strong 25 points of solvency or GBP350 million due to the progress made on current year profitability, alongside a reduction in claims frequency seen in Motor. Market movements is predominantly impacted by increasing credit spreads, which delivered a 6% headwind in the first half, though, narrowed significantly across Q2.

Capital expenditure was around GBP70 million in the first half and we reiterate our GBP150 million expectation for 2020. So, overall, our solvency ratio at H1 before any dividends was 213%. This strong solvency ratio means we are able to declare a 2020 interim dividend of 7.4 pence, alongside a full catch-up of the 2019 final dividend, the 14.4 pence. While significant market uncertainty remains from COVID-19 and other issues like Brexit, we recognize the importance of our dividends to our shareholders. And believe it is now appropriate to catch up on the 2019 final dividend.

Specifically, we have seen a marked improvement in the credit market since we canceled the dividend in April as well as a greater sense of certainty around how claims will be impacted by COVID-19 in particular in relation to travel and business interruption. Going forward, we will continue to be prudent in our management of the capital and liquidity resources of the group.

In normal circumstances, operating around the middle of our 140% to 180% risk appetite range remains appropriate. We do, however, need to acknowledge the unusual situation within which we are all operating, including the direct impact of COVID-19 and the consequences of the pandemic on the wider economy, including our customers. Accordingly, you can expect us to continue to be prudent in our management of our capital and liquidity. As usual, the Board will consider our overall position again with our full year results.

Before I hand back to Penny, I'd like to remind you of our targets. We are re-estimating our medium term expense ratio target of 20% in 2023. As outlined earlier, our trajectory to get there has been modestly delayed and so we may not be able to achieve the GBP50 million saving by 2021 we talked about in November last year. We are focused on improving our cost profile by delivering on the actions we had identified before the pandemic and some of the new opportunities that will arrive as a consequence of changes in behavior as a result of the pandemic.

For 2020, we reiterate our targets of a combined operating ratio of 93% to 95%, normalized for weather and we anticipate our restructuring costs of GBP60 million over 2019 and 2020 will be incurred in full as we strive to maximize the opportunity for operational efficiencies. We remain focused on a targeted combined operating ratio of 93% to 95% normalized for weather in 2021 and over the medium term and on improving the current year contribution to operating profit to at least 50% by 2021. I should [ph] acknowledge, these will inevitably depend on the duration and uncertainties of the COVID-19 pandemic and the pace of economic recovery and consequential impacts on customer behavior. We expect a net investment yield of 1.8% in 2020 and continue to invest in force for good activities. We reiterate our long-term 15% return on tangible equity target.

Thank you. I'll now hand back to Penny.

Penny James {BIO 15157212 <GO>}

Thanks, Tim. Now before I get into the detailed update, let me start by sharing with you how I feel about the last six months. While it's hard to believe that only eight months ago we established our vision and strategy for the group, though uncertainty remains for us all, I'm really pleased with the substantial progress that we've made in the first half against the strategic objectives, whilst also implementing significant operational changes as we've navigated the COVID-19 disruption.

We've shown we were a team that can make change happen even during a crisis. You can see some of the highlights in the slide and I'll explore these in more detail shortly. We haven't just survived during this period, we've thrived. Our people have delivered a great performance at every level of the business, all done with the creativity you've come to expect from us, from the new Direct Line superhero creative to Churchill's Little Chapters of Chill podcasts designed to help kids in lockdown.

But as you know, a large part of our strategy relies on the delivery of material technology. And what you can see from this slide as well is that, overall, our ability to deliver big change has not slowed during lockdown. Now, there still remains a lot to do through the rest of 2020 and into next year, so we are in an excellent shape and we're becoming an agile and digital company, which is people and customers as well as the world around us at its heart.

Now moving on to Slide 26, our tech transformation has continued at pace. Moving from left to right, following its launch last year, All Privilege new business is now sold on the new platform. Our in-house startup Darwin has gone from strength to strength and it is now live on four PCWs. The Green Flag team launched their new claim system and in just two weeks, they made more enhancements on it than they had in the last four years on the old system. That is agility.

Direct Line for Business rolled out another key product, Van, onto its new platform. And the NIG team continues to move products onto the pricing and underwriting systems, which helped drive some of the growth Tim discussed earlier. While all that was going on, our finance team delivered a new cloud-based Oracle accounting ledger and claims payment system during lockdown and we rolled out a new telephony system across CSA. [ph] These changes are material in terms of both delivery and impact.

Taken together, they involved training 7,500 colleagues and effects every customer conversation and every claim. (inaudible) near the end of the tech transformation, we moved firmly into the business transformation phase for the next couple of years, changing the way we operate to take advantage of the tools we are building and targeting larger [ph] improvement across the portfolio as we realize the full benefits of our tech investments.

So let me talk you through the progress against our six strategic objectives. The design is to help us become a more competitive business with a lower cost base. The aim is to support the shift in quality of earnings evidenced by the GBP63 million improvement we've seen this half and grow our market share.

Looking at the first three on Slide 27 which are all about making sure that our products are easy to use and available everywhere. Let's start with Best at Direct, which is where our margins are the strongest. In the first half we've launched a new superhero creative with Direct Line highlighting the brand's unique proposition. We've been working on some new fractional products and you may have seen, we recently announced our acquisition of Brolly, a small fin-tech company that specializes in flexible personal life insurance for the digital generation. So watch this space.

Moving to winning on PCWs, since I joined the group, I believed that we could grow our profitability in the PCW market. As a result of the improvements we've made, we're beginning to make real headway. A key part of our 5% premium growth in Q1 was Churchill's growth of 15%. Our Churchill brand has gone from strength to strength since the brand refresh and Churchill Motor has recently passed the 1.5 million policy milestone and we hope to continue this growth. Darwin has outperformed all our expectations, writing more business in Q1 2020 than the whole of 2019. And in Q2, it's still on a steep growth trajectory.

Moving to our third strategic objective, extending our reach. Our new customer platforms make it much easier for us to on-board new books of business. We're now in a place where we can scale up and this opens the possibilities to explore growth opportunities through partnerships and acquisitions.

Now moving to our three key enablers, starting with technical edge. Here, we aim to create a great experience for our customers and a sustainable competitive advantage. Throughout lockdown, digitization levels have transformed. In Green Flag, we saw the number of people accessing the app move from 12% to 35%. In Motor, digital customer interactions have grown around 40% and now represents 55% of transactions. And there is a similar picture in Home claims. And in Travel, which has had a particularly busy period, a new claims triage process means we can handle claims up to five times faster. The technical improvements we've made over the past 12 months have enabled us to deliver around a 5 percentage points improvement in our attritional current year loss ratio in half year 2020.

As said before, we are not yet a nimble more cost effective as we believe we can be. It's a reality in a market as competitive as ours that efficiency is critical. And that's why hitting 20% in 2023 is one of our key targets. We've made huge steps forward this year, some of which myself and Tim have already outlined. One of the few silver linings of COVID-19 is the fact that it opens the possibilities for us to re-imagine the way we work.

For the full year, we set out our agile transformation plan, and after only a slight delay, this transformation will go live in October. It will really help us to speed up getting changes and new products to markets, so that we can keep ahead of the competition. The world of home working means we can be less constrained by our physical office locations which not only gives us access to a wider pool of talent, so we can be more diverse and inclusive, but it can also potentially support significant cost efficiencies. We're currently looking how we use our buildings in the future to best support the cultural change and cost structure we are seeking.

Finally, and most importantly, great people. As you've heard, the pace of delivery during the first half was all made possible by our highly engaged people who have demonstrated their commitment to improving this business. Not only have they learned new skills and delivered exceptional results, but they have also refused to let systems stop them doing what matters to them, including the annual Sprintathon event, involving 350 of our people, which led to GBP110,000 being donated to Stand Up To Cancer. It also helps to support around 200 local charities with grants of up to 5,000 each as part of our community fund. And our Mental Health First Aiders have ensured that everyone has had the access to the support they need during these challenging times.

This period is probably one of the most disruptive that we will see in our lifetime. Customers overnight have changed their behaviors dramatically. As you can see on the slide, there are a number of underlying trends you need to be in front of to thrive in the post-COVID world. Of course, none of them are really new trends. And our strategy was built within the mind that many of them have been accelerated significantly as a result of COVID-19.

This has just increased the importance of our strategy and shown us that to win in the future, you need to be agile, digital, and flexible, both for your people and your customers. You need to have the ability to create new channels and products and get them out to market quickly. And that's what our strategy and agile transformation is helping us to achieve, making it easier for us to act quickly to serve our customers better.

But we also want to do this in a way that's sustainable. The past months have reminded us of the importance of the community and the world around us. When we have, as I'm sure we will, cracked COVID-19, the climate crisis will still be there. And customers will rightly demand our organizations play that part in addressing this.

Turning to Slide 30 then. Fundamentally, we believe that embracing sustainable practices leads to a better corporate culture, more reliable product and greater long-term sustainability. We have long been conscious of our impact on the planet. And as you can see, we've already met both of our 2020 targets, which we set in 2017. So we now look to go further to protect our business from the impacts of climate change and to give back more to the planet than we take out.

To help the business achieve this, we are committing to set science-based targets which are consistent with holding the global temperature rise to utmost 2 degrees above pre-industrial levels. And we intend to do this across all categories of our emissions, including the supply chain. In the meantime, from this year, we will be a 100% carbon-neutral as a business by offsetting our emissions by investing in high impact projects, whilst working towards reducing our emissions over time. And finally, we aim to be TCFD-compliant by the end of this year.

So that is the report for the year so far. As we move to the latter stages of the tech transformation space, we need to make sure that the business is ready to realize the full benefits of the investments we've made and that is our priority for the remainder of 2020. We intend to get our cost base back on track as we continue to target the 20% expense ratio by 2023.

COVID-19 has meant extra investment in the force for good initiative I've mentioned and some delays to our programs. But notwithstanding this, our business and tech transformation are starting to drive material cost savings, helping us to improve the quality of our earnings. From the autumn, a thousand of our people across motor, home, partnership, marketing, digital and technology will operate in a fully agile way, making it easier for us to implement change and quicker to service changing customer needs. And we will move Direct Line and Churchill Motor onto the new platform, helping us to deliver most to our customers quickly.

Taken together, these are designed to lay the foundations for the future growth of the business. So this is the investment case that we presented to you at our Capital Markets Day. Whether it's people and customers at the heart of our business, increasing our competitiveness, or improving the quality of our earnings, each has stood the test of COVID and remain as relevant now as they were eight months ago.

So, in conclusion, I believe today demonstrates that notwithstanding the environment, we are in excellent shape. We focused on being a force for good and have supported our customers, people, key workers and local communities through the crisis. We've traded well and our financial resilience in the face of COVID-19 disruption has enabled us to reward our shareholders' patience by paying a 2020 interim dividend, as well as a catch-up of our 2019 final dividend. And finally, our strategy has helped us navigate the testing first half while making great progress on our technology transformation.

So that ends our half-year presentation. Thank you very much for listening. And Tim and I will pass back to Rachel to coordinate the question-and-answer session.

Questions And Answers

Operator

Thank you, Penny. (Operator Instructions) Our first question comes from Kamran Hossain from RBC. Kamran, your line is open. Please go ahead.

A - Penny James {BIO 15157212 <GO>}

Hi, Kam.

Q - Kamran Hossain {BIO 17666412 <GO>}

Hi, Penny. Hi, Tim. Two questions. One is on -- both on the current year attritional actually. I guess it's really pleasing to see the measures coming through. You talked about 8 points improvement coming from these measures in Motor. Are there any other measures or kind of projects you've got on track that should kind of improve that further? So that's the first question. And then the second question is, you've improved the current year attritional quite a bit. You talked about the potential for transformational reinsurance once you do this. Are we getting a little bit closer to that or am I just getting way too excited? Thank you.

A - Penny James {BIO 15157212 <GO>}

Tim, do you want to take the attritional questions?

A - Tim Harris {BIO 16707496 <GO>}

Yeah.Thanks, Kamran. So I think you're right to point that we are pleased with the improvement on the Motor attritional 18% improvement. About 10% of that's COVID, which means 8% isn't. So we do have lots of things coming down the line actually that we hope we will maintain that advantage and potentially improve. And it -- some of it is a bit further down the line. If you think about the changes we're making to our underlying systems, lots of those drive changes through our pricing and underwriting practices, which is exactly how you'd expect us to be trying to maintain that competitive advantage. So, that I think is very good news.

I should say, just for completeness, that 8 point improvement will not look as good by the end of the year just by the way things earn through. We have half year's benefit last year in effect. So we do a have a bit of a comparative thing going on. But last year, overall, we finished at about 81.2% overall and we certainly hope to be on the light [ph] side of that by the time we get to the end of the year.

In terms of transformation of reinsurance, rest assured, we think about that quite hard, although we've had quite lot other things to think about quite hard in the first half of this year. And certainly the improvements we make and this transition towards a higher quality of earnings in the current year would be an enabler to doing that on a really competitive basis. I haven't got anything to tell you about today, but you can see that we're starting to make progress on that which is broadly part of our overall capital journey and you saw a first step on that through the debt raise that we did in May. So that's all part of our broader plan to think carefully about how we provide the risk capital of the business. And as we come up with more ideas, obviously, we'll let you know.

Q - Kamran Hossain {BIO 17666412 <GO>}

Tim, Penny, thanks very much.

A - Penny James {BIO 15157212 <GO>}

Thank, Kam. Rachel, have we got any other questions?

Operator

Our next question comes from Jon Denham from Morgan Stanley. Jon, your line is open. Please go ahead.

A - Penny James {BIO 15157212 <GO>}

Good morning, Tim.

Q - Jon Denham {BIO 19972914 <GO>}

Good morning, Penny and Tim. Thanks for taking my questions. Just coming back to Kam's question on the attritional, when stripping out COVID, it looks like the Motor attritional was around 75%. Tim, you mentioned headwinds (inaudible) premiums earned through. But I'm just wondering what would cause this to increase to the 81.2% in 2H that you just mentioned? And what are the additional headwinds there? And then maybe just a bit more on -- from Motor pricing. And you said risk adjusted prices increased by about 1.8% year-on-year and half and you said it was a tale of two quarters. So I was wondering if there is any more color you could give around what the changes in risk-adjusted prices looked like during 2Q and maybe into July. Thanks.

A - Tim Harris {BIO 16707496 <GO>}

So I'll take that one as well, Jon. Thank you for those questions. If it's okay, I'm going to answer your second one first and perhaps just take the opportunity to step back a bit and give you a bit more color about what was going on in terms of the pricing trends in the Motor book.

So, as you know, first quarter, really pleased. Very positive rating period, carried over the positive momentum we saw in the last part of last year. Certainly much better than the first half of 2019. Our price increases were sticking. We were seeing growth. We were certainly pricing in our longer-term claims inflation assumptions. So that was all very positive. And then of course we ended up with COVID-19, introduced a huge amount of noise into the system and obviously working through that, there's been a number of factors.

The first thing I'd point to, which is probably the most significant on premiums overall is the effects of risk mix and it's important not to underestimate the effect of that huge reduction in new car sales and also a reduction in new drivers to the market as driving test was suspended. And that really meant that some of those higher average premium policies weren't getting written. And so you saw a reduction in premiums as a result of risk mix issues. But we also saw some effects on the risk-adjusted rate increases coming through, partly because of some deliberate actions we took. So we've put through some targeted caps on renewal prices.

When we first went into lockdown, our operational prioritization was to look after our existing customers. We actually closed down the telephone lines for new business sales on the direct channel for couple of weeks. And that meant that clearly there was some action needed to make sure that we could improve retention. So, as I say, for a temporary period, we've put through some targeted caps on pricing increases on renewal. They were successful. And we've seen renewal rates respond positively, but that did have an impact on the rate increase we are seeing excluding the mix results. That is now working its way through, but certainly had an impact on the second quarter.

It's also true to say that we are seeing some stuff going on in the market more generally. You can see this actually in the ABI data that came out from May. Some price reductions coming through in some parts of the market. Certainly, that was a feature end of April, May time. We think it's stabilized more in June. And then of course the real question of course is what does that mean over the coming months and the honest answer is, of course, we will have to wait and see. But I'd just point to some of the factors, which I think are going to make a difference.

First of all, we are seeing the miles driven come back to slowly the kind of levels we were seeing pre-COVID. I think it's important though to say that this change in driver behavior and, if you like, the nature of the miles that are being driven and that does make the effect that we are seeing in claims and therefore the unknown [ph] impact on pricing is somewhat uncertain. Staycation is potentially a feature. But we won't really know until we see the schools go back in September and to see how much we see people going back to work on the back of that and how that will affect the performance of the market.

So how pricing behaves of course will depend on how individual companies predict future claims patterns. We remain committed to our practice, which is to continue to price on the basis of what we think long-term claims inflation will be. Of course, that depends on knowing what that long-term claims inflation will be. We think it will be -- continue to be within that 3% to 5% range blended for frequency and severity. Obviously, we will see how the companies respond to that. We do continue to believe, though, the behavior in the market will be rational and so we remain optimistic over the medium term that the pricing environment will be satisfactory for our purposes.

Coming back to your first question, which was about, we get to 75% and how do we get back to something more like the 81% or so that we saw last year. There's a bit of a just a denominator factor going on in terms of, we've got that 81% figure was a full year where half year didn't have really the benefits coming through, the second half did. This half year, you've only got the benefits, if you like. And so just as a consequence of the math, we think that will pull us back towards 81% figure, but I don't want to be too pessimistic about that. We are hoping that we will see some improvements on that 81% figure, but probably in real life not as good as a 75% as you can see in the first half of the year.

Q - Jon Denham {BIO 19972914 <GO>}

Brilliant. Thanks very much. And can I just check, did you say you are -- you still -- you are currently pricing for your 3% to 5% claims inflation expectation?

A - Tim Harris {BIO 16707496 <GO>}

Yes, that's pretty much what we do in the way we approach our pricing.

A - Penny James {BIO 15157212 <GO>}

Kind of how models work, Jon. We start with that.

Q - Jon Denham {BIO 19972914 <GO>}

Brilliant. Thanks very much.

A - Penny James {BIO 15157212 <GO>}

Rachel, have we got anymore questions on the line?

Operator

Our next question comes from Edward Morris from JPMorgan. Edward, your line is open. Please go ahead.

Q - Edward Morris {BIO 16274236 <GO>}

Hi, everyone. Thank you for taking the question.

A - Penny James {BIO 15157212 <GO>}

Hi, Ed.

Q - Edward Morris {BIO 16274236 <GO>}

First one is on reserving. I'm just wondering to the extent to which this period may have allowed some additional conservatism to go into the reserve, so can you talk a little bit about that? I wonder if there's been any change perhaps in the reserve margin or it's not done on that basis. Can you talk about what you've assumed in terms of frequency benefits versus what was experienced in the first half? And then you said that frequency was starting to tick up again in June. And just sort of understanding how you've approached that decision would be really helpful.

And then the second question is around solvency and capital management. Obviously, thank you very much for the catch-up payment. I'm sure it's highly appreciated by shareholders, but just thinking about how you'd approach this when we come to the full year. Obviously, you've mentioned this figure of 173, that's sort of ex-debts figure for solvency. Is there any reason to think that you might think about capital management differently this year or should we just think the same preference for buyback versus specials and you'll approach it like any other year-end process? Thank you.

A - Tim Harris {BIO 16707496 <GO>}

Thanks, Edward. I'll pick up those, if that's okay. So let me talk about reserving. So I should stress, there have been no change in our underlying reserving philosophy. But let me talk specifically about how we've dealt with frequency and severity. We've not had pandemic before, certainly not recently and so trying to reserve in this environment, clearly a lot of the way you tend to do reserves isn't relevant, because it doesn't really work off the back of historical patterns. So we do have to be cautious.

In terms of frequency, we've obviously been tracking frequency very, very carefully. And as I described to Jon earlier, in sort of the major parts of the lockdown, frequency was -- it was down about 70% as miles driven have increased. We're certainly seeing that increasing in line. It's not yet back up to sort of pre-COVID levels. And as I said, that might be a bit deceptive anyway because the nature of the miles driven could well have changed significantly. But we follow the data on frequency.

I think more difficult to read severity. Anecdotally, there is some evidence that on bodily injury claims they were a bit more severe during lockdown, possibly as a result of people driving faster. Also, fact that a lot more people were walking and cycling. So you have some more accidents involved people who were not in cars. Sort of some anecdotal evidence around that. But certainly what we've seen operationally, of course, is that although the number of car repairs on the damage side has been much lower because (inaudible) your cars to repair. The capacity issues around repairing cars have been impacted by things like social distancing.

We're very proud of our motor repair network. They continue to work throughout the pandemic, keeping key workers' cars on the roads. But necessarily, we do have some restrictions on capacity there, which we can manage through. But it will mean some potential impact on severity. How does that manifest itself? Potentially some higher -- credit higher costs if it takes a bit longer to repair cars. And potentially also if we see some supply chain is [ph] coming through. So we thought about all of those things in reserving and, as you'd expect, we've been prudent in our approach, which is what you -- I think, you expect from us. But fundamentally, the underlying philosophy is the same.

Think [ph] about solvency and capital, moving on to your second question, I think that -- as we said, at the time we made the decision to cancel the final dividend with a very heavy heart. We know how important the dividend is for our shareholders and the people they represent, the pension schemes, the charities. That was not a decision taken lightly, but it was appropriate at the time, but we always wanted to get back to dividend paying as quickly as we possibly could. This has been the first opportunity and we've taken it. We've taken it because we've taken positive actions to strengthen our capital and liquidity and that's meant that when we run stress and scenario testing, we can demonstrate the -- we can take the decision to resume dividend paying, confident that we're still in resilient shape to meet our promises to policyholders.

I think that in terms of what does that mean in terms of overall capital levels, well, I'm sure that in normal circumstances, what I said last year, the 140% to 180% range being somewhere towards the middle of that was appropriate, still stands. Unfortunately, I don't think we're in normal circumstances. The circumstances we are in are fairly extraordinary and so you can expect us to continue to be quite prudent in the way we're thinking about capital and liquidity as we negotiate whatever frankly pandemic and the number of other issues like Brexit flows of those, over the course of the next several months.

We like everybody want to get back to normal as quickly as we can, but we will be quite thoughtful about that in terms of preference for buybacks versus special dividends, kind of just depends, doesn't it, on the circumstances that exist at the time and whatever decisions we might make about returning surplus capital. And I'm going to save all of that through the end of the year.

Q - Edward Morris {BIO 16274236 <GO>}

Okay, thank you. Look forward to it. Thank you.

A - Penny James {BIO 15157212 <GO>}

Thanks. Have we got another question?

Operator

Our next question comes from Freya Kong from Bank of America. Freya, your line is open. Please go ahead.

Q - Freya Kong {BIO 20097488 <GO>}

Thanks.

A - Penny James {BIO 15157212 <GO>}

Hi, Freya.

Q - Freya Kong {BIO 20097488 <GO>}

Hi, Penny. Hi, Tim. Hope you are well? Two questions for me, please. So, firstly, you're reiterating your 93 to 95 call for the full year, but you did 90.4 normalized in H1. This is allowing for pretty tough second half. How much of this is conservatism or are you expecting a bit more frequency in H2 tough operating conditions? Secondly, premium per policy continues to drop even though on a risk adjusted basis your pricing is ahead of claims inflation. I understand risk mix was a bit lower in H1, because of COVID. Do you expect this to partly reverse in H2? And I guess, overall, do you have initiatives to try to get premium per policy up, not just Motor but also Home?

A - Penny James {BIO 15157212 <GO>}

I think, well, I will take the second one first. On premium per policy, I think on Motor, really it's a distortion, because of the COVID events more than anything else I think rather than a particular pattern. We don't particularly target average premium in our pricing approach. That's not how we do it, but we will see how things develop. We've actually seen over the last year, pre-COVID kind of more young drivers on the book and so on. So we had actually seen it moving in the other direction. Let's see how COVID unfolds and how fast that unwinds.

On Home, I think slightly different trend. On Home, we have seen (inaudible) falling over time because what you've seen is a lot of the growth coming through price comparison and there, there is definitely a differential on the average premium. And so there is a trend running I think in the Home book as we get stronger and stronger on the price comparison side.

Targets? (inaudible)

A - Tim Harris {BIO 16707496 <GO>}

Yes. So, we are reiterating the 93% to 95% call. As you say, we're coming off a strong first half in that regard. We are expecting increases in frequency. As I said, we're seeing that coming back as people return to roads. In particular, also in household actually, frequency is back to pre-COVID levels, albeit the mix of the claims that we're seeing is somewhat different. So, yeah, we'd expect a more normal, if you like, second half of the year as I explained to Edward, it's somewhat difficult to predict exactly what's going to happen. So you would expect over the year for this to be in line with our guidance.

Q - Freya Kong {BIO 20097488 <GO>}

Okay, great. Thanks.

A - Penny James {BIO 15157212 <GO>}

Thanks, Freya. Okay, Rachel, next question, if there is one?

Operator

Our next question comes from Oliver Steel from Deutsche Bank. Oliver, your line is open. Please go ahead.

Q - Oliver Steel {BIO 6068696 <GO>}

Good morning.

A - Penny James {BIO 15157212 <GO>}

Hi, Oliver.

Q - Oliver Steel {BIO 6068696 <GO>}

Two questions. First is, can I just come back on the reserving -- reserve release issue, because you've given us quite a lot of guidance on the attritional loss ratio, but actually there is a sort of not quite equal and opposite move in the release from prior year? How should we be thinking about what a long-term reserve release should be in your numbers? That's question one.

And then second question is, Tim, you talked about the risk to your travel claims estimates coming from travel companies and airline companies going bust. I'm looking -- I mean, there ought to be a sort of in terms -- I mean, now you've got the sort of whatever it is (inaudible) sort of insurance cover, which presumably covers that. So I'm just wondering how much of a risk that is actually to your book?

A - Tim Harris {BIO 16707496 <GO>}

Yeah, thanks, Oliver. Let me take both of those. So our prior year reserve leases, especially on Motor, have been decreasing over time and that's actually a result of some of the development that we see on the bigger bodily injury claims some of which are on the book for very, very long time. The releases in those reducing because of reinsurance changes we made a few years ago. And that tends to push down the prior year releases. As expected, frankly, the best guidance I can give in terms of how you should think about that is the sort of 50% of profits coming from the current year, which isn't just a result of improvements in the current year, but it's also a result of reductions in the prior year. And that's really what's going on.

In terms of Travel, yes, I think it is important that we acknowledge there will continue to be risks and the risks to the financial outcomes on Travel are related to, as far as COVID-19 is concerned, to the effect on airlines, travel companies, but you're absolutely right that it's not a straightforward kind of sequence of events that lead to us bringing online. There's a number of different kind of stopping points in terms of liability before it falls on our books. So you are right to say, the first obligation sits with the holiday provider of the airline. We've then got in the expense [ph] of insolvency schemes like (inaudible) sitting behind them. And then potentially and depends very much on the facts and circumstances in the individual policyholders claim, but potentially you've got the credit card providers behind that before we're liable.

But there is no doubt that if we did see a major airline, for example, to fail, we obviously hope that doesn't happen, then it would be a consequence of those. The only thing I would say is that I don't think we're talking about a catastrophic consequence. But it would be negative compared to our GBP25 million current estimate.

Q - Oliver Steel {BIO 6068696 <GO>}

Thank you very much.

A - Penny James {BIO 15157212 <GO>}

Thanks, Oliver. Any more questions, Rachel?

Operator

Our next question comes from Dom O'Mahony from Exane BNP Paribas. Don, your line is open. Please go ahead.

A - Penny James {BIO 15157212 <GO>}

Hi, Dom?

Q - Dominic O'Mahony

Hello, hope you're all well. Thank you for taking my questions. Just to start with, on capital generation, I am just looking at the walk on Page 21. I'm just comparing the operating capital generation net of the CapEx with the profit after tax and it's not higher. I mean, it's about GBP280 million versus GBP193 million. I'm just wondering whether there is sort of a special factor influencing that this period. Whether there is a recurring reason why that would be true, why that delta would be true? Obviously, this is absolutely the main driver of capital (inaudible) capacity. But then relatedly, the capital requirement increased by GBP70 million, so 9 points on the solvency ratio and the way you presented suggested this is not the impact of rates because rates presumably go through market differences. Why is the capital requirement going up by I think 5% in the period given that actually you de-risked the investment portfolio quite a lot? You had the cash rather than reinvesting. So those are just some questions on capital.

And then I guess more in terms of the regular financials. I noticed in Home, the prior year development is quite lot lower than last year, which last year may have been for the exceptional risk, is sort of 1% PYD in Home, is that a normal result you think? Is there reasons that might be lower than normal? If you could give any steer on that, that would be really helpful. Thank you.

A - Tim Harris {BIO 16707496 <GO>}

Great. Thanks, Dom. Let me have a go at that. You're absolutely right. The capital generation on Solvency II basis is strong in the first half. There are reasons to that and it's about the way the model works and the Solvency II technical provisions that tend to take a kind of forward look on the impact of some of the claims things -- claims issues that I discussed on future unearned premiums and they get modeled in. And as a result, actually those technical provisions are lower. And in effect what the model does is, it kind of anticipates some of that benefit coming through in the capital sooner than you'll see in the IFRS results. So I think that it isn't something that will recur period after period. Unfortunately, if it was, we would have discovered the sort of magic money tree. It is a bit temporary and I think, you can expect to see us when we report our full year results to see a closer alignment between IFRS profit and the capital generation just as those things even out over the course of the year.

So on the capital requirement, another good spot. Actually that's a result of the volatility we've seen in the debt market. One of the parameters in the model is an economic scenario generator that looks at a range of outcomes. And the capital of the market -- risk capital that's required is very much a function of that volatility. This will be feature for all companies, I should say. In fact, we all tend to use very, very similar economic scenario generators. There is not that many people that provide them and that has caused the capital requirement to move out a bit during the course of this half year. Where will I go into future depends entirely on the level of volatility in the financial markets going forward. And, well, your guess is as good as mine in that regard. But that's been the effect that we've seen in the first half.

In terms of Home, I think that the only thing I'd say -- I can't really guide you on an answer to what prior development will be by the full year. But there is, though, I should flag a bit of a timing issue about when we do our full annual reserving reviews and the Home one will happen in the second half of this year. And I imagine that may well have an impact when we come to reporting our full year result.

A - Penny James {BIO 15157212 <GO>}

The other thing I'd add on Home is that last year's prior year development numbers were buoyed because we'd had a lot of positive experience on escape of water which we recognized. And you can see that actually flowing through the current year benefits in Home as well. So it was kind of a bit of a catch-up of prior release. So I don't think we'd necessarily -- we haven't done the reserve review yet, so, but I don't think we'd necessarily expect to see in that kind of level again.

Q - Dominic O'Mahony

That's very clear. And thank you both for explaining that. Can I just ask a very quick follow-up on the capital piece. I get the point about the volatility in the market and not knowing what will happen there. But on the first point you mentioned, Tim, about essentially the forward-looking element to the solvency model, should we be expecting this to sort of reverse in H2 such that the full year number will be more in line with sort of profit or is your point that it will -- the gap will close and essentially this will normalize over time? I realize it may be a difficult question to answer, but any guidance would be helpful.

A - Tim Harris {BIO 16707496 <GO>}

I mean, all things being equal, I would expect the -- when we look at the full-year capital generation compared to the full year profits, I would expect that to be close in alignment as far as the effect [ph] to work through the IFRS numbers. So that does kind of suggest, I think, lower organic capital generation in the second half compared to the first half.

Q - Dominic O'Mahony

Great. Thank you very much.

A - Penny James {BIO 15157212 <GO>}

Thanks. Pick up another question, Rachel?

Operator

Our next question comes from Andreas van Embden from Peel Hunt. Andreas, your line is open. Please go ahead.

A - Penny James {BIO 15157212 <GO>}

Good morning, Andreas.

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

Hi, good morning. Just had one question really. You provided quite sort of substantial (inaudible) customer rebates to your policyholders (inaudible) Motor. Is there any way you could quantify the top line impact of those customer rebates? And then tied to that, do you have a view -- I know it's a bit early in the year, because we're still in the (inaudible) but do you have any idea as to the second order of fact of [ph] providing those customer relief measures, what would be the credit risk in the second half of the year and have you taken any provisions against potential non-performing premiums? Thank you.

A - Penny James {BIO 15157212 <GO>}

Okay, let me take those. I think the easiest way to think about the balance of the customer, I think as we've talked in the release, about GBP80 million to GBP90 million were of what we call our force for good initiative. And those cover everything we've done for customers, they cover what we've done for the community, and they cover what we've done for our people in terms of guaranteeing roles and so on, so forth.

About half of those are customer-driven and that would include both refunds and our estimates of what premium deferrals are likely to do across the year. So that's kind of our working view as to what those sort of customer give-backs will cost. Obviously, we will keep monitoring premium deferrals because the shape of that may change as the furlough schemes and so on unwind. But at the moment, we've allowed -- that's the allowance that we are considering.

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

And what do you think about the credit risk tied to that -- to your sort of insurance receivables in the premium (multiple speakers)

A - Tim Harris {BIO 16707496 <GO>}

So I haven't got a figure for you, Andreas. But we do look at the credit risk and we do make provision for that. In the greater scheme of things, we're not expecting that to be a very material number, but it is something that we consider.

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

Thank you very much.

A - Penny James {BIO 15157212 <GO>}

Thanks, Andreas. Rachel, have we got anymore?

Operator

Our next question comes from Abid Hussain from Credit Suisse. Abid, your line is open. Please go ahead.

Q - Abid Hussain {BIO 20229932 <GO>}

Hi, morning, all. Thanks for taking my questions.

A - Penny James {BIO 15157212 <GO>}

Good morning, Abid.

Q - Abid Hussain {BIO 20229932 <GO>}

Morning. I think I've got two left. One is really a follow-up on the claims outlook. I was just trying to get a sort of longer-term sense of your view on where we might end up with on claims post-COVID and based on the Motor book and the Home book as behaviors change and people sort of adopt to more working from home, more flexible working. You said sort of fewer miles driven, fewer journeys, but the nature might be different. Just a little bit more color on what that might mean for claims in Motor. And then sort of on Home, I guess we'd expect fewer thefts, (inaudible) fire and water leaks, but that might be offset by more accidental damage. But I'd love to hear your views on how you see that playing out on the sort of medium to long term?

And then the second question is on inorganic growth opportunities versus any buybacks. I guess the question really is, what's your view on kind of growth? Would you consider it? I think you have said you wouldn't in the past, but really sort of thinking about that versus resuming the buyback which you've canceled and possibly doing additional buybacks. So what sort of order of priority would you put that -- blend [ph] that in? Yes, those are the two questions.

A - Tim Harris {BIO 16707496 <GO>}

So thanks for those questions. I'm going to answer the second one. And we -- and talk about motor claims and then Penny will pick up the home claims trend.

So on inorganic growth, we said last November at our Capital Markets Day that inorganic growth and that might take the form of acquisitions. It might also take the form of more partnerships. We think those make strategic sense. We haven't got anything to talk about today, but I think that probably still is the case.

In terms of a prioritization call, I think we've got a number of things going on and the first one I'd come back to is, we are in the middle of a pandemic. And we do need to continue to be really thoughtful about capital and liquidity when we're thinking about capital in terms of what might be surplus and might not. Generally, actually I think about things a little bit separately. If there was a compelling reason to make an acquisition, then that's something we would expect to -- depending on the scale of course, but it's something we'd expect to be talking to shareholders about over time. And I'm sure we would -- generally the capital policy that we have, as I say, in normal circumstances would be that if we think the capital surplus, then we will return it to the middle of our range.

Coming back to your first question on claims outlook, very difficult to read, as I say, on the basis that we've not really been here before. But what we are seeing, first of all, on frequency is the frequency of claims increasing on the Motor book, pretty much in line with the increase in the miles driven. Although, I would say, it's not yet reached what we would consider to be normal levels, still -- claims frequency is still down a bit, but much, much less than it was in April.

But as I say, underneath that was probably some things I'd like to mention in relation to the nature of the claims. And I think there is some evidence that driving behavior is changing a bit. There is less commuting going on for the obvious reason that fewer people are in the offices. There is much less school travel going on, obviously, in the summer because schools are closed, but before the summer holidays because those schools weren't happening. We'd expect those to come back over time. We think that there will be a lot more miles driven this year through people's tendency to take the holidays in the UK rather than overseas. Exactly how these will work through in the long run, frankly, it's a bit difficult to tell. But we expect those to be the trends which will inform that.

I'll hand over to Penny on the household claims.

A - Penny James {BIO 15157212 <GO>}

Yeah. Household, so what have we seen through lockdown? We've seen -- we have seen a reduction in frequency, nowhere near the same levels as Motor but there has been some reduction. In terms of the mix, some of it I guess is expected. So you've seen less big escape of water type claims because our assumption is people are identifying it faster, less fire -- less theft and sort of personal possession type loss type claims. But on the other end, [ph] an increase in sort of smaller accidental damage type claims. But what we have also seen is severity increasing, because actually just on frequency, we're just kind of waiting to see how much of that is real and how much of it's delayed reporting. Our sense is most of the delays are probably getting out the system now as we come back to pretty normal levels of frequency now.

Just on severity, severities increased because what you've seen is a higher alternative accommodation cost where people have had to put up longer because their houses are under repair for whatever reason, and obviously people have not been able to access their homes and the supply chain has been disrupted because of furloughing and so on and so forth. So you've seen some increases in severity for that. I don't think it's obvious to us how much of this in home is an ongoing pattern. So we're already seeing frequency kind of write itself and the supply chain seems to be returning to normal pretty rapidly now. So I don't feel necessarily like they are necessarily long-term trends, I think.

Q - Abid Hussain {BIO 20229932 <GO>}

Great. Thank you. Thanks a lot.

A - Penny James {BIO 15157212 <GO>}

Thanks. Got another question?

Operator

Our next question comes from Andrew Crean from Autonomous. Andrew, your line is open. Please go ahead.

Q - Andrew Crean {BIO 16513202 <GO>}

Good morning, you two. Couple of questions, if I can. Firstly, reinvestment rate on the fixed interest portfolio, I mean it's less than three years in duration. Can you tell us what the reinvestment rate is because if the portfolio yields comes down by 1 percentage points, you need to bring the combined ratio down by 2 in order to retain profitability. And I suppose that leads into asking whether it's time to -- in this very low rate environment, whether it's time to review the 93.5.

And then the second question is on capital. In trying to give us some sort of guide on when specials occur, because you've given us the 140, 180 and the 160, then we've got to add in whether it's normal conditions or not. In the old days, you said this in abnormal conditions you needed 10 points more. You also said historically that you'd never operate outside the 140, 180 in return, anything above 180 or now 192 in the buyback hasn't been reiterated. What should we really think? Should we just be operating in abnormal conditions that you will be aiming to be 10 points above the 160 after you allow for the 22 call on the debt?

A - Penny James {BIO 15157212 <GO>}

If I take the second one...?

A - Tim Harris {BIO 16707496 <GO>}

Well, I'll have a go at the reinvestment rate. I haven't got a figure for you, Andrew. But the reinvestment rate is down. I guess you got two effects going on at the moment. You've got the reduction in interest rates, which is clearly unhelpful. You've got compensating that at the moment a bit of an increase in credit spreads, certainly compared to where we were beginning of the year. And broadly, we think that (technical difficulty) assessing at the moment. But it does -- as you say, it mean that the impact of investment return on the overall performance of the business is less positive than it was. And that's certainly one of the factors that's driving our view that the impact of the pandemic overall on the business is broadly neutral and a big part of that is the deterioration in investment return.

In terms of does that mean we should be changing the 93% to 95% guidance? At the moment, we're not doing that. It still remains our objective to meet that in the medium term. And that does mean there will be consequences on the underwriting results. You're absolutely right.

So I'll have a go at capital and then any comments Penny might like to add. I know it's frustrating, but I haven't got a kind of ready reckoner for you in terms of exactly what the levels of capital we will hold at the end of the year will be. And I just want to explain why.

The first thing which I hope is helpful is that we obviously can't make any announcements about the action we might take on whether we call the 2012 Tier 2 instrument, which is first callable in 2022, that's GBP250 million outstanding. But one of the reasons we moved to refinance that early was because of the positive impact it gives us in terms of a bit of a capital and liquidity buffer for at least the next 18 months or so, but we do have to, in all probability, think about redeeming that at some stage. So I think you need to remember that when you're thinking about our capital outlook over medium term.

In terms of the 140, 160, 180, believe me, I would love to be able to tell you that we were going to move to the middle of that range. That was certainly where we hope we would be when we stood up in Doncaster in November last year, somewhat inconveniently the sort of pandemic came along. And I think that is exceptional and I've got to say that. We do need to make sure that we are being quite prudent in our approach to capital reserves. We really didn't want to have to cancel the final dividend in April, but we made a sensible decision at the time to do so. We've returned to paying dividends as soon as we possibly could and we paid full catch-up. I think that's a really important first step, but beyond the no doubt, in the long run, we're here to return capital to shareholders and we get that.

A - Penny James {BIO 15157212 <GO>}

I think that's completely right. Our job is to look at this prudently, Andrew. It's really important that we get back on returning money to our shareholders and meeting our commitments, which is what we've done today. But I think there is plenty of uncertainty between here and next March and we'll view that when we get there.

Q - Andrew Crean {BIO 16513202 <GO>}

Okay.

A - Penny James {BIO 15157212 <GO>}

Thanks, Andrew. Rachel, any more questions on the line?

Operator

Our next question comes from Thomas Bateman from Berenberg. Thomas, your line is open. Please go ahead.

A - Penny James {BIO 15157212 <GO>}

Hi, Thomas

Q - Thomas Bateman {BIO 21707516 <GO>}

Good morning. Hi, there. Thanks for taking my question. And good to hear you both so upbeat and making excellent progress on the group strategy. Just one question on the FTA's review. (inaudible) agree the excellence of what they had in Capital Markets Day and I was wondering if you'd give us any sort of further update on this. You flagged that home premiums are down 2.5% and that's partly due to the mix effects we see [ph] in PCWs. Investor perception is that you're a little bit more exposed to this review. So I was just wondering if you could give us any comfort if there are other mitigating actions that you've taken and what the sort of impact may be later in the year? Thank you.

A - Penny James {BIO 15157212 <GO>}

Thanks, Thomas. Well, I think the short answer on the fact of the FTA review has been -- kind of pricing review has been delayed twice now. It was due in April and then I think in July. Somewhat understandably given everything that's going on. We don't have a revised date for it. So we don't know -- I don't believe the FTA has a set landing date for it yet. So presumably at some point later in the year as you suggest. And I don't think in that sense things have materially moved on from a regulatory discussion point since Kate did that update at the Capital Markets Day. So that remains -- that's probably the best insight.

In terms of what we've been doing and we continue -- and Kate laid out that we put, if you like, lines into the book in terms of margin and pricing. We continue to tighten those over time. So we continue that process and there's probably a small impact from that in the average premium movement that you can see. I think it's outweighed by the sort of mix, the book shifting towards PCW, if you like. But clearly there are some changes in there and that would be a component of that movement. And we will continue to keep moving forward on our sort of (inaudible) pricing arrangements and making progress until we're clear from the FTA what it is and how it is they want to approach it. So, yeah, so way the longer -- the longer the review takes, the more progress we would have made. It's probably the way for investors to think about it I think.

Q - Thomas Bateman {BIO 21707516 <GO>}

No, great. That's great. Thank you.

A - Penny James {BIO 15157212 <GO>}

Thanks, Thomas. So are there any more questions, Rachel?

Operator

We have no further questions. So, back to you, Penny.

A - Penny James {BIO 15157212 <GO>}

Okay. In which case, I'd just like to thank everybody for their patience this morning. I'm sorry, it's a call rather than face-to-face. It's never quite the same, but it was the best we could do. The best we could muster in the circumstances. But thank you very much for your time and if anybody has got any other questions offline, obviously you know where we are. Have a good summer. Take care.

Operator

Ladies and gentlemen, this concludes today's call. Thank you for joining. You may now disconnect your lines.
