Y 2019 Earnings Call

Company Participants

- Adrian Cox, Chief Underwriting Officer
- Andrew Horton, Chief Executive Officer
- Sally Lake, Group Finance Director

Other Participants

- Andreas van Embden, Analyst
- Andrew Ritchie, Analyst
- Benjamin Cohen, Analyst
- Jonny Urwin, Analyst
- Kamran Hossain, Analyst
- Nick Johnson, Analyst
- Unidentified Participant

Presentation

Andrew Horton {BIO 5697110 <GO>}

Good morning. Good morning everybody, and welcome to our Results Presentation for 2019. For many of you, who read our full set of report and accounts, which happen to be on the website this morning, you'll have seen on the front page it's talking about navigating change and it -- within it three areas of change, a reasonable management changes, and we're going to see Sally's First Annual Presentation. Appointed CFO in May last year. Having been with the company since 2006 and Adrian having had a first full year of Chief Underwriting Officer shortly, so we'll see that. But we also talk about the market changing, and we'll be discussing the market changes and finally, how the market needs to change and its use of data and technology, and we'll touch on that as we go through the presentation.

So I'm going to give an overview, and then going to hand over to Sally, who is going to go through the financials, and then to Adrian who will give you an overview of how the underwriting is going, and I'll come back for the outlook of 2020.

So if we just look at the numbers briefly. Profit before tax of 268 mainly an investment story. So we had great investment income this year driven by yields coming down or rates coming down, credit spreads narrowing, the equity markets having a good year, capital growth assets doing well. So the perfect investment environment for making a good return.

Small underwriting profit combined ratio of a rounding to 100%. Why is that? We flagged last year that with fewer reserve releases because of the catastrophe claims in 2019, 2018. We also saw some catastrophe creep in some of those claims, which we talked about at the half year. We're opening slightly higher, as we see claims inflation come through areas of our liability book, particularly D&O, employment practice liability and the healthcare book. So we're being reasonably conservative in our opening reserve position, and all of that has led to the combined ratio of 100%. Because of the claims environment, the rates are up by 6%. So profitability in the claims environment has driven rates up by 6% and because of that we've seen good top line growth of 15%. Couple of points to that, the facilities we are writing for third-party capital and they get reinsured out of that gross premiums written.

Prior year reserve releases, as we flagged, we're going to be lower, driven by a number of things, I just talked about. And in usual fashion, the dividend growth between 5% and 10%, so the dividend is up 5% over last year.

So a brief business update. It was great to hit $3 billion of premium, not that we're targeting anything, so we want profitable growth. But on the back of the growth, we managed to achieve our 3 billion of gross premiums written during the year. And the couple of bullet points down, you can see that we have growing our non-US premiums at Continental Europe, where we've been putting a lot of effort in growing our offices in Continental Europe specifically in Spain, France and Germany, up 17%, the US from a much larger base growing at respectable 13%.

Small more management changes, so Anthony Hobkinson actually retired at the end of January and Beth Diamond, who has been heading our third-party claims for a number of years, who joined us in 2006 based in New York has taken on Anthony's role. Some confusion this morning between Anthony's initials and mine, AH and someone asked me, where am I going. And I point out, I'm not actually going anywhere. It's Anthony rather than myself.

Strategic initiatives -- Mike Donovan -- sorry retiring in June 2020. So Mike has built a fantastic cyber business over the years. He joined us in 2004 and he's going to retire in June 2020. The expectation is we will be announcing an internal appointment before the half year to take over from Mike.

Strategic initiatives just touching on two of the four key initiatives that we're focusing on how we use technology and data better. So Beazley digital run by James Eaton and Andrew Pryde looking at how do we actually do small risk better, and we're giving you some pointers here about having quoted 75,000 risks in 2019 on our e-trading platforms. And looking at these technology connections to brokers, which are becoming more and more to the fore and the brokers are asking to connect with their systems more and more.

And then the faster smarter underwriting that Ian Fantozzi and Adrian Cox lead looking at how do we actually do our large complex risk better by looking at sources of data and use of technology. And we're partnering with four companies that have specific data that is useful to us to hope -- to help us make underwriting decisions better.

Tailwinds, we believe going to continue into next year, and we've seen that in the first month of 2020. So the rate environment is still positive into 2020. It's quite hard to tell where it's going to go into 2021. I was asked the question earlier on today. I think we just focus on sort of a one-year outlook. We'll have a better view of 2021 when we hit the interims later this year.

Looking at the chart over the past five years, a good steady premium growth, a bit better over the past couple of years, mainly driven by prices going down, profitability issues, rating environment being better. Right hand side combined ratio with 100. Catastrophe was impacted '17 and '18, a combination of factors in 2018. Good expense controls. We have been focusing on our expenses. So we are getting the expense ratio down. There is more to be done on the expense ratio, as we look into the future.

Bottom left say, the interim and second dividend, total dividends is going at 5% per annum, which is great. And return on capital is respectable 15% post tax, having have low returns over the past couple of years.

We have a long-term incentive plan, which has been in place since 2009, and the aim is to achieve if it tops out at 15%, plus risk free rate growth in net asset value, which is the gray triangle is the top of the -- where the LTIPs kick in and the bottom of the gray triangle is where -- sorry, the bottom is where the LTIPs kick in and the top is where the LTIPs top out. The diamond is what we've actually achieved. So we've achieved very close over a 10 year run, 15% plus risk free rate growth in net asset value. And our belief is we do that there will be good total shareholder return, which is the more volatile line above it. But good returns of 23% over the past 10 years for shareholders.

I'll now hand over to Sally to go through the financials.

Sally Lake {BIO 20925273 <GO>}

Good morning, everyone. So to reinforce what Andrew just said, we've got a really encouraging story this year, with strong growth continuing, along with a really impressive investment return. We'll come on to the fact that the reserving picture has definitely improved, and we end the year in a good position from a capital perspective.

So just quickly before I go into the usual trio, we'll talk about a few KPIs. So we've talked about the gross written premium growing at 15% slightly lower from a net perspective and that's for two main reasons. Firstly, the market facilities business that goes into 5623, which is backed by third-party capital initially comes into our core syndicates, and so that impacts the gross growth, but the majority is reinsured out, so that has a different effect on the net growth.

Secondly, we've talked about US trucking at the half year. In the second half of the year, we've chosen to reinsure the back book of that sector out and that has also had an impact on the net premium as well, so they are the main differences for the gross to net relationship.

Just a quick mention of expenses that Andrew has already said, there is a slight improvement here. I would -- I would not claim victory here at all. We're in a good position from a growth perspective, so we should be getting better. And secondly, the sterling versus US dollar position is also really helping us on that. So definitely more work to do there.

And finally on the claims ratio welcome to the reserve releases, that's really had an impact on the increase in the claims ratio over the year, and we'll come on to that.

So firstly onto investments, Stuart's in the back, so this is definitely his year. So big picture let's look at the portfolio. Generally speaking, the two donors that we look at haven't changed significantly over the last 12 months. We have 85% [ph] of our portfolio in fixed income investments with around 15% focused on capital growth assets.

One thing to note, as Stuart has been working very hard on for a number of years is that our cash position is improving year-on-year, as we aim to put the money that we have to work as much as possible and get the returns -- the returns working for the money that we have.

So during the year, Stuart chooses to make decisions around increasing or decreasing certain asset allocations depending on what's happening in markets at the time. And I think we'll all agree that he has made some really good ones this year. So what has that meant we needed a bigger axis on the Y -- on the Y axis this year, and we can see that the overall return is 4.8%.

The main driver of this is that we have some movement in our core portfolio of the interest rates reducing from 3.3 at the end of 2018 down to just over 2% at the end of 2019, as we mark-to-market that comes through as a capital gain for the year. But the thing to note that is whilst it's a good thing for this year. It does change our expectation of future returns going forward, as the yield on our -- on the majority of our investments is at lower position.

Now on to reserving. So the main reason that we have a difference in our combined ratio this year is that we didn't release a great deal of reserves this year and it's definitely lower than we would normally see from an average year at Beazley. Firstly, if I look at the positives, we had positive releases on our PAC division, along with positive albeit lower than average releases on specialty lines and cyber and executive risk. The reasons for that we've discussed at length already, where certain books within these areas have seen continuing claims activity especially in D&O, employment practice and healthcare. These positive releases have been almost entirely offset by strengthening on our some of our short tail books. So firstly our reinsurance book saw some loss creep from Jebi, as well as some performance and some areas of the book in addition to that.

Our marine book has seen some strengthening mainly caused by US trucking that we talked about at the half year. And finally, our property book in the second half of the year also saw some loss creep mainly driven by Irma. And also there was some strengthening required in our construction and engineering book, which we no longer write. Overall that's led to a small positive release for the year.

So that's the position looking back how do we look going forward, so on Sally's favorite graph. So as you can see, we are seeing an improving picture from a reserving perspective. To remind everyone what this graph is doing is looking at what we are holding in terms of reserves and comparing that to a bottom of actuarial estimate, which in itself has some prudence and is done consistently year-over-year.

And we aim to hold between 5% to 10% above the actuarial estimate. So it's pleasing to see that this picture is improving, and the reasons for that is that we've been taking action on our opening position in many areas, especially in specialty lines and CyEx for two years now and that's beginning to pay off. Now whilst this is an encouraging picture, we're not expecting the average reserve releases to go back to a more normalized position over the next 12 months.

And the reason for that is because whilst we will see some benefit from the improving market in the short tail business, the longer tail business takes longer to crystallize and we don't reserve -- release our reserves in those businesses until three years have passed from writing. So this is an encouraging picture, but we're not expecting normal service to resume immediately.

And then finally on the capital. So in very simple terms as we grow, so does our capital requirement and so as on -- net premium increases, so do the requirements that various people required us. The Lloyd's economic capital requirement is a thing that we tend to talk about. And to remind everyone this requirement is based on a slightly different view to what a lot of people are familiar with in Solvency II. It looks at ultimate position rather than a one year. So it's higher from that perspective and also Lloyd's have an uplift of 35% that they apply.

Now. we target internally 15% to 25% surplus over and above this number and that's an internal target that we look to be in. And at the end of this year, price dividend were at 22% and then after dividend we expect to be at 90%. So remaining right in the middle of that target range.

To remind everyone what we did in the second half of the year, we raised $300 million of Tier-2 debts and that was for two reasons, one to pay off a retail bond that became due at the end of September, which was done. But secondly we are in a significant period of growth, and we wanted to increase our capital position from that perspective.

It's also worth noting that we still have undrawn banking facility of $225 million, which we have not used yet, but it remains there should we need it. So Adrian is now going to give underwriting perspective?

Adrian Cox {BIO 16257010 <GO>}

Good morning, everybody. Okay. (inaudible) So an underwriting profit last year of $4 million just under, which was slightly less than our business plan, and slightly below the standards that we set ourselves. But as the slide mentions this is against the backdrop of claims activity that's been higher post 2017 than we enjoyed before that. That is the claims environment that we expect it to continue going forward, and our underwriting strategy reflects that.

Whilst we've grown across much of the business, all of the divisions have elements within them that are both growing and where we're very, very defensive and we expect that to continue also. And whilst our treaty team for example, grew this year they wrote significantly less than the original business plan because the marketplace disappointed us a little bit last year. That's sort of action isn't new for us. We've been talking about and dealing with cycle management and a change in claims environment for a long time now.

The good news I think though is that the mood music has changed considerably over the last 12 months. I've said this time last year that we expected to be able to beat the rate change plan that we had for 2019, which we did, and the market has indeed evolved quite a lot since then. Amongst carriers, brokers and customers alike, I think there is now a shared view and understanding of the issues that we'll face and then need to do something about it.

So we finished last year with a rate change of 6% on average that single number covers quite a lot of variation at the one end, our terrorism book lost another 6 points of rates and minus 6. But on the other hand, we had 31% on our D&O book, 7% on our aviation book, so there is quite a spread of rate change across the portfolio. And I think that really reflects the relative loss activity in those books. So again, we would like to reiterate, this is not a hard market in the traditional sense, but it is one that's reacting relatively proportionately to loss -- to loss activity. But this combined with the underwriting actions we've taken over the last few years they give us the confidence to grow, and all teams and all platforms did so encouragingly and both growth in dollar cents came on our London platform for the first time in a while, where we had a number of tailwinds.

We had a changing marketplace. We had an increase in demand. So we saw an increased submission flow onto our London platform last year and we saw a slight contraction in supply as businesses and teams either withdrew from activity or shrank slightly or stopped altogether, either voluntary or through regulatory action. And that combination of tailwinds contributed to some good growth on our London platform.

The increase in reserve strength, I think is also a positive, and as a result of a number of factors as well. The underwriting actions we've taken rate, increase in loss picks, limited prior exposure and so on and so forth. And our expectations for next year are for the market to continue where it left off this year.

If we look at the rate change, this is the combined actions since 2015. You can see once again the benefit of our diversified portfolio. I think the thing to take from this is that we are above where we were in 2015 in aggregate, which is encouraging, led by property, and which in itself was led by the D&F books at a large open market business is leading the rate change there.

PAC at the bottom has flattened out, again the terrorism rate change has been depressing that, despite significant activity in Chile and the like that market remains quite competitive.

So we do expect the tailwinds that we've talked about to continue this year and hopefully longer, but we'll see which does give opportunity for more double-digit growth. I think both here in London internationally and onshore in the US. But many of our lines and teams have significantly increased underwriting controls in place and oversight to continue to ensure that we evaluate and act appropriately to contain and manage the existing issues and new ones that will undoubtedly emerge.

We've been in a period of heightened underwriting action for the last few years and that remediation has revised in -- has resulted in revised risk selection pricing business mix and unfortunately from time to time, the closure of some businesses. So since 2018 we've exited from construction and engineering, last year we exited trucking in the US and earlier this year, we announced the closure of our UK marine regional book. We do use other tools to manage volatility so Sally mentioned earlier we reinsured out our trucking book, once we decided to put it into run off. It makes sense to cauterize that wound so we contain the tail by reinsuring it and we also passed over the management of the claims to the reinsurer, which saves us from management distraction over the next few years.

Again as Sally mentioned, we expect, reserve releases to be slightly below average this year. The difference in reserve release patents between our short and our long tail business. It means that they will take longer to reach our average again.

So all-in-all, I think we need to be -- continue to be disciplined and prudent, but there is some opportunity for sustainable profitable growth across all our platforms, which is a better position I think then we found ourselves in this time last year. Got a question earlier about the coronavirus, so to anticipate that might be useful to share some of that. We've done some investigating across our portfolio. I think our main exposure to this is in our contingency book where we write a number -- where we wrote some event cancellation some conference cancellation.

And pandemic cover is not given as standard rate in contingency, it's something you have to buy back, especially, and we have a limited aggregate capacity for that. It's a coverage that is -- it's a class that's covered by our casualty catastrophe reinsurance. So if we do have a number of losses coming from the corona virus. It does stack into a single loss with an attachment point of $25 million. So it's relatively contained. When we look at the number of events we're exposed over the next 6 months, we don't expect that much activity.

There may come a time if this pandemic gets worse, that people will begin to sue each other for not behaving or acting appropriately and which will give us other exposures but we can't really identify them yet. So as we look at it now the coronavirus has some fairly limited impact.

Andrew Horton {BIO 5697110 <GO>}

Thanks for that Adrian. So let's just have a look at the overall outlook for the year, because we've been preparing for Brexit for a number of years now and it is going to happen at some point. So we feel we are fully prepared with our European insurance company out of Dublin. And we are keen to grow European business. So it's important to us and of course we're using Lloyd's Brussels. So the combination of the platform in Dublin and Lloyd's Brussels means we can continue to grow in Europe, which is important to us as we talked about growth earlier on in Europe.

We continue to invest in technology, which is quite key. So looking at our initiatives Beazley Digital, and Faster, Smarter Underwriting and then linking that to the future at Lloyd's. So those two initiatives link very closely with the complex underwriting and the risk exchange which Lloyd's looking at and they're going to announce I think sometime this month, what the details behind what they want to do. We are big supporters of what they're trying to achieve, trying to get business placed more cheaply and more effectively into the London market and thereby bring more business into London.

Adrian talked about some people withdrawing from areas and that's always a great opportunity for an organic growth company to pick up some of their business and to pick up some of their people. So we do see an opportunity in 2020 to continue to do that. Sally mentioned the running yield is now 2.1%, which is lower than it was at the beginning of last year. So that's what we expect plus whatever we get on the capital growth assets in 2020.

And last topic, again, those people who managed to read the whole report and accounts will have moved on to the Responsible Business Report, which is we've also issued this morning, which is talking about some of the things we're doing around climate change. We are recruiting a Sustainability Officer, who is going to be that focal point of the opportunities around climate change, the threats of climate change, the things we should be doing for our clients, as well as our own impact as a company and our strategy around climate change. So there'll be more to come throughout 2020 on that.

We are now open to questions. There is a mic wandering around.

Questions And Answers

Q - Andrew Ritchie {BIO 18731996 <GO>}

Hi, sir. Andrew Ritchie from Autonomous. I have lots of questions. I'll try to restrict myself. So for Sally, the specialty lines loss pick it's actually -- it's reduced on the opening for 2019, I was [ph] looking at the triangles at the back. I think there's some commentary in the text about this is mix. So maybe just give us the breakdown because presumably there is parts of that where the loss pick has gone up and there is parts where the loss pick has gone down or there's a mix effect. So that would be the first question.

Secondly, I had expected your capital surplus to go up a bit more with the benefit of the debt issue. I appreciate that debt isn't, you can't count in Solvency II, but you can't count it in your kind of ECR measure. So was there any sort of moving parts, look like the Solvency II equity must have come down a bit in the second half.

The only other question, could you just clarify what the total sort of reserve adjustments were for short tail in 2019, as in -- I'm describing as one-off, but the Jebi affect, the trucking effect, I think it was more of a trucking effect also in the second half because of the reinsurance you bought, I think it was an Irma effect. I can't remember if I'm missing anything, but just the quantum of that sort of short tail negative would be useful? Thanks.

A - Sally Lake {BIO 20925273 <GO>}

Okay. So the -- taking those in order, so the SL loss pick. So we are opening each line of business that we write consistently year-on-year, but we hold different parts of Specialty Lines and another areas at different levels each year. So the three things that are held differently and the mix that's factored that is that we open our, what I call the medium tail traditional business at the same loss ratio. We do have cyber in our Specialty Lines division, as well as in the Cyber division, have to take another question on that. And then we also have our market facilities in there as well as we -- I spoke about earlier on. So those three things are being opened at a similar -- at a similar level between '18 and '19, but the addition of them depends on how much premium is written. So that's the effect that's happening.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Presumably the healthcare, D&O, EPL is higher loss picks?

A - Sally Lake {BIO 20925273 <GO>}

Yes, and they're opening at the same level, but they are all grouped together with other things bring a different premium feature.

A - Andrew Horton {BIO 5697110 <GO>}

This was -- we already recognized that last year. (Multiple Speakers).

Q - Andrew Ritchie {BIO 18731996 <GO>}

There's no additional raising versus what you raised two points, three points in aggregate in '18.

A - Sally Lake {BIO 20925273 <GO>}

The only change is mix.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Is mix. Okay. Great.

A - Andrew Horton {BIO 5697110 <GO>}

So the key issue for this year is, we're not taking the benefit of the rate increase on those lines in the loss picks. We're continuing to hold them until we see where this claims inflation goes.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Right. Okay.

A - Sally Lake {BIO 20925273 <GO>}

And then on to the debt. So we raised debt in order to use it, and so we were planning to grow, as we did. And so we've taken -- we've taken advantage of the market that we've got, and we've remained in a good position in the range. We have to pay our dividend and where we are is a strong position of capital going forward. So it's -- we were expecting to use it when we did it. So generally speaking, the capital has grown up in line with what we expect to grow our growth rate.

A - Andrew Horton {BIO 5697110 <GO>}

I guess the only issue there is the final business plan was probably slightly larger growth than we originally thought back in June, July, when we were thinking about it and we raised the debt. So the growth may be marginally higher.

A - Sally Lake {BIO 20925273 <GO>}

Yeah. Possibly. Yes, good point. And then the last one?

Q - Andrew Ritchie {BIO 18731996 <GO>}

All the short tail reserves prior year. I just want to know the quantum to sort of back that out as you (Multiple Speakers).

A - Sally Lake {BIO 20925273 <GO>}

I do need a ruler. It looks -- if I just look at page 13 below would looks about all those aggregate looks about 60 million to me.

Q - Andrew Ritchie {BIO 18731996 <GO>}

Basically all the (Multiple Speakers).

A - Sally Lake {BIO 20925273 <GO>}

All those things together, yeah, sorry.

Q - Andrew Ritchie {BIO 18731996 <GO>}
(Multiple Speakers) all this --

A - Sally Lake {BIO 20925273 <GO>}
Yeah. All of that together that we're strengthened.

Q - Andrew Ritchie {BIO 18731996 <GO>}
So there was no underlying released, you see what I mean.

A - Sally Lake {BIO 20925273 <GO>}
So in each division there'll be ups and downs that add up.

Q - Andrew Ritchie {BIO 18731996 <GO>}
But do you think 60 million is Jebi, Irma, the trucking book.

A - Sally Lake {BIO 20925273 <GO>}
Yes, yeah.

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

A - Sally Lake {BIO 20925273 <GO>}
To the nearest five.

Q - Jonny Urwin {BIO 17445508 <GO>}
Thank you. Jonny Urwin, UBS. So just -- just back to the reserving buffers, surprise-surprise just how should we think about the opening loss picks 2020. It sounds like you're going to hold the line a bit and keep a bit of conservatism just to be sure, in which case would we expect on your business plan further reserve buffers to grow again in a normalized claims environment for 2020? It's basically the same question as last year?

And then just on 1 Jan pricing, what's -- what's your, I think what's your experience there. Thank you.

A - Andrew Horton {BIO 5697110 <GO>}
On --

Q - Jonny Urwin {BIO 17445508 <GO>}
1st of January pricing.

A - Sally Lake {BIO 20925273 <GO>}

So we haven't decided how we're opening 2020 yet. But I would probably think that at the moment, we wouldn't have any reason to change as yet, depending on what happens during the year. So if we're looking to start at the 10 hour [ph], I would probably say, it would be in line with what we've done over the last couple of years unless my colleagues disagree with make. And then in terms of the reserve buffer, I've spent 14 years, so I'm basically not predicting what's going to happen over the year. So -- but if we're continuing to do the right thing and opening a prudential margin, then we should remain in a good place in the buffer. I'm not going to give you any more than that.

A - Andrew Horton {BIO 5697110 <GO>}

The buffer has too many elements driving it because it's the end of a very detailed process of looking at four to five different business lines across a number of underwriting years. It's very difficult for Sally to predict and we don't predict. So we are going through a very consistent process, and therefore, we expect the buffer to come somewhere between 5% and 10% mainly because the process is consistent.

So we're not trying to target a certain number. It's the output of the process. We do know it's lower in the past last couple of years mainly because of the catastrophe claims, where we're holding no buffer from catastrophe losses, where the actuary in that business held were the same by default. If you've got no buffer, you're going to lower the overall average about that.

Q - Jonny Urwin {BIO 17445508 <GO>}

Is it fair to say that you're more comfortable like at 6.8%, i.e. would you say this is a normal-ish point.

A - Sally Lake {BIO 20925273 <GO>}

We've been in a similar place in the past, which is what I'd say.

A - Andrew Horton {BIO 5697110 <GO>}

(inaudible) platform.

A - Adrian Cox {BIO 16257010 <GO>}

Or you can say in the summer that we were going to -- we hope to end the year higher than we started and we did.

January 1 prices, I think the marketplace start to work continued where it left off at the end of the year. And so I don't the -- I don't think the mood has shifted at all in general. I think is a continuation of what we've seen largely speaking what the market is doing is in sync with what we wanted to do, So we're more -- we are more in sync with the market than we were a couple of years ago. I think the only area, we're a little more disappointed was on the catastrophe treaty side, where although there was some rate in the US and Europe and the UK and that was still flat to down, which is not what we are looking for.

Q - Kamran Hossain {BIO 17666412 <GO>}

All right. It's Kamran Hossain from RBC. I want to just ask about the -- in your statement, in the Q&A, there is a discussion around the combined ratio, and what we should expect for 2020. I guess, we saw here this time last year and from memory, the number was something like 93 for the year, with slightly lower reserve releases than we'd anticipate. So we're now sitting here a year later, with six points of rate rise reserve releases to be lower again this year. How we kind of square, you're starting at 93 last year, six points of rate, a similar reserve release picture to mid 90s.

A - Andrew Horton {BIO 5697110 <GO>}

Just at the starting point. We're just not taking the benefit of the rate through the combined ratio. Yeah, that is reserving conservatively forward so that benefit is not really feeding through into the combined ratio. Now we hope it will at some point. When Adrian talked about the spread of rates, we're just not taking that benefit. I mean any other comments on. I didn't hear.

Obviously since then we have seen some more claims inflation in some lines, which we didn't recognized a year ago and have recognized this year.

Q - Benjamin Cohen {BIO 21227414 <GO>}

Thanks. Ben Cohen, Investec. I had two questions, firstly, just to follow-up, can you be more explicit on those -- on the Speciality lines. The sort of the delta between the price rises that you're seeing versus the loss cost inflation, that you're observing and any forward-looking view that you'd like to give on that would also be helpful. And the second question was, if you achieve the double-digit top line, I think that you were talking about, would you expect your expense ratio to improve further this year.

Thank you.

A - Adrian Cox {BIO 16257010 <GO>}

So the rate change that we show is a risk-adjusted rate change based upon the pricing tools that we have, and all the pricing tools we have elements in them, which adjust for inflation, then they do it in different ways according to what we think the exposure base is or what's happening to the losses. But we do try to adjust for inflation in our pricing tools. The inflation that we have reacts in different ways. So is it going to be exactly the same as the inflation that we end up experiencing probably not. But we do try to think about inflation as we do our pricing tools and we do think about inflation as we set our loss reserves.

And so the 6% that you see, is a risk-adjusted rate change, might it be that the inflation you are seeing particularly outweighs the long-term average, yes it can, from time to time. And I think that's why we're seeing rate changes of 31 for example in D&O because there's some catch-up to be done because inflation may have jumped a little bit.

A - Sally Lake {BIO 20925273 <GO>}

On the expense ratio, I would definitely like to see the expense ratio improve. There are things that are under our control, there are other thing as I've spoken about with the Sterling that can go the other way against this. But yeah, we will definitely be looking to on an annual basis, improve our expenses position.

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

Andreas van Embden, Peel Hunt. My first question is about specialty lines rate, rates seemed flat in 2019 year-on-year. Just wondered why that was.

A - Andrew Horton {BIO 5697110 <GO>}

That's a typo.

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

Oh, that's a typo. Oh, okay.

A - Andrew Horton {BIO 5697110 <GO>}

So we inverted PAC and special lines.

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

I saw it was going up.

A - Andrew Horton {BIO 5697110 <GO>}

So it's actually should be 5 in specialty lines and zero for PAC. So it was a good pick up. We're hoping no one noticed that.

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

So the 5% you're happy with the 5%.

A - Andrew Horton {BIO 5697110 <GO>}

As being the right number.

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

No, no, but (Multiple Speakers).

A - Andrew Horton {BIO 5697110 <GO>}

So I know the right level. Being the right level of rate increases.

A - Adrian Cox {BIO 16257010 <GO>}

I think broadly speaking, yes. I think it's more important is what it is can we maintain that momentum this year. But yes, and I think we were happy with 5% last year.

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

And another question about specialty business, it seems that the architects and engineers book seems to have deteriorated is this linked to what we're seeing in D&O and employers' liability or is this something one-off completely different?

A - Sally Lake {BIO 20925273 <GO>}

'18 strengthened a bit. No, it's a different thing. It was (inaudible) experience in one year.

A - Adrian Cox {BIO 16257010 <GO>}

Yeah. We had a couple of big losses in one year that's all.

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

So it's not a spill over from social inflation onto other?

A - Adrian Cox {BIO 16257010 <GO>}

No. I mean we do -- we have a large risk and e-book, where we cover some of the -- some very large design professionals and contractors with some quite big events out there, and they are involved in some quite big infrastructure projects, so we can get some big losses from time to time. Last year we saw a couple.

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

And my final question is about the adverse claims development in the US cover holder book. Can you may be talk around that what are you seeing in that portfolio? Are you re-underwriting that? Is there any significant reserve addition --

A - Andrew Horton {BIO 5697110 <GO>}

Yeah. We're taking quite a -- we're taking quite a lot of action on that covers book and on property side since 2017, the reserve deterioration you've seen is a reflection of the catastrophes that Sally was mentioning that deteriorated this year. Some of that came through the covers book. That our cover holders as a -- the cover holder book in general was slower to react than our open market book. And so we had to take some quite severe underwriting action on that to pick the partners we could work with and to get the underwriting remediation that we needed. So that book is quite a lot smaller than it used to be because we needed to force some change, but the reserve deterioration you saw was mostly related to the cat activity, and mostly Irma.

Q - Nick Johnson {BIO 1774629 <GO>}

Thank you. Nick Johnson from Numis. Just a question on, you say that you expect medium term combined ratio to get back to -- into the low 90s. Is that based on the pricing you've seen to-date. What does it include the outlook for 2020 if we see another year of rate increases, is it plausible for us to expect the combined ratio to get below 90? Thank you.

A - Andrew Horton {BIO 5697110 <GO>}

Below 90.

Q - Nick Johnson {BIO 1774629 <GO>}

Yeah.

A - Andrew Horton {BIO 5697110 <GO>}

It has been below 90 obviously in history. So in theory, that is -- that is possible. I think we're just looking at the underwriting now and compare it with other times and we'll feel comfortable about the underwriting now based on the rate, we're getting and the change in terms that we've seen. And therefore, we believe based on the balance, so we can get back to where we've historically been in low 90s what we've averaged over a decade or two. So I think that gives us a sensible place to be.

Q - Nick Johnson {BIO 1774629 <GO>}

So it does include what your expectations are for rate increases this year.

A - Andrew Horton {BIO 5697110 <GO>}

Let's say looking at the -- now, so we got fantastic great rate increase this year and there were claims didn't follow it, in theory we are better than that.

Q - Nick Johnson {BIO 1774629 <GO>}

Thank you.

Q - Unidentified Participant

Yes, hi. Firstly on, I -- just management liability, D&O books, healthcare, we are seeing quite pronounced rate increases there. I was just wondering how much of those pronounced rate increases are driven by loss activity that we've seen recently versus your initial expectations, so if look at the last three underwriting years, where do you stand versus initial expectations. And I guess it's also driving force for the overall markets whether or not you can comment or not, I would appreciate that.

And the second question would be on cyber, over the past half year we've seen quite a lot of changes when it comes to your businesses. So we've seen cancellation of the agreement and we've seen you coming out, we see new product, with rendering [ph]. Can you please give us an idea of the changes in that line of business and how it could potentially impact growth going forward.

A - Andrew Horton {BIO 5697110 <GO>}

If I start with the second one, because I can remember that, nothing really much has happened to our Cyber plan. So we had a joint venture with Munich Re, called Vector which was specifically targeting 14,514,000 business and trying to sell cyber insurance to them in a different way. Because we felt that companies like that needed hundreds of millions of dollars of cyber not 50 and we joined up immediately to be able to sell primary cyber insurance in chunks that were big enough for them to go to build those towers. That job is largely done and so we decided that we didn't need to be joined at the hip in the way that we wanted to do that.

It was a very successful four years we had with them. And we still -- Munich Re are still a very close trading partner with us, there was definitely no separation. We just decided to go -- we decided to cease the joint venture and we're working with RenRe to make sure that we still are in our appropriate line size for large risk business. But the story on cyber is unchanged. Still a growth story in the US, all of the growth is starting to tail-off a bit as the market begins to mature, but we're seeing some very exciting prospects internationally as demand is beginning to take off. And so our plans for cyber are changed.

Looking back at the first question, healthcare, the rate changes are absolutely linked to loss activity. I think the market has changed more than we had anticipated that it would do this time last year, which is a positive. Do we need that rate change? Yes, we do. Have we fundamentally changed our plans for those lines of business, which are the heart of the claims inflation? No, we haven't not yet.

Q - Unidentified Participant

Just a follow-up on that. You think that the rate change you are getting now covers loss cost inflation going forward from the way you see it today, I guess.

A - Andrew Horton {BIO 5697110 <GO>}

Yes. So 31% rate change we got last year is definitely higher than trend and but there is some catch up to be done, right because rate change took a while, it took a while to come. As I've said that it is a risk-adjusted rate change, right. So within our D&O pricing, there was an element of measuring inflation as well. And do I think that price will continue? Our plan for 2020, is that, that momentum is increasing. Yes.

Q - Unidentified Participant

Hi. Just the first question is coming back to the combined ratio, which you see the underlying margin for 2019, If I look at different moving parts. It feels like maybe there is a point or two of margin build in reserves and maybe a little bit of excess catastrophe is sort of mid-90s, fair is a starting point, there? And related to this in your reserve margin, do you take credit for the pricing improvements in the actuarial best estimate, but not in the, what you book. And so I guess, does the benefit come true, as an increase in the actuarial -- in the margin over the actuarial best estimate?

Then the second question, just going back to cyber, how material is the agreement with RenRe in terms of hedging, I guess accumulation process. And how far are you from a point, where you would see that as a constraint on growth? Thank you.

A - Sally Lake {BIO 20925273 <GO>}

So on the actuarial numbers, so to remind you the best estimates, the measure that we look against is not our best estimate. It's got some prudence within it already. But that said, we do make allowances for the rate change that we're getting, as well as making allowances for claims inflation. So we do take credit for some, but we also take -- we take the rough with the smooth, as it were in the actuarial number, and always have done, and we approach that consistently throughout the graph.

In terms of combined ratio for this year, I think we've said that mid-90s is -- is a good starting place for that. And then the -- did I miss the last -- did I miss one there.

A - Adrian Cox {BIO 16257010 <GO>}

No. I think the last question is about -- was about sorry, but, I mean you raised a good point. So we like to maintain a diversified business anyway. So we don't want to -- you can have too much of a good thing. So we want to make sure that we don't write too much cyber, just like we don't want to write too much of anything. Cyber does have systemic or accumulation risk, and so we do need to make sure that we measure that as best we can and we hedge against that, which we do. The RenRe agreement that you referenced wasn't -- isn't driven by the need to shed aggregate or to hedge, we do that in different ways but we do have a number of different ways that we both manage the total amount of cyber that we write and that we manage the accumulation risk. And that's something we take a great deal of care over because it's a meaningful book for us.

Q - Unidentified Participant

And at the moment do you still see significant headroom to where -- I guess the binding constraint on that to be achieved.

A - Adrian Cox {BIO 16257010 <GO>}

Yes, yes. No, we're still keen to take full advantage of the growth in the Southern market. Absolutely.

A - Andrew Horton {BIO 5697110 <GO>}

Anything else.

Q - Unidentified Participant

Sorry, just on your own reinsurance purchase as an average reinsurance. Looking at the PMLs, at the back, it looks like your PMLs gone down slightly for nat cats. And I think you referenced the cyber PML is equal to the Northeast windstorm now so did you buy a bit more reinsurance or is that just repositioning, and broadly just remind us is the casualty clash cover. I think it's 35 access 150 [ph], is that still broadly the same or is there any changes there.

A - Adrian Cox {BIO 16257010 <GO>}

It's the cash to cash is broadly one 14x30 for combined syndicates I attachment point of 25 the Group roughly speaking. And our PMLs came down a little bit, mostly because what we did on the growth side rather than buying more reinsurance per se.

A - Sally Lake {BIO 20925273 <GO>}

Anything else? Wonderful.

A - Andrew Horton {BIO 5697110 <GO>}

That's great. Thank you for joining us.

A - Sally Lake {BIO 20925273 <GO>}

Thank you all so much.