Q3 2016 Sales and Revenue Call - Trading Update

Company Participants

- Anthony Jonathan Reizenstein, Chief Financial Officer & Executive Director
- Paul Robert Geddes, Chief Executive Officer & Executive Director

Other Participants

- Andrew J. Crean, Analyst
- Gordon Aitken, Analyst
- James A. Shuck, Analyst
- Janet Demir, Analyst
- Oliver George Nigel Steel, Analyst
- Philip Kett, Analyst
- Thomas Seidl, Analyst

MANAGEMENT DISCUSSION SECTION

Paul Robert Geddes {BIO 2474781 <GO>}

Morning, everybody, and welcome to our Q3 Update. As usual, I'm joined by Paul – I'm Paul Geddes, joined by John Reizenstein, and I have with me on the line other members of our management team. I'm going to start with our trading headlines and then hand over to John for a few words on costs, investments and on our outlook.

Overall, in summary, we're pleased with how we traded this quarter. We maintained the strong momentum across our own brand portfolio that we built in the first half of the year, particularly in Direct Line in both policy count and premium growth. We believed we've delivered these growth attractive margins by continuing to make the business more competitive. Our multiyear transformation program has continued to improve our service and propositions to differentiate our brands, to refine our pricing, to excel in claims and to control our cost. We can, therefore, reiterate our 2016 core guidance that will be towards the lower end of our range.

So now for the headlines, as you can see from the tables on page 3 of our trading statement, we increased both Motor and Home own brand policy count to 3.6 million and 1.8 million, respectively, taking the year-on-year growth to 4.3%. Within that, it was another strong quarter for our Direct Line brand.

Our overall policy count was flat compared to Q2, a strong retention and strong new business in our own brand fully offset reductions in our partnerships. Written premiums also grew again in Q3 to £883 million and year-to-date are now 4.2% higher than last year, largely driven by strong premium growth in Motor.

So let's now move on to the categories starting with Motor. Motor demonstrated its competitiveness again this quarter taking market share at attractive margins. We continue to grow our in-force book, particularly our own brands which are up 4.8% year-on-year. At the same time, we grew premiums by 10.1% versus the first nine months of 2015.

Our risk adjusted prices, excluding IPT, were up around 10% versus the third quarter last year, consistent with the trends of recent quarters. Claims trends continue to track at or slightly higher than the top of our long-term expectations of 3% to 5% per annum, driven by damage inflation.

So, what does this mean for our margins? Well, whilst we believe we've been writing at improved current-year loss ratios, there are three factors to consider when comparing the headline 10% price increase with the claims inflation around or slightly above 5%.

Firstly, we've been reinvesting some of this into our customer propositions such as guaranteed hire car, standard, seven-day repair, or free rescue on Churchill. Second is mix on account of the increased levels of new business. Third is timing as pricing data is on a written basis and it takes time for these premiums to earn through. But we believe the investments we've made in our propositions and new business growth should contribute to attractive long-term results for our shareholders.

Moving now on to Home. At the half year, we've highlighted that we've seen signs of the market stabilizing after many periods of price deflation and this stabilization continued into Q3. Against this backdrop, we grew our own brand policy count again. The IFP is now 3.2% ahead of the same time last year. This is the result of many initiatives to increase our competiveness over the past few years, including strong brand propositions combined with the benefits from pricing and claims projects, the latest proposition being our three-hour emergency plumbing service for our Home Plus Direct Line customers.

Our own brand risk-adjusted prices were up 0.6% versus Q3 last year, whilst the risk and business mix was down 4.2%, as our pricing models continued to lead us to lower risk and lower premium policies.

Moving on to Home partners, where the trend was also in line with the half year, policy count was down by around 1% in the quarter, and year-to-date written premiums were 6% lower than the prior year.

A few notes on the weather. We had another fairly benign quarter, and year-to-date weather losses now total £18 million. I'll remind you that our core guidance includes a normal annual weather allowance which is £72 million. And although we're currently running below this, recent experience has taught us not to get too carried away until the year is absolutely fully over.

Turning now to Rescue and other personal lines where GWP was up 1.7% versus the prior year, although policy count was down due to the ongoing trend for declining package bank account volumes. In terms of Rescue, premiums remained ahead of last year. Within that, our Green Flag direct offering had another strong quarter, growing both premium and policy counts with IFPs around 7% higher compared with this time last year.

Finally, Commercial, which grew both policy count and premiums in Q3. Policy count was 2.9% higher than the same period last year, largely driven by the continued growth in Commercial Direct, or DL4B, which is now 7% ahead of prior year. Commercial premiums in Q3 was 4% above last year with growth across both direct and broker channels.

Let me now hand over to John for a few words on costs, investments and our outlook for the rest of the year.

Anthony Jonathan Reizenstein

Thanks, Paul, and good morning, everyone.

I'll begin with costs where we reiterate the total business as usual costs for 2016 are expected to be no higher than 2015, even including the Flood Re levy. At the end of the third quarter, our cost base was around £16 million higher than the prior year as we partially offset the £24 million Flood Re levy which we incurred in Q2. In Q3, our total costs were 3.3% lower than Q3 last year. You'll recall there's some volatility quarter-to-quarter and some costs have been reallocated from claims handling to OpEx during the year.

For these reasons, it's best to look at the total cost base when assessing our cost progress to-date. As I said, we expect our total costs this year will be no higher than 2015, having it all for Flood Re levy, as well as costs associated with our new business growth. So, evidently, we're expecting to see further savings in Q4.

Overall, we're pleased with the progress on costs, particularly against the backdrop of growing our top line while investing in new proposition. These comments on costs exclude the risk of a higher-than-normal impairment charge referred to in our statement. Each year, we run a series of tests as we undertake an annual impairment review of our assets. Given the levels of investment we're making across all systems, we expect this could lead to a higher impairment cost at this year-end.

The reason for flagging this today is that it may result in us missing our reported cost target for the first time, albeit that the impairment will be a noncash item. As you all have seen from the trading statement this morning, we're also confirming that even with the additional impairment, we do expect to be at the lower end of our core range of 93% to 95%. As intangibles are not recognized on Solvency II, this impairment has no material impact on the group's capital position nor the group's dividend paying ability.

Moving on to investments. Despite all the political and economic uncertainty, our performance has been in line with our guidance with a yield of 2.5% and a very small gain of £100 million (07:29) in Q3. Conversely, falling interest rates and narrowing spreads in

Q3 led to an improvement in the AFS reserve which increased to £109.6 million post tax at the end of September. At the end of October, this has come down to £82.4 million post tax.

In the quarter, we sold down our securitized credit portfolio as it was suboptimal under Solvency II and we also made further investments into commercial real estate loans, maintaining our conservative lending criteria. Our Q3 property revaluation resulted in no material adjustments, and the diversified portfolio continues to perform in line with expectations. Although we think it's prudent to expect some asset volatility, our investment portfolio has so far performed as expected and we believe it's just centrally positioned should the UK economy come under pressure.

Finally, to the outlook. For investments, our outlook remains unchanged. We still aim to achieve an income yield of 2.5% in 2016 and 2.4% in 2017 on lower AUM. Our business-as-usual costs are expected to be no higher than 2015. However, reported costs may be somewhat higher due to intangible asset impairment. And finally, our combined ratio for ongoing operations is still expected to be towards the lower end of the 93% to 95% range even aligned for this cost outlook and including full annual weather.

So in summary, we're pleased with how we traded this quarter, maintaining the strong momentum across own brand portfolio that we built in the first half of the year, particularly in Direct Line, in both policy counts and premium growth. We believe we delivered this growth at attractive margins by continuing to make the business more competitive.

With that, operator, we'd like to start with some questions.

Q&A

Operator

Thank you. And the first question comes from the line of Thomas Seidl from Bernstein. Please go ahead.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Morning.

Q - Thomas Seidl {BIO 17755912 <GO>}

Thank you. Good morning. Yeah, three questions. First, on inflation, you say now it's at or slightly above your target range, 3% to 5%. So, do we read into that an acceleration, and related to that, post-Brexit input cost go up and legislation on bodily injuries, that doesn't change? So, is your business subject to rising inflation? That's the first question.

Secondly, if this is the case, how does that impact your prior-year development? Has it started to show in those numbers or will it show going forward?

And thirdly, pricing net of mix and inflation, you and the market seems to take hardly any real margin now with this rising inflation. Is it fair to say that this price cycle has just started, rather than is soon to end?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Okay. Thank you. John, I'll answer the (10:32) I think on the final point, we're clear, we are pressing ahead of our price inflations. We just want to manage expectations (10:43) between those two numbers, but we have said that we believe we're trading an improved current-year loss ratios. And some of it, it will catch up written to earn some of it through investment in new business growth, some of it's investment on – some of it's investment in propositions which I think we'll we get paid back for.

In terms of inflation, yeah, listen, we've been playing for a while that damage inflation has been pushing us up towards or maybe even slightly above the 3% to 5% range and that's a pre-Brexit translation.

Now, in terms of impacts on Brexit, I think there are various kind of buckets you can put those into. Clearly, paint and parts in motor and in terms of household, jewelry, gold, white goods would be quicker to have impact from the weaker sterling. But they are the minority of our claims costs. Even within things like accidental damage, quite lot of the cost is the people work for us in our garages and people who work in other garages. And absolutely, therefore, wages is the big thing to call. And I think history would say that those are probably slower to move up. So, certainly, we only have to get to try a year ahead. We don't need too much of a crystal ball on this stuff.

So, yeah, listen, we've got good sense of all this. We manage a lot of our supply chain really well. We're relatively cautious people. And so, we spend a lot of time thinking on this. So, I think we'll get it right or we won't get it too far wrong. Given the level of the movements, I think we anticipate many good stuff. And we spend a lot of time, that's what we do for a living, pricing risk, so we're all over it.

So, John, in terms of prior?

A - Anthony Jonathan Reizenstein

Yeah. Just one thing, just to be clear, our premium numbers exclude IPT.

Q - Thomas Seidl {BIO 17755912 <GO>}

Sure. But if I take the 10% and the mix, you've increased premium by 6.8%. And given your inflation number is 5% to 6%, so there's not much left in terms of premium improvements.

A - Paul Robert Geddes {BIO 2474781 <GO>}

In terms of real number, so the 10% is the – what we're saying is the like-for-like risk-adjusted (12:52) So, the 10% minus the 5% (12:57) And then we're saying, some of that is for profit increase current year, some of that is timing of profit increase which is risk into earned, some of that is investment in propositions, some of it is new business which we'll bid a new business stream.

A - Anthony Jonathan Reizenstein

So, are you happy with that on that side of things, Thomas, on the current year pricing and so on? Did you get those – that equation or...

A - Paul Robert Geddes {BIO 2474781 <GO>}

That waterfall.

A - Anthony Jonathan Reizenstein

...that waterfall, if you like?

Q - Thomas Seidl {BIO 17755912 <GO>}

Yes.

A - Anthony Jonathan Reizenstein

So, the 10% is like-for-like. And just to say, when we talk about some of this improvement in current year, we won't necessarily get it all recognized this year because, obviously, we're slow to recognize through our reserving, as you know.

And that takes me to the second point which is have we seen any problems or are we worried about the prior year, but we fairly haven't seen (13:40) anything yet on the prior year. It's a little bit early to say that we would. However, obviously, our prior-year reserving is pretty conservative, and it was only going to be able to absorb some inflation that might come through and hit the outstanding claims reserve.

And I think in addition to that, which is a comment about ABE being conservative, we also have margins, including specifically margins for general inflation. We've put in some while ago and I've talked about in the past. To be honest, we did put it in because we thought there was going to be a Brexit referendum, but we put it in for other reasons but we do have it.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay.

A - Anthony Jonathan Reizenstein

We're confident about that.

A - Paul Robert Geddes {BIO 2474781 <GO>}

I think it was a comment about the market, Thomas, just to kind of round off on your question and, of course, we made no forward-looking statements ever on pricing, but I think you can add Brexit into some of the suits or factors which we think has led to a market taking pricing, including more players being listed, including the Gibraltar impact of Solvency I to Solvency II, including this damage inflation, which we think is a market-wide phenomena. So, I can't say how long that will last, but certainly it's not a contributing factor, lower investment yields, these are all contributing factors to the market as it has been till yesterday. I can't make any comments about today and further.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Very clear, guys. Thank you very much.

Operator

The next question comes from the line of James Shuck from UBS. Please go ahead.

Q - James A. Shuck {BIO 3680082 <GO>}

Hi. Good morning, everybody. Thanks for taking my questions. I had three questions today, please. Firstly, just a bit more on the mix change. So, the rates are 10% (15:15) on the Motor side, and the mix change is dragging on that. Could you just explain where that mix change is coming from? Is it the growth in telematics? Is it that you're growing in kind of just low-risk segments in general? And you do actually mentioned a model change, I don't quite follow why that would impact on the mix impact within that number, so if you could just elaborate on that a little bit.

Secondly, around the prior-year development that we're expecting in the second half of the year. So, the 93% to 95% guidance at the bottom end or lower end of that range for the full year, within that number, are you expecting an elevated level of reserve releases relative to your normal planning assumption or is it kind of back to normal levels? And if you're able to shed any light on the trends you're seeing around prior-year development, that would be helpful.

And then, finally, around the value proposition, this is a very interesting thing that you're doing in terms of kind of seven-day repair and guaranteed car hire, those sorts of things. I'm just interested to kind of know what kind of impact is it having on things like your retention rate. So, could you tell me what your retention rate is in those and how that's actually responded in the period? And over the medium term, when do you actually see these value propositions kind of maturing to in terms of the overall proposition that's coming to a customer beyond just price? That would be very helpful. Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Thanks, James. So, let me do them in somewhat a reverse order. On the kind of the value proposition, we've been investing in Direct Line on multiple fronts. We've got propositions which customers really like. We've got a service which we grew a lot. We've got a great Web experience. We also recognized that those customers are intrinsically very, very valuable customers. And interesting phenomena is on those – everything else is just a basis. They have lower trading costs.

So, all of this means that we can give customers a really good value, high-service proposition and it's very valuable to us, too. And that manifests itself in a number of metrics, including strong retention. But also strong business growth, and that's a relatively recent phenomena to go back several years when I started this job, Direct Line was a – we didn't talk about its growth deliberately. But we're very, very pleased with it, particularly on digital channel on how it's performing.

So, it monetizes back for us in many ways and that creates a confidence cycle. The marketing is particularly effective. We were the first insurer to win an IPA Effectiveness award last week. So, Direct Line is in really good space and we will continue to invest behind the new propositions. Customers can see the confidence on there, are starting to feel confidence in the brand. It's got some really nice momentum. And as I said, it monetized itself in multiple ways.

John, can you do the other question?

A - Anthony Jonathan Reizenstein

Yeah.

Q - James A. Shuck {BIO 3680082 <GO>}

Are you able to tell me the retention rate, please?

A - Paul Robert Geddes {BIO 2474781 <GO>}

No. I mean, we've said this periodically. I mean, it's significantly about average and it's the strongest in our portfolio.

Q - James A. Shuck {BIO 3680082 <GO>}

Okay.

A - Anthony Jonathan Reizenstein

Yeah. So, just on reserving. Yeah. It's coming through strongly, if anything, a bit better than expected, especially on BI and also commercial general liability which is a major class for us but has been very strong. I think today, what I'd just say is with long term, we do expect it will come down, as we've always said. That's partly due to the greater level of reinsurance, of the lower retention level we have on reinsurance in recent years which means some of the runoff is shared with our reinsurers.

But we do think it will still be significant in terms of contribution to profit in the medium to long term, and the reason for that is because we're continuing to reserve conservatively to current year, which I think is just as well given, as we know, today inflation which has not been a topic of great conversation for a long while seems to be back. So, no real change to the story, but we're very pleased with the way the prior year is developing at the moment.

A - Paul Robert Geddes {BIO 2474781 <GO>}

On mix, mix is the item which is the difference between the premiums we've written at and the actual underlying like-for-like prices we think we're writing at. So, it's not in itself, therefore, a drag on margin, to be neutral on margins. It's a drag on – it's just a purely drag on ADP. So, we are relatively neutral to where our models find the risk. And if they happen to find it in high premium business, there it'll go up in reverse direction, but it's bringing all the way back to neutralizing margin.

Now, what happens is there's multiple effects, James, I could bore you with all of them, but there's an ongoing thing which is because we price off our risk models, there's almost a mechanical factor. We'll therefore tend to attract business to where our models find lower risk. So, that's one phenomena.

The second phenomena is how our prices are relative to what other people in the markets are doing. And it just so happens that in both Home and Motor this time, our models are finding more attractiveness in the lower premium parts of the market, and that could equally reverse in other periods depending on decisions taken by our competitors.

Then you've got a bit of channel mix in there, which is a slight drag on Home, which is more PCW business. And then there's a difference between new business – there's a bit of new business strain also in that mix effect as well. New business tends to be lower premium in Home but higher premium in Motor. And so, as we grow in both, that's a little bit of a drag on Home but a little bit of a boost on Motor. So, multiple factors. I think the kind of summary of it all is it's where our models say the profit is and, therefore, we have to just follow it around.

Now, as a long-term ambition, I think we could be writing more business in the long term in higher premium parts of the market. We think there's an opportunity there, but (21:30) really carefully, doing it uncarefully have got all sort of problems. So, on a multiyear basis, we do hope that we will start getting some boosts to that number, but not until it's ready.

Q - James A. Shuck {BIO 3680082 <GO>}

Okay. That's very helpful. Thank you very much.

Operator

Your next question comes from the line of Gordon Aitken from RBC. Please go ahead.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Morning, Gordon.

Q - Gordon Aitken {BIO 3846728 <GO>}

Yeah. Morning, guys. Just one question, really. I mean, you talked about areas of potential growth. I think you just talked about the potential to go into some point when competitors reduce them, what they're doing in terms of the high-risk areas. But in terms of Green Flag and SME, those are two areas where you've talked about. They are potentials for growth (22:12) what's been happening in Q3?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah, thank you. I mean, I think, listen, we've got a really good success story in Direct Line's business. It's currently concentrated really on kind of three products. And watch the space, I think, in terms of our ambition to take that Direct Line of business magic into other products. So, for landlord and for (22:34) if you listen to classic FM, we'll bombard you with adverts about it and everyone knows we sell it, and the product is really good, and the prime process is pretty slick. We will be following those up with other business areas, which we see opportunities also in terms of going direct. So, probably watch the space a little bit on that, Gordon.

I think in terms of Green Flag, we've got some innovation going on in Green Flag, At pilot level, we've got a very interesting innovation which is we call Green Flag Alert Me, which enables customers to see – to talk to their car's engine diagnostic system to find out what all those lights actually mean and what's going on under the skin. We also are just rolling out a really cool app which is familiar to Uber user, I guess, in terms of saying I have an accident, and it will work out where you are and whether Van is in relation (23:27) to you. So, we're launching that. We're innovating on Green Flag.

As I said before, I think this could be really nice in search of business. And if you take out some of the package account side of things like the Green Flag itself, it's growing nicely. So, now, we're feeling good about both of those things and, as I said, as well as organic opportunities particularly in Motor kind of in the medium to long term.

And then the Home performance, I think we should be really pleased in markets like this. We're growing our own brand IFPs which is a metric which we said you should judge us by. Partnerships come and go, and the market we're saying is competitive and, therefore, the fact with our premiums have come down, you shouldn't be surprised. So, really, the metric we're saying you should judge us by is the IFP policy count and we're really pleased with the trend there.

Q - Gordon Aitken {BIO 3846728 <GO>}

Great. Thank you.

Operator

The next question comes from the line of Oliver Steel from Deutsche Bank. Please go ahead.

A - Anthony Jonathan Reizenstein

Morning, Oliver.

Q - Oliver George Nigel Steel {BIO 6068696 <GO>}

Morning, John. Morning, Paul. Three quick questions. First, could you just talk a little bit more about home claims experience relative to those small price increases?

Secondly, going back to the impairments of the intangibles, I mean, by implication, this is sort of unexpected. And I'm just wondering, does that implicitly mean that some of the IT spend haven't gone quite as well as expected or what's going on there?

And then the final question I've got is you talked about having sold your holdings of securitized credit. Is that meaningful from the Solvency II perspective or should we just ignore that?

A - Anthony Jonathan Reizenstein

Okay. Shall I – you want to talk...

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah, let me – I mean, home claims, I think we were saying probably at a market level, you'd expect something like 3% to 4% kind of home claims inflation. We think we've beaten that a bit ourselves in previous years through our own initiatives, but probably that's where within market terms should be running at. And you'd expect to be running higher in that range towards the top of it probably in a kind of post-Brexit world. And it's something again we don't need a crystal ball. We'll react as we see data and when we see trends in that.

A - Anthony Jonathan Reizenstein

Yeah, on the impairment, is it unexpected? Well, we actually expect a bit every year. We have an impairment every year, and if you look in the accounts at the back, you will see this time every year. We're saying this is going to be a bit a more than usual and the reason for that is simply the volume has changed.

And while we're talking about it, well, the reason we're talking about it is because it's going to mean – if it happens, it's going to mean that for the first time, we don't meet one of our published targets or guidances. It's not happened since the IPO. We're very proud that we have met, we're not particularly pleased that we'll meet one and (26:27) one, we need to make it clear to people, but it is noncash, it's not going to affect our capital and we can go get through it.

On the final one, securitized credit. There is a marginal change in – very marginal change in the Solvency II capital. We're going to reinvest that cash back into other forms of credit, we've got some great credit probably outside the UK, U.S. and global. And net-net, there won't be much change but we'll get a slightly better return. So, it's more about the return we can get on that amount of capital. It's not going to make any difference to our total capital position or dividend.

Q - Oliver George Nigel Steel {BIO 6068696 <GO>}

Okay. You say a marginal change on Solvency II. Is that a marginal up or a marginal down?

A - Anthony Jonathan Reizenstein

The securitized – obviously, there's a marginal release when it comes out on a diversified basis but quite marginal when it comes down. Then we're going to back in with other forms of credit which will absorb pretty much the same amount. So, net-net, the revenue won't (27:27) change.

Q - Oliver George Nigel Steel {BIO 6068696 <GO>}

Okay. All right. Thanks.

Operator

The next question comes from the line of Janet Demir from Morgan Stanley. Please go ahead.

Q - Janet Demir {BIO 19462264 <GO>}

Hi. Just two quick questions from me. The first one is on the major weather loss budget. Are you still breaking that down in terms of quarter? So, I realized it's more heavily weighted towards 3Q and 4Q, but does that mean, for example, we can expect that the expectation is £24 million for 4Q now?

And secondly, you mentioned before that you would possibly develop another model to aid pricing, and I'm just curious whether that's still in the works. And if it was developed, how would you expect that to impact the risk mix? How would you price with those two models? Thanks.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. In the works is exactly the right expression and, therefore, I'm not going to say anything more about this but, yes, it's in our thinking we're working out different ways of essentially doing that, but we'll update as we get nearer to that. But nothing imminent on that front, a medium to long-term opportunity I think.

And then on weather, basically, it hasn't had (28:30) right? We can easily get through the whole weather as we have in previous Christmases. So, we don't want to count any chickens at all. We do an annual guidance and, obviously, we don't have to split it out by quarters because we don't get profitable by quarter.

Q - Janet Demir {BIO 19462264 <GO>}

Yeah. Okay. Thank you.

Operator

Next question comes from the line of Philip Kett from Macquarie. Please go ahead.

Q - Philip Kett {BIO 19507232 <GO>}

Thanks, guys. Just one quick question from me. At what proportion of new business and renewal business is direct?

A - Anthony Jonathan Reizenstein

Give us a quick second on that. We will...

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. We're just getting the figures for you now. It's not a normal disclosure that we make. So, rather than us be rushed into kind of giving it now, we'll consider whether we should make it, either we're making more of our direct story. So we'll consider that for year-end whether to make a disclosure on it, but we haven't today. I want to think about whether we should because it's somewhat commercially sensitive, okay?

Q - Philip Kett {BIO 19507232 <GO>}

Okay. Thanks. Just one quick follow-up on that. Are the margins higher in direct business? Are we right in thinking that?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yes. I think the profit characteristics are these customers are somewhat more expensive to recruit and we have given richer propositions and we service them all, but their intrinsics are they're loyal and they bundle things and they have a very good potentials forward (30:23) and that will balance it out. As I say, we're very, very happy to be growing in Direct Line.

Q - Philip Kett {BIO 19507232 <GO>}

Thanks very much.

Operator

And the next question comes from the line of Andrew Crean from Autonomous. Please go ahead.

Q - Andrew J. Crean {BIO 16513202 <GO>}

Good morning.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Hello.

Q - Andrew J. Crean {BIO 16513202 <GO>}

Two questions, please. Just could you give us the proportion of your overall motor claims bill which is paint and parts? I mean, even it is not exact, it'd be interesting just to know what proportion is going to be vulnerable to inflation.

And then, secondly, I think in the quarter, your overall balance sheet investment holdings were slightly up. And I was wondering whether that after a long period of falling investment holdings, do you now think you've reached the base or was it potentially just a currency effect if you're holding overseas bonds?

A - Paul Robert Geddes {BIO 2474781 <GO>}

Yeah. Andrew, clearly, we do that number but – I mean, it's – the damage is about half and it's obviously only a subset of that damage cost because a lot of it is the Rotterdams (31:41) that work in the carriages.

Q - Andrew J. Crean {BIO 16513202 <GO>}

Yeah. No, I'm just wondering, just in broad order, is it 20%, 30%?

A - Paul Robert Geddes {BIO 2474781 <GO>}

It's less than 20% in total claims costs. I think we'd be happy to say.

Q - Andrew J. Crean {BIO 16513202 <GO>}

Yeah.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Motor.

A - Anthony Jonathan Reizenstein

On the AUM, Andrew, the reason it's a bit lumpy is because the dividend payments, cash flows and so on. We still think it's on a slightly downward trend over time, the AUM.

Q - Andrew J. Crean {BIO 16513202 <GO>}

Okay. Thanks very much.

Operator

We now have a follow-up question from James Shuck. Please go ahead.

Q - James A. Shuck {BIO 3680082 <GO>}

Thanks. Yeah, just a few follow-ups for me. Firstly, there seems to be some debate about the whiplash performance next year and whether (32:25) should be inactive or not. Could you just share your thoughts on whether do you think this will come through? And also, weather, it's looking like some former insurance premium tax increase will be implemented in the autumn statement.

Secondly, any update on the (32:45) kind of products for customer? The numbers are kind of products held by – of kind of Home held by Motor insurance customers, those sorts of things would be very helpful, indeed.

And finally, just in terms of the large BI and PPOs, are there any – could you just remind me of the numbers of PPOs that you have and whether you're seeing any negative trends on that side, albeit from claims notifications or, indeed, from trends amongst the various laws? (33:16) Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Okay. So, whiplash, we continue to lobby that it should happen. It will be a thing which is going to offset some of these trends in the marketplace. We stand shoulder to shoulder with the ABIs saying that clearly there are multiple priorities of government and clearly the change of administration has meant that some of the original sponsors of the legislation have changed. We've never dressed it up to be the easiest piece of reform because there's a quite a law that needs to be change and (33:49) are pretty busy on other banks right now. But we continue to lobby.

On the IPT, I think we've clearly said before, we don't think it's particularly (34:01) Customers I think do kind of realize it and, of course, have shopped around but, ultimately, it's not our choice who and how to impose taxes. We will implement whatever we're told. But clearly our feelings again have been shared with government quite publicly I think in terms of we don't need to be seen as a gift that keeps on giving but, ultimately, it's their choice.

Cross-sell is always a focus of ours and, again, as we said before, one of the things we like about customers that like our brands is it gives us a longer, bigger, deeper relationship with them. These are metrics which we share. We shared some metrics only back at the IPO, which I think showed that we're pretty good at this, but it's always an opportunity if we can make it easier and better value to customer to buy more products from us, generally, we think they will. So, it's the focus of our activities that changed but not separate the disclosure.

Q - James A. Shuck {BIO 3680082 <GO>}

BI?

A - Anthony Jonathan Reizenstein

Large BI has been pretty stable and we found – and we said this in the past that prior years have been well reserved. It's been one of the drivers of our prior year, reserving releases. On PPOs themselves, we've got about 150 in our ongoing book and about another 60 in the runoff. I think they'll be there for quite some while. But if we continue to reinsure at the £1 million retention level, by the way, which is not necessarily automatic and we debate that every year, but if we were to, we wouldn't get many more. Obviously consideration in whether we would change that range, for instance, and take more risks would be the impact on the PPOs going forward.

In terms of propensity, broadly, it's broadly flat over time, and we haven't seen any risk to our reserving on that side of things. And then in terms of the sort of cost of the PPOs, as you know, we have a relatively active investment plan against our PPOs through asset classes we've selected to give good color for that, namely, property and infrastructure bonds, and that's performing well, and that will have a little spike and (36:23) index that you might have seen from previously quite low levels, but I think we'd be well set up to deal with those kinds of things, that kind of volatility.

Q - James A. Shuck {BIO 3680082 <GO>}

Can I ask you a quick follow-up? Just on your Solvency II sensitivity to lower interest rates doesn't indicate a particularly sensitive number, and yet you do have a reasonable number of PPOs. I appreciate there's the retention level, but that retention level hasn't always been at the £1 million level, it's been higher than that in the past. What should we be thinking about what's driving the Solvency II sensitivity? Because you would think that the PPOs would drive a reasonable amount coming through that ratio.

A - Anthony Jonathan Reizenstein

Well, yes. And obviously, the reason we've got the reserves on PPOs in the first place is because we retained a high level – we're at very high levels in the old days, up to £10 million, in fact, that's why we've got them. If we were starting with a £1 million – a new company with £1 million, we probably won't have hardly any, but we've got (37:22) So, you're absolutely right.

In terms of sensitivities, we use a zero real risk, real return in how we value these in Solvency II as in IFRS and therefore provided we have justification for believing we can justify that zero return which we can given our investment policy, we have less volatility than you might think.

Q - James A. Shuck {BIO 3680082 <GO>}

That's very helpful. Thank you very much.

Operator

We have no further questions coming through. So, I'll now hand you back to Paul Geddes to conclude today's conference. Thank you.

A - Paul Robert Geddes {BIO 2474781 <GO>}

Well, thanks very much, guys. February 28 is the next time we have planned to speak to you and hopefully we'll give you some more positive update on the business then. Thanks very much.

Operator

Ladies and gentlemen, thank you for joining today's conference. You may now re-place your handsets. Thank you.