Q3 2020 Sales and Revenue Call

Company Participants

- Penny James, Chief Executive Officer

Other Participants

- Analyst
- Faizan Lakhani
- Freya Kong
- Greig Paterson
- Ivan Bokhmat
- James Shuck
- John Denham
- Ming Zhu
- Thomas Bateman

Presentation

Operator

Ladies and gentlemen, welcome to the Direct Line Trading Update Call. My name is Adam, and I'll be the operator for the call today. (Operator Instructions)

And I have the pleasure of handing the call over to Penny James. Penny, if you'd like to go ahead, please.

Penny James {BIO 15157212 <GO>}

Thanks, Adam. Good morning everybody and welcome to our Q3 Trading Update. Now, we don't, normally do a call at Q3 as the reporting, very light, but we are conscious or have been quite a few questions in recent weeks around external factors. So we thought it was a great opportunity for Q&A session.

So firstly a quick apology, frankly Tim is unable to join us today, as a family member is unwell, and it is much more important that he is with them at the moment. So with Tim and his family, our love and best wishes. We do have Neil Manser here who you will know well as Chief Strategy Officer and meet chain across the organization. And the events are run-off the balances you went through our came early thing --. Now you will be delighted that I don't have a long speech. But I'll catch up the key thought on the quarter while you cover up your questions.

The first slide, what are we kind of trading. Now overall Q3, shopping levels increased across the portfolio following the easing of the lockdown restrictions and our strong competitiveness has helped drive growth across a number of brands and channels. Own brand policy count grew compared to Q3 2019 and growth written premiums were stable, which is a really good result compared to the 20% reduction in premiums that we saw in Q2.

In motor, own brand policy count held flat as we saw some recovery in new business shopping and retention normalized following the increase in Q2. We also saw a continuation in the risk mix impact on average premium that we highlighted at Q2 with fewer new cars, new drivers or midterm amendments of people add drivers will change cars. But as well as this, we've seen a modest market premium deflation, leading to a slight reduction in own brand gross premiums overall.

Looking at claims motor damage severity is running a little higher than the long-term average as the repair industry response to COVID-19 related factors such as slightly longer repair times, supply chain glitches, increase cleaning costs that kind of thing. But this was more than offset by claims frequency remaining below pre-lockdown levels. In the home, we grew direct own brand policy count and premiums demonstrating our improved competitiveness in particular in the PCW channel. In green flag, we've had a really strong quarter delivering 9.6% premium growth, as green flag continues to demonstrate its competitiveness, and this has helped offset a reduction across other platform lines.

Commercial delivered an incredibly impressive result across all channels. Direct premiums grew by 12.4% in Q3, whilst NIG also grew premiums by 8.7%. The business was also recognized that the National Insurance Awards as Direct Line, one commercial lines insurer of the year and Churchill was awarded great company of the year.

Now despite further lockdown restrictions, we've made no changes to our estimates on COVID related claims in travel or commercial which remain at 25 million and 10 million, respectively. There were two other areas that I wanted to say a few words on before we went to Q&A.

First the long-awaited FCA reporting to pricing practices. As I've said before that we are supporters of the FCA reviewing this area. I think it's fair to say the pricing practices report did go further than we were expecting and represent substantial change to the way the entire market operates. That said it is something we've been preparing for sometime and you'll recall Kate speaking to you about it last year at the Capital Markets Day. We and other players are working with the FCA on the practicalities of how their intense is translated into market practice. And so it remains too early to say what the financial impact is, but I've been clear and I remain confident that on a level playing field, our portfolio of market leading brands underpinned by exceptional customer service and indemnity controls, operating across multiple channels will enable us to thrive.

The second thing I wanted to comment on, with our progress on the transformation agenda. In terms of transformation agenda, I really want to say how proud I am of the way our people have continued to respond to the pandemic. Not only people adapted to home working without compromising own customer service, but they've continued to drive our transformation forward. I talked half year about the progress that we've made since lockdown started, replacing our accounting ledgers and claims payment systems, replacing the green flag claim system and upgrading the telephony throughout the organization.

Well in Q3 that progress has continued, we've launched a new mileage Moneyback proposition for Direct Line motor customers which offers a more flexible approach to managing mileage on their policy. We passed another milestone in our technology transformation with the migration of our technology to a new Plateau -- mainframe platform. And we also continue to make progress with our new Motor platform and are on track to start writing Direct Line in Churchill policies on it this year.

As I've said before, organizational change is just as important as technology change. And in Q3 our trading and change teams have moved to a new agile operating model. Changing the way we work to take advantage of our technology is a crucial part of our strategy to offer customers better value and choice, by unlocking our ability to be more innovative, and enabling us to move faster to market with our products. So I'll start -- some timing to refaced in the early part of lockdown our transformation continues at pace. So overall, we've delivered an encouraging trading performance while making good progress on our strategic transformation.

So what does that all mean in terms of our outlook then? Well, we're on track to deliver our combined ratio targets this year and actually expect to come in slightly below the 93%. Our ambition to deliver a 20% expense ratio in 2023 remains that we reiterate that. And we recognize that there are some uncertainties remaining in the relations of COVID, in relations to Brexit Transitions and in relation to where we are in the process with the pricing practices review. But based on the things we can see so far, we're reiterating our 93% to 95% guidance for the medium term.

So I'll leave my comments. Thank you for listening, and I'll hand back to Adam to coordinate the questions.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) Okay. It looks like we have our first question. This one comes from Freya Kong of Bank of America. If you'd like to go ahead of your question, please Freya.

A - Penny James {BIO 15157212 <GO>}

Hi, Freya

Q - Freya Kong {BIO 20097488 <GO>}

Hi, Penny. Good morning. I have two questions, please. Firstly, on the FCA, you've not provided that much comment today, pending the consultation. What are the biggest issues or practicalities you expect to be addressed during this consultation? And what sort of industry pushback are you expecting? Secondly, on Motor. Could, you please give us a sense of what frequency benefits you saw in Q3 versus Q2? And I guess, the outlook for Q4 and next year and the path to normalization? Thanks.

A - Penny James {BIO 15157212 <GO>}

Thanks, Freya. Okay. Let's do FCA first, shall we? Look, if I stand back, I've said that -- as I said, I think we can thrive on a level playing field and the key for us just to make sure that but that, that field is clear. It's not at those levels, but most importantly, that everybody understands it the same way. I think what it's done is kind of very material in as much as it kind of affects pretty much every policyholders price across the market. And so, it's a major intervention in practical terms and away logistically in the way that the market operates. If I kind of go -- let we pause for a second on the intent, and then I'll go to sort of some of your specific questions.

It's pretty clear what their intent is. Their intent is to get fair value for customers, which is something that we and I'm sure other players in the market have been thinking hard about for some time. It's to have new business prices that are greater or equal to, if you like, renewal prices for customers within equivalent segments so they recognize there can be differences between brands, channels, products and so on, and so forth. They're not trying to shrink margins in the industry, importantly. They've made that very clear that they actually think the margins in the industry overall are fine. But they are flagging -- they want to see reduction in unnecessary churn, as they might put it. And therefore, they may seek to see less shopping, less marketing, less commission costs.

So I think the intention of what they're trying to do is unclear -- is really clear. I think there were lots of uncertainties as to how that would operate in reality. And that's where I think all the energy is going at the moment. You asked, do I think there will be a mass industry pushback? I'd be really surprised to see the industry a mass pushback. We said -- and the ABI has said that we will support the FCA in this process that actually most of the CEOs I deal with, would like to see some of that pricing -- the price -- concept and it's very difficult for individual players to do that.

So, I think you will see, on the whole, the industry supports that, but push hard to make sure that it's right first time that it can be implemented sensibly that people have got time to get it right and that people understand it in the same way. And if I just put a little bit of color around the kind of thing. So there are lots and lots of areas where I think we need greater clarity and credit to the FCA. They have a series of webinars and conversations with industry happening over the coming weeks that will work through which of those points of things that they've thought through and know the answer to and which of those points where they need to work with the industry on what the right answer is. And I'm sure there'll be some of both. Kinds of things that are unclear that make a real difference in the real world. It's clear that you can't have new business prices above renewal prices. But for example, can I offer cash -- pull it back? Can I offer 12 months for the price of 10?

Can I offer a soft --? I know I can offer a rescue product or a different kind of product add on as long as I include it in pricing the same way, but does that mean I have a different pricing structure for Direct, things like I sell direct, things I sell next to an insurance product? Can a price comparison sites offer all those things because they're not directly covered by that and then cross-traded back through commission, et cetera, et cetera? How does it apply to broker? So there are lots of areas where -- to make sure that their intent lands safely within the industry, we need to be really clear and consistently clear so that we don't end up in a position where one insurer does it one way, one insurer sees another way and the market is chaotic.

And the reason -- the other reason that's important is because I'm relatively relaxed about what version of those answers we get as long as we're clear what those answers are. But I can't finalize my trading strategy through it until I know what those answers are, which is why I think it's too early in those conversations to be putting numbers on the table at this point. So really important that we get clarity, and I suspect by the time everyone's pulled their questions, there'll be quite a lot on that list. But I don't think there are things that insurmountable. I think it's more about making sure that the lines are drawn appropriately clearly so that when we implement this as an industry, we implement it once and everybody is understood it consistently.

So if I follow the intent, but what they're trying to do -- what they say they're trying to do that is a market that we can drive in, brands, service quality, multi-channel, claims advantages and a strategic step that we've been taking on all things that put us in the right space to operate really affectively in that market. I'm just really focused on making sure that what we get is a sensible transition into that world and that the conversation that will carry on with the FCA through the ABI and other CEOs to make sure we get to that point.

Does that deal with the FCA question, Freya?

Q - Freya Kong {BIO 20097488 <GO>}

Yes, thank you. That's very helpful.

A - Penny James {BIO 15157212 <GO>}

Okay. Then if I go on to kind of frequency and outlook and so on and so forth, what are we saying in frequency in the market? I think what we saw -- I mean the broad answer is the shape will follow driving patterns, which are kind of publicly available, but we were obviously very materially down in Q2. We've seen that restore in Q3, but it's still if you look at the October data, I think October driving levels or something like between 10% or 15% below what they were pre-COVID. And you're seeing generally a frequency lag -- claims frequencies lag on that as well. So -- and there's lots of debate about what's driving that differential. But broadly, we're seeing a slightly different mix of context -- happening and I think you're seeing kind of left commuter bump into the back of the car in the front part accidents. And that's probably -- most driving any mix differential.

So, still lagging behind those overall driving levels. And obviously, as you come into the winter, people will be taking views on what is now looking like a sort of a choppier winter from a pandemic perspective for all of us. People are taking different views on what that means they're pricing. And if I look at -- if I touch on severity first, -- frequency, severity we'd seen accidental damage, so damaged severity is running slightly ahead, a little ahead of our normal expectation level. I think two things were driving that, mainly that is what I call COVID-related factors through the recovery -- the repair industry. So supply chain glitches slightly -- taking slightly longer to repair vehicles, cleaning costs, those kind of things. So, what I would call non-structural, but COVID-related type effects. There's a bit of mix which is really as I say, I think slightly different kinds of accidents happening in there as well, which again you'd say it's not long-term -- not necessarily it's a long-term structural.

And then as you look forward, the only thing I'd say that we are the people are alert to the -- could be structural is how any Brexit transition lands and what the implications on cross-border kind of activities there. So that has the possibility of putting it inflation and depending on where that land. So that's kind of the severity picture and then if I kind of put it all together into pricing, but how we think about pricing and we always are trying to look forward at what pricing -- what claims trends are for the next 12 months for the life of the policy and reflect that as our pricing base.

Usually what we do is use long term inflation as our guide for that. It's very clear as you run through these kind of circumstances that you need to use some judgment on top of that as well because whereas perhaps as we came out of Q2, it was reasonable to assess that things would rise relatively quickly. I think as we've moved through Q3, all of us have become clear that the winter is not -- it's going to be tougher and there are going to be more restrictions as one that we would have hoped. And therefore, some judgment around those long-term assumptions is kind of natural. And I think when you look at what's happening in the market, there's a couple of data points out there around, I think -- come out and so on that suggest the market has come off a little bit, probably a couple of points, I think, in those data studies. I think that's quite natural and rational. If you look at what's happening pandemic wide, and you look at some of the claims frequency effects that we're seeing at the moment. Then that feels like a pretty modest and rational response to that set of circumstances.

Q - Freya Kong {BIO 20097488 <GO>}

Okay. Thank you.

A - Penny James {BIO 15157212 <GO>}

Thanks, Freya. Adam, back to you.

Operator

Thank you. We have our next question. This question comes from John Denham of Morgan Stanley. If you'd like to go ahead with your question please, John?

Q - John Denham {BIO 1644513 <GO>}

Brilliant. Good morning, Penny, morning Neil. Firstly, I was just wondering how you think your comparative advantage changes in a flat pricing environment? You mentioned the importance of brands in your intro. And then secondly, you're guiding to a combined ratio better than target this year. You've already taken various actions to support customers, and it feels like you've already been fairly cautious in recognizing frequency benefits. So given that you've said you don't want to make excess profits after crisis. I was just wondering if you expect to announce additional measures for customers if frequency drops in 4Q, may be something which requires less action on the customer's behalf, i.e., rebates instead of changing mileage or maybe passing future benefits through via pricing instead? Thanks.

A - Penny James {BIO 15157212 <GO>}

Thanks, John. Why don't we take the second one first because it sort of rolls on from the last question, and then I'll come on to the long-term one, comparative advances question. Yes. So core -- yes, we do think core investment target, as I flagged by the end of the year. Actually, we've done a lot of things for customers. You're right. We said from the outset, we didn't want to make excessive profits as a result of COVID. I don't think we're doing that. When you look at the operating profit in the round, you look at both the $90-odd million of -- good type initiatives, as we call them, where we've either given back to people or customers or communities through this program or through this period. And when you look at what's happening on investment income and so on and so forth, there are lots of things happening in the P&L.

And I think when we're look in the round, we don't think we're leaving this year even with the core slightly outside the original guidance targets with what I would describe as excessive products profit. How are we thinking about customers in that context at the moment? Well, as you know, we made kind of mileage adjustments available to all earlier in the year. We've been in contact with all of our customers to offer that and many hundreds of thousands have taken that up. That remains open to people.

And then, obviously, we've just touched on the new proposition to Direct Line customers, which is really a permanent and ongoing approach to giving mileage flexibility to customers. As I said, it was something we've been thinking about anyway in terms of giving greater flexibility. What you can do in the Direct Space is seek to personalize product much more. And that's where we see it going over time, whereas price comparison is really largely homogeneous products with the competitive pricing. We think in the Direct space, that with great digitization, you can improve and tighten personalization for customers, make it that easy to use and make it a much better fit to them. And in a way, the mileage proposition that we've just put out there is kind of a first step into that space for us.

So we're quite excited about that. And the feedback from customers is great so far. And we've already had a couple of hundred thousand people take us up on it in the first week or two. So those are kind of the way we are thinking about that. And as you say, whereas in the original lockdown, we were kind of all in, I think, quite a different space. It's a very different kind of lockdown position we're in at the moment. We're now in the process of looking forward and trying to assess overall what those implications are, our frequency implications are and start reflecting those as our -- as we would do normally in our trends when we're pricing. So I think we're giving back in lots of different ways, if you like, overall.

And I think in a round, it's not -- we don't view this as excessive profits. So hopefully, that deals with the second question. In terms of the comparative advantage point, I think if you move -- if you throw yourself into a world where there's less shopping around potentially and less drive for customers to investigate other products because of -- because of price alone, which is where I think you should expect us to sort of start moving towards. Then having powerful brands and brilliant service become a more important differentiator.

Now you still have to be really sharp on costs, so you can't carry cost disadvantages. So the strategy that we have in place to address the cost base increase -- through increased digitization and automation underpinned by the technology changes. That's all really, really important as well. But actually, having those different brands -- having great brands and great service and back office claims advantage and so on, those things still really matter in that world and probably even more. So we see those as real comparative advantages.

I think the other thing is that with or without kind of any change in the marketplace, we had always envisaged, as I said, over time, that Direct lets you operate a more tailored product over time for people that it can -- you can demonstrate greater value for people, but you can also make product more tailored. So you'll see a lot of our growth in the home space at the moment is content driven. We bought broadly in the summer because they've got a great vision and some tech around what you can do with much more tailored products for the rental market, for instance. And I think you can do that in a digital world, much more straightforwardly than you could do without the overhead -- it would -- in the old world, it would have come with a lot of overhead that I think increasingly it will, but the Direct distribution in peripheral of advantage in that space.

So we see having multiple channels kind of as really important in the direction of travel, and it also lets us segment our book in a different way. So as things move forward, if we're comfortable with the pricing for a particular cohort, and we're comfortable with those margins, we can take new business in a different way through different -- or different products or different propositions by having a variety of options. It gives us choices and it gives us levers. And I guess what I'm saying at the moment is I don't yet know exactly how we want to use all those levers because that rather depends on what's the exact way the market operates, which is what the next few months are about. But I'm confident we've got choices and choices that some others don't have.

Q - John Denham {BIO 1644513 <GO>}

Very clear. Thanks Penny.

A - Penny James {BIO 15157212 <GO>}

Thanks John. Adam?

Operator

Fantastic. We have our next question Penny, it comes from James Shuck of Citi. If you'd like to go ahead with your question, please, James.

A - Penny James {BIO 15157212 <GO>}

Hi, James.

Q - James Shuck {BIO 3680082 <GO>}

Hi. Good morning. Hi, Penny. Hi, Neil. So a couple of things from me. Just -- there's a comment about the rollout the most platforms in Direct Line and Churchill. You're taking a more measured approach. It's been quite measured for quite some time. It sounds like it's getting delayed again. Could you just elaborate a little bit about what's happening there, please? And then secondly, on the -- so the guidance for kind of better than $93 million in 2020. Obviously, there's COVID impacts in there, which include frequency. Could you just elaborate, is that a normal run rate when you look through frequency and the COVID losses? So are you delivering slightly better than the target range currently? Those are my two questions. Thank you.

A - Penny James {BIO 15157212 <GO>}

Brilliant. Thank you. So let's do the -- what's going on in the transformation space and I'm kind of -- I guess, the expense space too. And actually, if I look across the year, James, I'm just really pleased with -- the thing that surprised me most, and I guess that is for Q2 is how fast we got back on to the transformation agenda.

And if you'd ask me coming into lockdown, whether it would be possible to move to an agile operating model, deliver multiple systems into a full home working environment, out of kind of just looked at you as if you were mad. But actually, that's what we've done. So I'm super happy with the progress we've made on transformation. We've had -- where we had delayed. Some drops we -- some areas, finance systems have no delayed tool. We have delayed a little on the motor drop a few months because we lost developer productivity in India in the half of a lockdown is the main reason that's got deferred.

But we're still hitting the target that we set ourselves, which was the end of this year. So we're pretty much in the territory we expect it to be in. What's the measured rollout? I think it's a reality check here. We've got -- we're trying to roll out a system into a pandemic across 3,000 people that looks after the vast majority of our customers. And you wouldn't expect me to compromise customer service for the sake of pace. And we had hoped to be able -- As much as we've been rolling systems out, we had hoped to be able to deliver this with in the early weeks with people in offices and roll it through that way. We can't do that. We're delivering it in the homes.

Actually, training is going really well. But the pace at which we roll that out will reflect really how severe restrictions and lockdowns are. So productivity is great with homeworking, it's high 90%. They're right up there. It dropped significantly to schools around, for instance. And really, all we're saying is, we'll roll out at the pace that is right as we start to train this out and deliver it into our customer base and our people.

So not concerned about the technology. In fact, we are technically live on DL and Churchill at the moment and going through the kind of fine-tuning processes that you go through before you actually start putting customers on it. So not worried about that, just recognizing the realities of getting the balance between customer and cost delivery for want a better description right in a pandemic. Does that deal with your question on the technology side?

Q - James Shuck {BIO 3680082 <GO>}

Yeah. I think so, very understandable. Thank you.

A - Penny James {BIO 15157212 <GO>}

Brilliant. Thanks. And the other one, I didn't write-down, which is hopeless or the second question. Believe me I wasn't -- I should have written it down.

Q - James Shuck {BIO 3680082 <GO>}

Is there a net COVID benefit from that or are you actually running at that level?

A - Penny James {BIO 15157212 <GO>}

Thank you very much. Sorry. Let me answer that. Are we running? I think the way I would I would clearly it is COVID -- COVID is sort of in intent for the numbers at the moment. So trying to draw a net total ttl COVID view is slightly challenging at times. But I think what I'd say overall is we had hoped to be able to improve our current year loss ratios and so on over the course of this year.

That's part of the plan. And we feel as though we've done that on an underlying basis is such I think was allowed to be reported as well as on a post COVID basis. I'm not sure that I would turn that into a projection that says we're going to long-term beat 93% to 95%. That's not what we're saying. But I think we're comfortable with the progress that we're making in real terms, if you like, underneath, not just the COVID effect that are coming through.

Q - James Shuck {BIO 3680082 <GO>}

And if I may, just quickly, when it comes to 2020 loss picks, are you baking in a bit more conservatism based on the potential for a rebound in frequency and severity in this year and perhaps into next year? Could you just elaborate a little bit about how you're setting the loss picks in relation to that $93 million?

A - Penny James {BIO 15157212 <GO>}

Well, I think I said -- we haven't set our year-end reserves yet. And there are some rules of the game. So you can't anticipate claims frequencies that haven't happened in the future and so on and so forth. What you would expect us to do is to take full account of the risks that around the current -- the claims have incurred at that point, if you like. And there are risks in some of those spaces, in particular around inflation effects of some of those claims close outs and so on so forth. So you should expect us to take the same, pretty prudent approach to reserving that we always take, -- I think as we get to year-end, is probably the message.

Q - James Shuck {BIO 3680082 <GO>}

Okay. Thanks very so much.

A - Penny James {BIO 15157212 <GO>}

Thanks, James. Adam, anyone else in the line?

Operator

Yes. We have another question. This question comes from Greig Paterson of KBW. Greig if you would like to go ahead with your question, please.

A - Penny James {BIO 15157212 <GO>}

Morning, Greig.

Q - Greig Paterson

Good morning. Switching to Home. I did note RSA made a statement about that its MORE THN brand had grown strongly, and they wanted to push further for share there. So just wondering if I could switch the discussion a bit to Home, and it's looking for some numbers here. I was wondering what your underlying claims inflation is there currently in terms of the range, 3% to 5%, is it below or above, et cetera? And I wonder if you could talk a bit about what you achieved year-on-year in rate and year-on-year on mix there, please?

A - Penny James {BIO 15157212 <GO>}

I'll give you a feel, Greig. Obviously, we haven't published all of those numbers at Q3. But what's the essence of what's going on in Home? I think, look, Home is a super competitive market and has been for some time. It's not -- no change there with or without more than whatever the comments are. But what we've seen -- I think we've had a good year. We entered the year. And you'll have heard us talk about this kind of before. At the back end of last year, we booked a positive with escape of water kind of actually moving into low, if not negative claims inflation territory.

There is a number of the actions we've put in place there kind of started to rise. And the thing that we did that had the most fundamental difference is kind of bring what we would call a manufacturing units, sort of bring claims and underwriting and trading people together to really understand the picture and then use a combination of levers to tighten up some pricing, some terms and conditions, some selection, if you like. And the net result of all of that is we were seeing improvements in claims inflation as we came into the year. And as a result of that and on an ongoing basis. And we were able to, therefore, reassess price a little in the market and started to grow considerably.

And in particular, where we've been, I think, not so strong in price comparison, what you've seen over the last 18 months or so is that price comparison channel on Home seems pretty strong growth, and you've seen that continue in Q3. So underlying, we were coming in with claims inflation, I know, the lower end of that range, sort of thing overall, something like that. It's hard to say exactly how that got started in Q2 by COVID. And although claims frequency did not drop at the same level as not said it's dropped very materially, it's pretty much back in shape now, slight mix differences, but pretty much back in shape.

But we're still seeing it at a pretty controlled level as we were in the first quarter. So pretty comfortable there. You're seeing broadly, IFP growth and premium growth, therefore, driven primarily by the PC channel. So what we've kind of seen as we've come through Q3, and actually, it's not just true of how is that the price comparison channel came back on faster than the direct channel. And I think there are a few reasons for that, but some of them are that we had deployed a lot of people out of the operations areas into travel to support it. And so some of our marketing activities didn't come back on until the back end of Q3, early part of Q4.

So I suspect some of it is idiosyncratic to us, but nonetheless, we thought PCW come back faster. So, I think overall, claims inflation has been running -- was running at the lower end of that and probably when the distortions run out, there's any reason to believe that, that shifted significantly. And we're able to take the margins we're comfortable with and grow in that marketplace at the moment. So we're really pleased with how Home's doing.

Q - Greig Paterson

So Penny, so I assume if you're saying you've been pricing in-line with your claims inflation numbers, and there's been a negative mix because of more PCW new business?

A - Penny James {BIO 15157212 <GO>}

Yes. So what you're seeing in the mix terms is that average premium -- where you see that as an average premium. So -- because the average premiums on PCW are lower than in the Direct space. So that's where it comes through. And -- but what you'll see in the Q3 numbers relative to Q3 '19 is that we've grown both -- and premiums, notwithstanding the average premium drop, which gives you a sense of the kind of levels of growth they are going through.

Q - Greig Paterson

Right.

A - Penny James {BIO 15157212 <GO>}

Hope that helps.

Q - Greig Paterson

I'm sure I'll send you another question via email. Thank you.

A - Penny James {BIO 15157212 <GO>}

I should look forward to it -- at least. Thanks, Greig. Sorry? Okay, Adam. If you got anyone else on the line?

Operator

Yes of course, we have some more questions on the line. This question comes from -- Autonomous Research, if you like to go ahead with your question please.

Q - Analyst

Good morning, everyone.

A - Penny James {BIO 15157212 <GO>}

Good morning --

Q - Analyst

I've got two questions, please. Hi. I've got two questions. The first one is regarding your comments on the first year review. You talked about the logistical challenge in terms of implementation and the need for sensible transition period. So I was wondering whether you can share what that sensible transition period is. That's my first question. And then secondly, just a point of clarification on Motor pricing. You are still pricing not been inflation. And you mentioned that in the market, what you think is a decrease of the comports which we believe will actually a rational response, so not necessarily an increase in competition. Is that correct?

A - Penny James {BIO 15157212 <GO>}

So pricing, what I'm saying is that, yes, what we and I presume other people will try and do is try and always understand what the claims impact on is going to be on a 12-month policy. And so as the base position, if you like. So people have to take more of a view in an environment that is uncertain as this than they do in a normal year. I guess, it's the first thing. I think the -- so the -- a couple of points coming out of the market, therefore, what does that mean? I think that means really that my interpretation of that is, therefore, that some people are reducing prices to reflect for whatever reason in that space. So is that -- that is more competition, if you like. But really, it's, I think, likely to be the fact that people are looking at their margins, looking forward and taking a different view on what their claims expectation on those margins are. Hope that answers the question. I think it does --

Q - Analyst

Yes, it does. Thank you.

A - Penny James {BIO 15157212 <GO>}

Brilliant. FCA, logistical, what are the challenges? I think the -- two things. There's some risk so market-wide risks, if you like, and then some practical challenges. So market-wide risk. I think it -- the FDA will appreciate this, and they will now first time. There is a risk if two -- well, twoplayers with a significant or not interpret rules in a different way that means they think they can trade under a different set of rules in the marketplace. So there is a logistical -- there's a risk there that, A, you get customer outcomes that are on; B, you get some weird effects in trading and C, that you have to then change the rules again to get it clear. So that's the kind of transition effect that we are keen to avoid, which is why I said the most important thing is getting clear what we actually will mean.

So I think that's sort of base one in terms of transition. Then there were some logistical challenges. So what are those kinds of things? Well, everyone will have to do some kind of -- bear in mind, this impacts basically the prices of everybody in the market, every kind of policyholder to some degree. Then there is clearly a substantial piece of work for everyone in the market to do to kind of rebuild or tailor or adjust accordingly their pricing model. So that's the first thing. There's likely to be customer communications that go alongside that as well. And any customer communication effects underlying systems takes energy.

And just by way of example, the last year renewal disclosure, last year's sort of renewal price disclosure, I think the market had 8 months to implement that because it required going into the underlying systems and changing customer communications and so on. And then the last sort of over the top of my head, the last logistical kind of area is a very extensive data request that sits around this from the FCA. So when you look at less the actual pricing intervention they're making a more fair value question. They're asking boards to assess what their value is, which we kind of do -- we do under -- today to a large degree, anyway, but they're formalizing that. They're not determining or stating what fair value is, that's for the Board to get comfortable with. But they are surrounding that with a significant data request, ongoing data requirements to the FDA, presumably so that they can monitor exceptions and to understand how the market is operating and so on and so forth.

Some of those data challenges will take time to build literally because they're quite big systems engineering and data changes and on. So there are just some practical implementation things. I don't know where time lines will end up in order to preempt where the FDA, what people in the industry will ask on B, what the FDA will choose to do. I don't think anyone has talking about multiple years. So I don't think it's a matter of pushing step out beyond planning horizons. I just think it's a matter of making sure that we can get everybody in the space, where they're fully implemented and ready to go in a safe way and a land it safely first time.

Q - Analyst

All right. Understood. Thank you very much.

A - Penny James {BIO 15157212 <GO>}

Thanks. Adam, any more questions?

Operator

Yes, we have another question. This question comes from Thomas Bateman of Berenberg. If you like to go ahead with your question, please Thomas.

A - Penny James {BIO 15157212 <GO>}

Hi, Thomas.

Q - Thomas Bateman {BIO 21707516 <GO>}

Hi, morning Penny. Thanks for taking my question. Hope you're well and wish Tim and his family well as well.

A - Penny James {BIO 15157212 <GO>}

Thank you. He'll appreciate that.

Q - Thomas Bateman {BIO 21707516 <GO>}

Just a little bit more on the FCA review, I know the market probably got a little bit more clarity, but I understand it's difficult for you to gate the review now. When you talk about reviewing prices in recent years, can you -- particularly sort of in-home insurance, can you talk about what you've been doing there? And maybe clarify what sort of rate?

Second question, on commercial lines, very promising growth. Do you still see this as an underpenetrated market? And how do you see profitability going into 2021? And one more question, if I may. Given the slightly more positive outlook, vaccine use -- I know there's a lot of risks out there with Brexit, the FCA consultation in COVID. But if the rose were to be navigated successfully, what would stop you reinstating the buyback at the full year results?

A - Penny James {BIO 15157212 <GO>}

Okay. All right. What have we been doing on how I think those who would go back to the Capital Markets Day. The main thing we do on Home which we do actually across all of our products, although we started it on Home first a number of years ago. So it's kind of more progressed in Home, if you like, is we review at the 5-year point, everybody is kind of, at 5-year 10-year point, each policy holds us margin and percentage in pound terms. And if they're over a certain percentage or a certain pound value, then we adjust on renewal and bring them back within those bandings.

And then over the years, what we have done has tightened those landings. So all the time you're bringing the tail in, if you like, and so you start off in the early days just dealing with kind of the people in the very end of the tail, but progressively, it's touching more and more customers. So many hundreds of thousands of customers have had -- have their prices sort of fixed or held or reduced as a result of that process. So I kind of -- so a lot of our work in the Home space has been around making sure that, overall, we're comfortable to that -- at that point that the value that people are getting is appropriate.

And that's the way we think about that, and we've made considerable progress on that across the years. And that has been reflected in the Home results as well. So that's kind of the stance we've taken, which is why I say we -- and I think that's important less in the context of the new business price equals renewal pricing intervention, but more in terms of the overall value, kind of sort of part of the package that the FDA has put out there. So that's really where we are on Home. Commercial, I'm glad you noticed it because we rarely get a question on commercial. And I think they deserve some sunlight. So their Q3 performance, I think what we've seen as kind of a proper bounce back.

And we -- I think in Q2, we had expected a really tough year for the commercial business because it's very SME focused. We were expecting the economy to -- hard on the SMEs and so on. And I think certainly some of the government initiatives has smoothed that. But also, I think we sometimes underestimate how entrepreneurial people do entrepreneurial things to keep moving. So that's been incredible to see. But it's also supported by some of the initiatives that have been in. So we've talked a little about kind of transformation programs but in deals to be, we had a big drop on van, in particular, on their new system and supported by some new pricing tools, and that has given them the capabilities to price much more effectively in the marketplace or in a less constrained way than they were before from a systems perspective.

So what they're really doing is bringing some of the learnings across from the personal lines book and methodologies into the commercial space. So I think that's done well. And I think NIG as well have for the last three or four years, been pricing ahead of claims installation. And we've continued -- and in the early years, they were contained growth, but what we're seeing at the moment doing that and growing as well, which is great to see. So in terms of profitability, I mean, the Direct book is one of our -- the upbeat book has loss ratios that are amongst the best in the organization. So super happy with that. NIG has been improving and for many years it's below our kind of return target, but it's certainly up or around there now, so getting that -- so pretty happy with the profitability development there as well. So that's commercial.

And then are we going to do a buyback? You won't be surprised at me to say a bit early at the moment to answer that question. I think what I would say is, as we come in our first -- the learnings of this year is our first and foremost focus is on getting our normal dividend reliably and safely paid out to our investors. And that's why it was so important that we restored it and restored the catch-up at Q2. The solvency position, you could see it at half year and will not move so dramatically, it's clearly strong at the moment. What that means in terms of buybacks and special dividends and so on is something the Board will come to in the early part of next year, not yet it's really helpful.

Q - Thomas Bateman {BIO 21707516 <GO>}

Thank you, Penny. Really helpful.

A - Penny James {BIO 15157212 <GO>}

Thanks. Adam, any more questions from the line?

Operator

Yes. We have another question, this question comes from Ivan Bokhmat of Barclays. If you'd like to go ahead with your question, please.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Hi. Good morning, Penny. I have a question on the pricing approach within the light of the FCA reform. Some of the things you mentioned on the call today are quite encouraging. The improvement in current year loss ratio on an underlying basis, the planned reduction in expense ratio. And then, of course, one of the outcomes of the FCA reform, I suppose, over time, would be a further improvement in retention ratios. So just from a competitive perspective, I was just wondering why not grow a little faster now because you would appear to get that operational leverage in the future, more so, I guess, than in the past?

And the second question I wanted to ask was just on the investment income throughout the third quarter, there was no mention in the trading statement. Maybe you could just give us a brief update on that.

A - Penny James {BIO 15157212 <GO>}

Yes. I mean, I think investment income, we kind of set some guidance at half year that -- from memory that was about 1.8% as we need about 1.8%. But I think we wouldn't materially change that now. So nothing kind of nothing particularly to call out. And top of that, I think in terms of -- I'm not sure it's wise for me to discuss trading strategy with you in that plans over this time period. All I will say is it's a pretty competitive market already. So I'm sure it will continue to be competitive in the run-up to any FDA changes and so on and so forth. And it's another reason why it would be really good and that to be clear on the exact boundaries as we go through a transition to make sure that the market remains fully orderly. But thus far, it seems to be operating sensibly.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

But just a follow-up, in the aftermath of this FCA announcement, have there been any movements in the new business pricing? One of the wide expectations was that we'll have to, to some extent, rise to offset lower margins in the back book.

A - Penny James {BIO 15157212 <GO>}

I think -- so the reality, I think, at the moment is that the claims frequency effects out there in motor are dominating anything in that space. And Home is a pretty competitive market and has been a pretty investment -- and remains pretty competitive. So I don't think you can sit there and say, it's obvious from October that the first week of November that there have been X, Y and Z, price moves as a result of the pricing practices. I think there are certainly many other dynamics out there at the moment that are more dominant, if you like, than that is at the moment. But it's an interesting question as to whether people choose to hold on to the current model basis until the point at which the rules become effective or whether people try to evolve their pricing into the new environment. And I shouldn't the competition reason to start commenting on that, I think.

Q - Ivan Bokhmat {BIO 15378004 <GO>}

Thank you, Penny. I appreciate the color.

A - Penny James {BIO 15157212 <GO>}

Thanks. Adam, any other questions?

Operator

Yeah. We have another question, this question this time comes from Faizan Lakhani of HSBC. If you'd like to go ahead with your question, please.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Good morning, Penny. Good morning, Nigel. I just had a few questions. On Home insurance, Home partnership, all the running off in part still mix with that third of your household book. Now although I expect that to shift over time, given the FCA review, does that have to accelerate? And can you just provide, at least qualitative what the margin differential between the own brand and partnership businesses. That's question one.

Question two, just coming back to the combined ratio. When I look at the half year, the motor combined ratio net of COVID, is very, very strong. Now I understand that there'll be some true-ups and seasonality, but your commentary suggests that although we can see an improvement year-on-year, it won't be to the same extent as we saw at the half year. Could you explain why we shouldn't be anticipating a greater improvement? And just on the third question as well, just can you just provide a guidance in terms of how reinsurance renewal discussions are going? And what does that do for margins in 2021?

A - Penny James {BIO 15157212 <GO>}

Okay. Right. So why don't we do Motor first. Yes, there's a few things in the shape that mean because we were at about, what, 75% , but I think loss ratio at half year. I think we're at 81% or something like that at the end of last year. And we said we would want to improve on that 81%. Now there are a few things in the shape that I think mean that 75% doesn't project forward in itself because you've got a couple of things. One is we entered the year with kind of strong premium growth and that ease of an average premiums reduced during Q2. So in the second half, you're seeing more of the reduced average premium flow-through than you did in the first half, because it hasn't yet earned.

Equally, on reinsurance, we were at the better range -- end of the range that was of outcome in last year's reinsurance renewal, but nonetheless, in the first, it was an increase of 5-so-percent. So in the first half of the year, you're not taking -- taking the strain of a bit of that in the second half of the year, you've got all of that earnings through, if you like, as well. And claims frequency is not the same shape in Q2, as it in Q3 and Q4, albeit it's still depressed. So I think there are a number of factors in there that say that the 75% is kind of not seasonable, but it's influenced by a number of effects that don't repeat in the same way in Q2. So as I say -- sorry, go on.

Q - Faizan Lakhani {BIO 20034558 <GO>}

So you mentioned average premium factor, but I'm assuming the average premiums come down these -- because of the COVID benefit, and therefore, net-net of any underlying frequency benefit of should really have much of an impact? And just trying to understand, can you try and quantify what those Tier 3 elements constitute of? And how you're sort of thinking about it?

A - Penny James {BIO 15157212 <GO>}

Yes. I'm not going to quantify the components on the call. But the -- in essence, I'm saying that the average premium effect, some will be coped related some ways. So the net upshot is average premium will be more depressed in the second half than it was in the first half because in the first quarter, it was kind of buoyant relative to the Q2 effects coming in.

Reinsurance. You had the earn through of a lower reinsurance premium from the previous year in the first part of the year, some effects of that still earning through, whereas by the second half, that's earned out. And then you've got the claims frequency shape. So you've got all of those components. I think it's difficult to peel a part component by component. This is COVID, or this isn't, I think when you bring it, it's around that's why we're saying, don't expect to be at 75% again because the earnings -- don't support that, if you like.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Have you taken the full frequency benefit that you saw in the first half of the year? And will you look to take any of that in the second half?

A - Penny James {BIO 15157212 <GO>}

So there are rules about how you take frequency benefits. So you take -- you count on the claims that you can see at the time, and you're only estimating the ones that haven't been reported yet. So that's just the nature of -- that's the nature of accounting, which is why I say as there's more estimation, not on claims numbers but on claims severity, that's where you're in reserving terms that for your estimation plays rather than frequency. I think that's Motor. Then as a question on Home partnerships, I think -- yes, you're right that the Home partnerships are significant parts of the book. They are also covered by the FCA review. There are a number of questions in the clarification category around how some of those work. The book is are slightly different about how, in particular, closed books in the partnership space might work, although most of us are not in that category some are.

I think in terms of the current book, interestingly and in the Natwest part of that book, in particular, something like, I get 40% maybe of the policies we've been writing or on a three-year basis, flat premium anyway. So there are different effects in that book. The margins in Home in both parts of the book are cast, if you like. So that's not -- I think, the area where it's more different is price comparison because of the average premium point. So in margin terms, just to give you a sense.

Q - Faizan Lakhani {BIO 20034558 <GO>}

As you move towards PCW business, should we expect margin pressure on the Home book?

A - Penny James {BIO 15157212 <GO>}

Well, I think we've said all the way along that the PCW is more competitive, we're still comfortable with the returns we get. If we get the strategy underway -- as we move through the strategy and get cost base rate cost ratios improve and so on and so forth. Then we are -- our aim is to get those two equivalent, but actually, as we come then, we know that the Direct margins are stronger than the price comparison margins. But we're not growing, but the price comparison margins are adequate, if you see what I mean, are appropriate. So we're happy right on price comparison business. Otherwise, we wouldn't be growing in it. It's really to --

Q - Faizan Lakhani {BIO 20034558 <GO>}

And that's the FCA review accelerated -

A - Penny James {BIO 15157212 <GO>}

It's really driven by the average premium points. It's really driven by the average premium points because they are smaller premiums.

Q - Faizan Lakhani {BIO 20034558 <GO>}

And as the FCA review accelerating to move away from partnership and to -

A - Penny James {BIO 15157212 <GO>}

I don't see it as an accelerate away from at all I think there's still huge potential and partnership business. So, I don't see them with -- I think is perhaps the way I would say so for me price comparison was always something that was underplayed and therefore was an opportunity rather than the something we have because something else is dropping. That's where I look it up. And then the last one is that reinsurance renewal too early to make clearly conversations have begun with the reinsures and it will be an interesting renewal around because obviously in some areas COVID has had a huge impact some reinsurance, but equally they will be quite comfortable with the margins, they've made on Motor. This year, so but it's early discussions and it will it's a negotiation process as they always are so I don't have no view at the moment I'm quite frank.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Thank you very much.

A - Penny James {BIO 15157212 <GO>}

So I'm conscious of time, so Paul, can you shout if you think we need to stop. But Adam, are there any more questions on the line?

Operator

Yes. We have a final question on the line, and this question comes, this final question comes from Ming Zhu of Panmure Gordon. If you'd like to go ahead of your question, please.

Q - Ming Zhu {BIO 17001429 <GO>}

Well, hi, good morning.

A - Penny James {BIO 15157212 <GO>}

Good morning.

Q - Ming Zhu {BIO 17001429 <GO>}

I'll try to keep it quick. Just two questions, please. First one is on the -- you gave an unchanged estimate on your BI and travel from COVID-19. Have you changed all the wordings in the policy? And are those policies will be running off by beginning of next year? And because I understand, I think you originally said you assume lockdown until end of September. So I'm just wondering, going forward. And second question is, what have you seen in terms of change in customer behavior in motor insurance and since the lockdown? And do you expect some of that changes in customer behavior to stay for a longer period. Therefore, it might have an impact on your pricing going forward, pricing and reserving going forward? Thank you.

A - Penny James {BIO 15157212 <GO>}

Yes. Let's -- I think just on the last one. I mean, clearly, there are changes in customer behavior in Motor, as I sit here from my home, talking to you. I think the comments that I made earlier about claims frequency are really people trying to -- the market will be trying to work out which of those are structural and which of those are not. Our sense from the bounce back in mileage through Q3 is that lots of those things are not sort of long term structural, but clearly, some will be, and that's something the market will evolve into over time, I think.

In terms of BI and travel, just one comment on BI. I mean, we haven't changed our estimates, no reason to at this point. And we are no more really than interested observers from a distance in the test case now. So I think the risks around those numbers reduce rather than increase. We've not, at this point, any made material changes to policy wordings in that space. And then in terms of travel, we said $25 million. I think what's happened over time is that the sort of full of uncertainty around that number is reduced when we start -- when we first put it up -- we had a wide range of sort of estimates and picking up. We thought were sensible within them.

I think as we've moved forward, that's got Holter. Yes, it was based on a number for September. But now where the market is, the travel levels are so low that actually the benefit of not getting normal claims versus COVID claims on the other side means that we're kind of more and more confident in 25. And actually, the biggest risk in travel is really an airline going down, a major airline going down.

That depending on what -- how that happens and what the sequence events are. That's probably the same that is within those numbers, the sort of the biggest sort of level of uncertainty and estimation. But actually, length of lockdown now, I think, is less of a factor. And perhaps the indicator is, whereas through most of this year, we've gone from what was pre COVID the team of 220 people to a maximum of 750 to cope with the volume of the customer questions and calls every time an average drops or every time there's a travel announcement.

When the new lockdown restrictions went into place last week, there was no surgical. So that probably tells you the levels of holiday bookings and things that are out there now are much, much diminished. So not worried about that. In terms of policy wording, the -- we have made changes to the own brand wordings, which actually a very small proportion of the book, but those changes will mirror through on the packaged bank account wording, which is the majority of the book from the beginning of January.

And essentially, what they say is we will cover you if you have to cancel because you have COVID, and we will cover you if you have COVID abroad. What we won't cover you for is if you have to isolate because of track and trace. So you can't leave the house because of that. And really, what you're seeing the market move to is much more flexible bookings now, and that's what we're encouraging customers is to book flexibly through those periods.

So that gives us comfort that as travel starts to take off again into whatever form of vaccination process we have and so on and so forth, but we've got some air cover there, if you like.

Q - Ming Zhu {BIO 17001429 <GO>}

Thank you.

A - Penny James {BIO 15157212 <GO>}

Hopefully, that answers the question. In which case, I'm conscious we've overrun, which given it was a fairly short call, it's probably time to draw a line. So thank you all for your time. I'm for dialing in, and I'm sure Paul and I can take questions offline if we haven't dealt with everyone's questions. But look after yourself, everyone, take care. Thank you.

Operator

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