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Transcription

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Presentation

Operator

Ladies and gentlemen, welcome to the RSA Q1 2017 Trading Update. For the first part of the conference all participants are on listen-only mode so there's no need to mute your own individual lines. And afterwards there'll be a question and answer session. Just to remind you, the call is being recorded. I'll now hand to our host Stephen Hester, Group Chief Executive. Please begin.

Stephen Hester

Good morning folks. Thank you for joining us this morning. It's, as you know, to report on our Q1 2017 Trading Update which comes ahead of the AGM tomorrow. And I think what we can say is that while of course we're only reporting on the beginning of the year and there's plenty yet to play for, the year has started very well for RSA. We continue we believe with the out-performance trends that have been so marked relative to others in our industry over the last 18 months or so. And you'll notice with these results some of the key elements of that in terms of improved attritional loss ratios, improved expense ratios, continue to go the right way. We believe that we are proving excellent husbanders of risk and the balance sheet. And of course we completed the last elements of our tidy up in the first quarter to significant advantage I think both in capital and P&L terms. And finally there are some important proof points that the improvement is not just something that shareholders are seeing but is something that customers are seeing with our top line beginning to improve and that's true both in volume terms as well as in total premium terms. So we're really happy with our progress. We think there is nothing in this company that can't be done better, even than is being done now. And so we have plenty of work left to do. And of course, you know, tough external environment. But nevertheless the year has started well.

Scott, do you want to talk through some of the figures?

Scott Egan

Yes. Good morning everyone. So really just build on what Stephen said. The first quarter saw a really good start to the year for RSA and I think really provides further evidence again of our progress on the self-help levers that we talked so much about around customer, underwriting and costs. And more importantly we continue to improve the quality of our earnings. If I start with the top line, our Group net written premiums were up 14% or 4% at constant exchange rates. We're pleased with the trends we're seeing which build on the progress that we saw at the end of last year and I think reflect the capability enhancements that we've been implementing and continue to implement. But particularly improvements to our customer offering and to our underwriting capabilities. As an example, we've seen retention rates across all of our regions improve by around 1-2%. This is reflected therefore in overall volume growth of 2% in the quarter with rate increases adding a further 2%. Looking at our largest businesses, Scandinavia delivered 2% growth at constant exchange, driven by rate increases, while Canadian premiums were up 6% and pleasingly included modest volume growth circa 1%. UK premiums were up 7% driven by volume growth of 5% and rate increases of 2%.

Turning to profitability, while we don't disclose actual numbers in Q1 and recognising that it is just one quarter, underwriting and operating profits were strong and ahead of our expectations. In terms of the underwriting result the attritional loss ratio, expenses and the expense ratios were all better than the prior year, as we have targeted. Weather and large losses taken in aggregate were slightly worse than our long-term trends with weather relatively benign and large losses higher than trend. Although the weather was benign overall, Canada was impacted by some wind storms in March across Newfoundland and Ontario. Within the prior year underwriting result we've taken a net charge in the UK in the first quarter of around £40m for the Ogden discount rate change. You'll recall that we built additional reserve margin at 2016 year-end in anticipation of the Ogden change of circa £45m. And just to be clear this £40m charge is in addition to that cost. However, this was more than offset by positive reserve development elsewhere in the Group and overall prior year profits for the quarter were in line with our expectations. Our investment performance was consistent with the guidance we gave at full-year results in February and below the operating result we also booked items as we previously flagged in relation to the investment gains on the disposal of our legacy liabilities, the commutation of our adverse development reinsurance cover, debt buyback costs and reorganisation costs. Further details on these can be found in today's release.

Turning to the balance sheet and capital, at the end of March we announced the successful completion of our planned capital actions for 2017. As a reminder, these comprised the disposal of our UK legacy liabilities which we announced in February, the successful issuance of circa £300m of restricted tier one notes in Scandinavia and the retirement of £592m of existing high coupon debt. These actions have further improved the Group's capital quality, lower debt leverage and will materially reduce interest costs. We now expect to reduce interest costs of around £54m for 2017 and circa £40m in 2018. This compares to interest costs of £99m in 2016. Tangible net assets of £2.9bn were flat over the quarter and the Group's Solvency II coverage ratio with 166% compares to 158% at the beginning of the year. Within this tier one and tier two capital provided 151% coverage. The Solvency II increase includes the benefit of the legacy disposal partly offset by the net reduction in debt. There were further impacts on profits in the quarter and the accrual of a notional dividend for the first quarter in line with our treatment in Q3 last year. Market movements were modestly positive in the aggregate driven by equity gains.

So that concludes my review of the quarter. I'll now hand back to Stephen and we'll open up for Q&A.

Stephen Hester
Scott, thank you very much. Operator, do you want to go straight to Q&A please?

Q&A

Operator
Thank you. Ladies and gentlemen, if you wish to ask a question please dial 01 on your telephone keypads now to enter the queue. Once your name's been announced you can ask your question. If you find your question is answered before it's your turn to speak you can dial 02 to cancel. So once again, that's 01 to ask a question or 02 if you need to cancel. There'll be a brief pause now whilst we register your questions.

Our first question comes from Thomas Seidl of Bernstein. Please go ahead, your line is open.

Thomas Seidl
Yes, thank you, good morning. Two questions. First on the attritional loss you say it's better than prior year. Does this mean prior than prior year Q1? Or better than prior year full-year? And also last year you said it's better in all regions. Can you repeat this statement this year or is it different by region? That's my first one.

On second, reserves. You used to guide for 1. You have never done this year. Always released more than 1 and we are now [inaudible] for[?] Ogden back to above 3% level which we haven't seen since 2011. So I wonder what is the source of these higher reserve releases and why would you maintain the guidance of 1? Thank you.

Stephen Hester
I'm going to need to take the second and Scott will take the first. On reserve releases we have absolutely no reason to believe that our long-term guidance is wrong, you know. If it continues to be conservative that will be terrific but we certainly have no – we haven't – we – the long-term guidance we give is exactly what is in our plans and we see nothing to make that definitively wrong. PYD is always a highly-volatile series and frankly I would ignore quarterly volatility in it. It happens to be that this quarter away from Ogden we had some good releases. The biggest amount of which was in Scandi but I don't think it's of any substance. And by the way, that was true of the first quarter last year as well. So I wouldn't read anything into it other than of course we're happy to have been able to cover the additional Ogden hit.

Scott, do you want to talk about the attritionals?

Scott Egan
Yes. And just to be clear, I think your question was are they better – the reference point is last year Q1 so just to be very clear that's what we're benchmarking against. And the improvements, as you'd expect, are across all of our regions because that's what we're targeting in terms of improvements. So those are the responses to your two questions.

Thomas Seidl

Okay. So even UK where some of your peers have reported inflation ahead of prices like in home but also in some other lines other UK attritional is improving?

Stephen Hester

The – well what is true is that we have seen inflation tick up on home in the same way that Direct Line reported yesterday. And so it is true that the home attritional ratio is worse in the first quarter than last year. But I would say that's – and then obviously there's – you know, there's the pricing increases in motor reflecting Ogden. Although the Ogden costs will mainly come through the large and the reinsurance line. But I would say 60% or so of our business is obviously commercial lines in the UK and there, you know, things in the first quarter seem to be, you know, coming under control as it were.

Thomas Seidl

Alright, thank you.

Operator

Thank you. Our next question comes from Nadine Van Der Meulen of Morgan Stanley. Please go ahead, your line is open.

Nadine Van Der Meulen

Yes, good morning. Two questions. Number one, on the investment performance usually with the trading update you give details around the investment performance. I didn't spot that this time round. Could you update us on the growth in the investment portfolio, perhaps also the book yields of the total portfolio and the average yield of the bond portfolios and the reinvestment rate?

And the second question is around the Solvency II. You're now still sort of above the top end of your previous target range at 166%. Can you comment on what you plan to do with excess capital? Yeah, and I've got a couple more questions; I'll stick to these two.

Stephen Hester

I'll ask Scott to talk about the investment performance. On the Solvency II, we have no different plans than the ones we've always articulated which is to say that we see this year as a year when we finish the balance sheet restructuring as we largely have done. Hopefully we move the cash generation of the company forward. We've obviously still got [inaudible], we've got some restructuring charges this year, so we're pleased with the strength of the capital base but I don't think it changes our view about timing of dividends and so on and so forth. But you know, clearly it's on the positive side of neutral in terms of where we might otherwise have been.

Scott Egan

And indeed, on the investment performance, the portfolio was broadly flat during the quarter, as a reminder, it was £15.6 billion at year end. The average yield over the period and total portfolio was 2.5%, at the end of the year it was 2.6%. Average reinvestment rate 1.6% for the bond portfolio, then we caveat, I'd say that sometimes fluctuates depending on you know, what investments are coming off and on etc. So you know, nothing – my macro measure would be nothing particularly changed of any significance during the quarter, hence the statement that we've made.

Nadine Van Der Meulen

Alright, thanks a lot.

Operator

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

Andrew Crean

Good morning. Couple of questions; firstly, do you expect to maintain the volume trends which you've seen in the first quarter through the year?

And then secondly, following up on the Solvency II question, and this isn't related to this year or next year, but overtime one would expect the retentions to keep pushing the Solvency II ratio further above the 160% high point. I mean, what would longer term be your thoughts around that in terms of bringing it back into line with the ranges. Are you talking about buy-backs? Special dividends? What approach would you take? Would it be M&A?

Stephen Hester

The – I would say there was nothing per se unusual in the volume trends in the first quarter that of itself suggests that they wouldn't continue. The only hesitancy I have is you know, I don't think you should ever count your chickens after three months of the year – mixing my metaphors terribly. And you know, it remains our trenchant view that we're more interested in bottom line than [inaudible] top line and so if were to have to sacrifice top line we would. But at the moment, there's no particular reason to believe that those trends don't continue and I think they probably did continue in April though we don't have final April numbers.

On the capital position, I mean, first of all, you know, I continue to urge people not to think that capital should be managed like a computer programme and to think you know, that there's some magic number available A or B beyond which you take action, B or D because we look at our capital position in the round, we look at the cash flows, the quality of the cash flows, we look at our credit ratings and only one element of this happens to be what Solvency II says at any one moment. All of that being said, if in the round we feel that we are in the position of excess capital, we wouldn't want to be in a position of excess capital for long periods of time and therefore, over a medium-term view, we would want to deploy that excess capital and you know, clearly the most obvious deployment is back to shareholders. I've never ruled out M&A, but I think M&A is more likely to be rare for our business model than you know, an everyday occurrence.

Andrew Crean

Okay. Great, thanks.

Operator

Thank you. Our next question comes from Dhruv Gahlaut of HSBC. Please go ahead, your line is open.

Dhruv Gahlaut

Good morning, just a couple of questions. Firstly, can you give me a bit more colour in terms of the UK business? It seems you've grown volume 5% there, what has driven that?

Secondly, on the capital position, yes, the Solvency is about 166, even excluding Tier 3, it's about 150, is that a number that you guys look for in terms of even if you didn't have a Tier 3, that's the minimum you want to operate the Group at?

And thirdly, could you give a progress on, in terms of Ireland, are we still on track for the target for this year, from a claims perspective?

Stephen Hester

I'm sorry, could you repeat the last bit, I didn't quite…?

Dhruv Gahlaut

Sorry, the Irish business, just wondering as in if the claims trends are pretty much as you expected at full year and are we on track to break even in Ireland.

Stephen Hester

Sure. I'm very hesitant in Ireland you know, after just a quarter but the first quarter is more or less exactly what we thought it would be in our plans barring there's a small Ogden effect in Ireland because we report Northern Ireland as part of Ireland but excluding that it was – you know, Ireland was where we thought it would be.

On your other questions, the UK, there's a – the volume trends looked quite good in the first quarter. Part of that is that our – on the commercial side, our European business was going quite well and that writes an unusual amount of its business in the first

quarter. Part of it was in personal lines where our motor is recovering well, driven by telematics which continue to grow fast, especially for us and there was some home volume which there hasn't been in recent years. To be fair, I would be surprised if we average 5% in the UK for the year, but that was broadly where the volumes were coming from.

And on capital, again, I sort of go back to what I said before; we're not managing as automatons to any particular ratio. It certainly would be true to say that we are more comfortable with the ratio at or above the high end than if we started marching down, although it would depend why we marched down. If we thought, for example, it was temporary pension volatility that didn't impact cash, we'd be more comfortable than if it was some you know, long-term erosion of our ability to generate capital or some other sort of huge hit of some sort. So we'd have to think about what was happening to it and why.

The Tier 3 thing, I think in some ways is a red herring, although you know, we always want to be transparent. But what do I mean by that? Any time we want, we can replace the Tier 3 with Tier 2 but it just costs shareholders some extra interest and given the Solvency II rules about Tier 3 and given that we, as a consequence of our unfortunate past, have got tons of it around and it will last for many years because the UK tax regime has halved the rate used, it seems dumb not to benefit the P&L by reducing our financing cost. And so, you know, we're very conscious Tier 3 has less good quality capital but we're also conscious we could replace it with higher quality capital anytime we wanted, provided we were prepared to pay some extra interest. So that's the sort of the gives and takes around it I think.

Dhruv Gahlaut
Can I ask just a follow-up question on the Tier 3 as in is there – how much more of Tier 3 is there? How much flexibility is around Tier 3 currently which you can get on the balance sheet, assuming there is still tax –

Stephen Hester
I think, not a lot because of the change in the UK tax rule which halved the amount of tax assets you could put on your balance sheet. But the flip side of that is it'll last for longer.

Dhruv Gahlaut
Alright, thanks.

Operator
Thank you. Our next question comes from Andy Hughes of Macquarie. Please go ahead, your line is open.

Andy Hughes
Thanks very much. A question on growth really. On the 4% benefit from lower reinsurance costs, are you saying that's ongoing or is that just a Q1 benefit because I can imagine if all your reinsurance was renewed in Q1 then your – that 4% benefit would kind of be a one-off in Q1. And if it's an ongoing benefit, could you clarify what's happened because it's quite a big change to the net written premiums from reduced reinsurance?

Also on Canada, I guess you're not seeing the same trends as Intact, or in Q1 with the increase in their personal auto short tail business loss ratios; could you just clarify that?

And, I just want to double check, so the growth – so you're saying that basically the growth in the UK may not be sustained for the whole year. And if I'm right about Canada, it being a Q1 thing only, possibly that growth is also not going to be sustained for the full year, and yet, you kind of opened up by saying that the previous question, there was no – nothing exceptional about these numbers. Are you kind of implying that Scandinavia is going to grow to offset those two potential one-offs? Thanks.

Stephen Hester
Andy, you're quite right, the world's going to come to an end and the share price will go back to 440. But possibly, trying to answer your questions, reinsurance: our main renewals are at the beginning of the year and so when – obviously this doesn't impact P&L because in P&L terms it's spread in a premium. But when you're reporting net written premium, you have all the reinsurance things that impact your first quarter results. The main place where reinsurance made a difference was in Canada because we changed the reinsurance covers in Canada and so that was the only place where we've reported it specifically

because the difference was rather minor everywhere else. And so in that sense, although it made a difference to Canada, I don't think it's you know – I don't think it's a material item and it's certainly not a material item in P&L terms for the year.

In terms of auto, I would say everywhere in auto, there are one or two inflationary bits in terms of cars becoming more sophisticated and the electronics in it and then different markets have different trends from time to time on the sort of bigger items which tend to be bodily injury type stuff. So in Ontario, specifically as you mentioned, I would say we've seen a bit of inflation, but you know, nothing that's moving the dial enormously. We've seen a bit of negative PYD from bodily injury, but I think that was pre the 2016 reforms. So you know, I don't have anything particular to call out from that.

And you know, as I say, after three months, I'm reluctant to give volume figures for the full year, but you know, it continues to be our ambition that we're in positive territory for the full year; by what amount, we'll see.

Andy Hughes
Can I just clarify, the 4% benefit in Canada is just a Q1 number rather than an ongoing thing?

Stephen Hester
Yes.

Andy Hughes
Okay, good. Thank you.

Stephen Hester
But obviously, the Q1 in terms of net written premium, it's clearly an ongoing thing in terms of net-earned premium.

Andy Hughes
Sure. But in Q2 you'd expect it to drop down to 2% annualised growth with the rate increases and the –

Stephen Hester
Well, I think you're imagining a world which isn't the one we inhibit, where everything goes in smooth lines – that we inhabit. But if it did all go in smooth lines then that would be true.

Andy Hughes
Okay, thank you

Operator
Thank you. Our next question comes from Rotger Franz of Société Générale.

Rotger Franz
Yes, hello. Thank you for taking my question. Actually, most of my questions have been answered. Just one little more question regarding the capital structure. There has been quite a few moving parts in the first quarter. How much leeway do you actually have with regards to RT1, Tier 2 and Tier 3 size limits? So how much RT1, Tier 2 and Tier 3 capital do you have now as a percent of SCR and how much RT1 do you have as percent of total Tier 1?

Scott Egan
Hi Rotger, Scott here. So look, I think what we've tried to do through the deleveraging etc. that we've done is effectively remove as much ineligible capital as we possibly can from the structure. I mean, we've got to take you through exact percentages and how that works. But in broad terms, we've got some slight excess in the Tier 1 restricted that we've done which cascades down into Tier 2. And I think we're comfortable with that because we expect to grow into our core Tier 1 anyway and effectively removed the ineligible Tier 2 and effectively Tier 3 from the work that we've done.

So that's what we're trying to do. We're trying to move redundant capital from the structure, from the refinancing work that we've done. But in terms of specific percentages if you want to pick up with Rupert offline, he can take you through the exact rules around Tier 2 and Tier 3 etc.

Rotger Franz

Okay, thanks.

Operator

Thank you. Once again if there are any further questions on the line, please dial 01 on your telephone keypads now.

Okay, as there are no further questions at this time – actually, just as I say that there is one coming through. That's from Arjan van Veen of UBS. Please go ahead, your line is open.

Arjan van Veen

Thanks. Just one follow-up on the Solvency ratio then and particularly around the gearing. Can you just maybe give a bit of colour around how we should think about your target ranges on gearing and where you sit now post the capital restructuring in Q1 and whether there's other constraints that you have say, around S&P gearing levels.

Stephen Hester

We're done on gearing to save for trying to tidy up the remaining bits of the high cost debt that we – you know, sort of the small amount that we'll call in June that we didn't quite buy back and there's a small amount that we'd like to buy back still or else call in 2019 of the Tier 3. But apart from those sort of minor things around the edges, I think we feel we're done for now.

Arjan van Veen

And you're sort of comfortable within your target ranges, it sounds like it, right? In terms of –

Stephen Hester

Yeah.

Arjan van Veen

– what you have done. Okay, okay, perfect. All right. So there's no sort of actions you can take around that, that is still left over, most of it's been done.

Stephen Hester

There's certainly none in our plans.

Arjan van Veen

Okay, understood. So just a bit more fine-tuning and then that's it.

Stephen Hester

Yeah.

Arjan van Veen

Okay, thank you.

Operator

Thank you. And we have a follow-up question from Andy Hughes of Macquarie. Please go ahead, your line is open.

Andy Hughes

Hi. Just a quick question on telematics stuff in the UK. Obviously with the Ogden discount rate change, are you expecting much more growth in UK telematics? I'm just wondering how big the telematics premiums are now and how quickly you think they're going to grow following the Ogden discount rate change. Thanks.

Stephen Hester

I think it's, to be honest, Andy, it's hard to project not least because we don't know whether the Ogden discount rate will change back again following the consultation that the government's got ongoing at the moment. So at the moment the telematics market is relatively restricted to very young drivers. Whether it becomes a bit more widespread I think it's premature to guess and so I don't know what our premium levels will be. But they were, from memory, about £70 million last year and I would think that they'll get into triple digits this year. But beyond that, I think it's hard to project.

Andy Hughes

Thank you.

Operator

Thank you. And that was the final question. So I'll hand back to our speakers for the closing comments.

Stephen Hester

Terrific. Well, thank you for joining us. As I said at the beginning, we're extremely conscious that one quarter does not make the year and so trends can go up and down from here. But notwithstanding that, we feel pleased with RSA's progress. We're continuing to improve in all the areas that we have been improving. We see many, many things we want to make our business better at doing in future years and of course there are one or two areas that we're particularly pleased about such as the growth size, mainly. Not because that's our key aspiration, but mainly because it underlines that some of our capabilities are being seen better by our customers, just as shareholders have been seeing the fruits of our labours. So thank you for joining us and we look forward to reporting again at the half year.

Operator

Thank you. This now concludes our conference. Thank you all very much for attending. You may now disconnect.