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Presentation

Operator

Welcome to the RSA Q1 2019 Trading Update Call. Throughout the call, all participants will be in listen-only mode, and afterwards there will be a question and answer session. Just to remind you, this conference call is being recorded. I'll now hand the call to our host: Stephen Hester, Group Chief Executive. Please begin.

Stephen Hester

Good morning, everyone. Thank you for joining us for RSA's first quarter 2019 Trading Update. Normal format: We'll talk a little bit about the update that we put out today and then spend most of the time taking any questions you have. As always, the IR team will be available throughout the day for any supplementaries that come along. And I should note that as a one-off, as part of driving our expense ratio lower in the quarter, I'm presenting this on my own, and we manage to move Scott's cost salary into the UK, although I'm hopeful that by the time we get to the half-year results, I will be joined by our new CFO, who, as you know is a non-executive director and getting up to speed, as we speak.

So, in terms of the results, although the IMS speak to the first quarter, I know what April is, and April is basically identical in terms of all the trends. So, effectively, I could speak for the first four months of the year, although the numbers will be slightly different, but fundamentally you'd say the same things. And, I think, what we can say is that RSA has made a good start to the year. And I say that with three things in particular in mind: number one, simply at a headline level with an improvement in underwriting profit; number two, that there was a laundry list of things that didn't go as we wanted last year and that we needed to take particular action to improve, and there were some things that we needed to keep going well and, at least in the first four months of the year, we see a positive response on all of that laundry list of items; and thirdly, I would say that, clearly, the actions that we have been taking over the last six or nine months are going to be appearing in the P&L in the next six or nine months, given the written versus earned pattern of insurers and, therefore, just as importantly as the numbers that we're actually putting up, is the actions that we've been taking that should influence the numbers that we'll up in the future. –We are at a minimum on, and in a number of cases, ahead of the underwriting and pricing actions that we have scheduled, which hopefully bode well for our planned improvements in the balance of the year.

So that's, if you like, my big picture take. Just to delve into a few of the parts that we note in the trading update: From a market standpoint, my general view is that the big picture is that the insurance markets have not significantly changed and that is to say that in those areas where industry profitability is good, you see quite a lot of price competition and the other forms of competition and only modest growth available. But nevertheless, you do see some modest growth available, and in those areas, which we're challenged in industry profitability terms, you are seeing a more positive response in terms of being able to execute pricing and underwriting actions than perhaps there has been in recent years. And I think that's in line with some of the other Q1 reporting that you will have seen. From a – and obviously I can go into that in more detail, because clearly, we have some businesses that respond to international trends and some that are very regional in terms of their impact.

Financial markets: net on the negative side for us, although no great dramas there. Clearly, stock market positives, but we care more about interest rates and spreads and foreign exchange. And yield came down a bit in the quarter, as you know; spreads came down a bit, particularly in sterling, which created some pension accounting volatility and, in particular the Swedish Krona has been weak, which is an important country for us. So, some mild headwinds there, but no dramas, I think.

In terms of the premium trends that we announce, as you can see, headline is up 3% for the Group. However, it's flat on an adjusted basis and that's pretty much the pattern that we had last year; which is to say that where we were happy with profitability, or with underlying profitability, last year, we are continuing to get volume growth, in addition to whatever the rate gives us, and that is in particular in our international business, as you can see in Scandinavia and Canada. And where we were unhappy with the underlying financial profitability and, therefore, have been taking more radical pricing and underwriting, and in some cases, exit actions, we are sacrificing volume for improved profitability and it's that blend that gives the flat overall position. But we're basically exactly in line with where we thought we would be after three or four months, depending on which view you want to take.

When we move on to some of the profitability trends. Clearly the first quarter is often a notable weather quarter for a company like us with three northern regions. And, at a Group level, I'm pleased that the weather was more or less bang in line with our long-term averages and with our plans. But that was built up of two very different trends. UK and Ireland had a much more benign winter than last year, and better than we planned, and Canada had a much worse winter than last year, and last year was bad already; as you saw with Intact's results yesterday. And for us, fortunately, basically, one balanced out the other and therefore we came in on plan on weather for the Group as a whole. But the Canada combined ratio looks poor in the first quarter and the UK&I combined ratio looks excellent in the first quarter as a function, largely, of weather in addition to the things that we'll talk about on the other underlying items.

Pleasingly, the large loss ratio improved substantially, better than both the run rate last year, and indeed the first quarter. Of course, we are only talking about a quarter, or we could be talking about four months, same difference. So, no victories being declared yet, but nevertheless important, and pleasing and our qualitative analysis of the large losses suggests a continued improvement in underwriting quality in addition to the quantitative. The large loss improvement was relatively broadly spread, because we needed to improve in every region that the UK has obviously got the biggest commercial lines in the UK and international, and so that was where there was the biggest improvement.

Attritional loss ratio improved slightly. I would say that that is against a tough comparative, because last year we had adverse attritional trends which meant that the ratio worsened in the year. This year, it's our belief, we're likely to get positive trends during the year because the pricing action and underwriting action that took last year and this year should earn through in stronger amounts, so to be slightly ahead of a tough quarter I think is a good start to the year, in attritional terms.

Controllable expense ratio, although we think for the year it will probably be slightly worse, as we discussed at the year-end results, we did better than we expected in the first quarter, which is why it fell again. And as you can see on prior year development, that would be the only thing that went in the wrong direction, at broadly flat. And the trends were, frankly, the same in every region. No big item. Every single region has positives, what I'll call normal prior year development, in all years, up to and including 2017, but that was balanced out by strengthening of 2018. And as I say, because there's no big individual item, I think the best way to think about it is that when underwriting results improve over a period of time, the actuaries are often slow to recognise it, and so PYD on a trading basis does better than you'd expect. And when you have a bad year or two in underwriting trends, the actuaries don't quite catch up on day one, and therefore you get a bit weaker PYD on a trailing basis. As you know, we planned for weaker PYD, so we're not very twitched about it at this stage. And it's very volatile, but that's, I think, the nearest I can say to what's going on there.

Investment income in line with what we expected. And the exit portfolios which we promised we will – when we do full reporting at the half-year and full-year – fully disclose had a modest loss, high single digits, millions, of just one large loss actually in the period and running off fast, and as expected. So, that's a positive. And from a capital standpoint, I would say the underlying capital: nothing to talk about, because the profitability is positive, positive cash generation, net of dividend accrual. But we normally have market volatility on top of that, the biggest amount which is pension accounting, which accounts for four of the six points, and then yields and foreign exchange are a point each. So at 164% we're obviously ahead of our target range, but below where we were at the year-end. But, again, I think, just noise rather than anything important going on in that. And you'll note that we've called a bit of expensive remains for subordinated debt which will be out by the end of Q2.

So, that's really what's going on at RSA for the first four months. We're extremely conscious that four months does not make a year. But, nevertheless, we're pleased, at least, that the evidence of the first four months suggests that we have a good shot of the positive response this year occurring that we are targeting. Thank you very much and over to questions.

Q&A

Operator
Thank you. Ladies and gentlemen, if you wish to ask a question, please dial 01 on your telephone keypad now to enter the queue. If you find your question is answered before it's your turn to speak, you can dial 02 to cancel. Our first question comes from the line of Andy Sinclair of Bank of America Merrill Lynch. Please go ahead. Your line open.

Andy Sinclair [ph]
Thanks. Three questions from me, as usual, if that's OK. Firstly, on Canada, very strong growth in the quarter. Just wondered if you could break that down between the different elements of pricing increases versus volume? Secondly, just on the reserve movements you had in the quarter: just wondered if you could give us a little bit more on that? How comfortable are you now that the actuaries are up to speed for 2018, so to speak, and that we aren't going to have any further strengthening there? And thirdly, just on the progress on the UK exits: are you able to give any more thoughts now that Scott's had a little bit more time in his role as Head of the UK to have a look at that business? Thanks.

Stephen Hester
Thank you for those questions. So, in terms of the Canada growth, I would say, by the way, some of the first quarter growth numbers can be a bit weird as NWP, because reinsurance or else big 1/1's in different businesses slightly exaggerate percentages sometimes, but let's set that aside. In Canada, I would say, in the first quarter, there was quite a lot of rate affected, you would expect, and so the commercial lines business didn't really grow at all, which is a combination of volume shrinkage made up by a corrective rate increase, but also a lot of the remediation in commercial lines with cancelling certain areas. So, the growth all relates to our personal lines businesses. And, I would say, that the rating is between four and ten points, depending on business line and then there's probably one to two points of organic growth and then there's a bit of inorganic growth as Deeks roles in, which wasn't in the first quarter last year, in the Johnson business, and the Scotiabank just begins to start up. So, that's what's going on in Canada. And, I suppose what I'd say is, because Canada is of necessity a hard market, because everyone has crappy underwriting results from last year, and indeed the first quarter of this year, the volume give up for hard rating is much less than it would be in our other markets. And that's why, although we're rating as hard as we're allowed to, on our personal lines businesses, it's not causing us volumes sacrifice, because everyone else is doing the same thing.

In terms of your question on PYD, in a sense, for the whole reason that we plan it lower than we have been getting, we have very little visibility – I've always thought of it as low quality earnings and haven't wanted to rely on it – and so I have no idea what PYD will be for the rest of the year. What I would say, is what I did say in the year end, we plan for it to be below the level that it has been in recent years. If you ask me to guess, I would say it would be below the level it's been in recent years, for the reason I gave. But equally, as I say, there is no one book of business, or one regional, one particular thing that I know now is producing a negative for the second quarter. I just think that there is some lag effect after a bad year of the actuaries catching up and knowing what was temporary and what was a trend and take a little while to sort some of that out. But that's the best I can say for you. And, in terms of UK exit. No new news, we, as again, we plan to update in more detail on all the stuff that we've been doing in the UK at the half year. And we haven't made final determinations as to whether we're going to change the envelope of the exit. But I would say the probability is that if we change it, it won't be a drama – it will be tactical changes, rather than dramatic changes.

Andy Sinclair [ph]
That's great. Thank you very much.

Operator
Thank you. Our next question comes from the line of Jonny Urwin at UBS. Please go ahead. Your line is open.

Jonny Urwin [ph]

Hi there. Thank you. Good morning. Just three quick ones from me as well. So, firstly, on the reserves, I guess it's the negative versus our expectations today. Is there any change to the overall view of reserving buffers? Or is that just unchanged versus full year? That's the first question. Secondly, how are you tracking versus the 96%/97% combined ratio target in the UK for 2019? Just some qualitative comments there would be great, please. And then, finally, Intact is now seeing underlying improvement in the loss ratio, and also flagging a hard market in Canada – they're pretty bullish on the outlook – are you seeing that as well, please? Thank you.

Stephen Hester

Thank you for your questions. No change in the buffers that we know about. Obviously, as you know, we are the only insurance company that is public about our reserve margin that keeps it the same, plus or minus tiny bits of FX volatility. So, the implicit buffers which are the ones that produce positive PYD most of the time are the relevant ones, and we don't calculate implict buffers, because we don't know what they are. So, certainly no change that we are aware of beyond the things I talked about.

In terms of the UK, I would say our target hasn't changed. However, in the first four months of the year, we are way ahead of our target on a run rate basis, simply, but that is because of the benign weather. If you took the benign weather out, we would be consistent with our target on a run rate basis. Now, I regard that as good by the way. If we're lucky, we'll get to bank some of the outperformance of weather, but four months into the year – I'm not going to make any predictions about that, because obviously you can have swings and roundabouts on all of these volatile items. But, at the moment, the underlying performance of the UK on underwriting actions, on attritional loss ratios, and on large, to an extent we can tell is at least in line with the improvements that we were targeting, subject to understanding it's only four months into the year. When I say UK, I'm talking UK and international.

And, on the Intact comments. As I say, Intact is sort of the bellwether in Canada, but also the best performer generally, I'm pleased to say that in the context of a crappy set of results, our results are pretty much the same as Intact's in Canada for the first quarter, whereas normally they'd be a bit better than us. So, that's a relative positive. But, weather really drowns everything else out. Because of that, that market is very hard and so all of their comments I agree with. And I think it's having to be hard not just to correct loss ratios, but because most of us are putting a heavier weather load into our assumptions than we did before. I think Canada is probably the one place where there is reasonably clear evidence that global warming is creating more expensive climate volatility. What I would say, on the positive side, from our Canadian results, is, as you know, we put in place for the first time a weather aggregate in Canada this year on the reinsurance side to compliment our large loss aggregate. And we are something like 80% of the way through that aggregate in the first four months. So, that should give us a lot of weather protection in Canada for the second half, which is important, because often the third quarter in Canada is a very bad one for weather. So, there probably will be a better than usual second half for us, if only for reinsurance reasons in Canada, specifically. Thank you.

Jonny Urwin [ph]

Great, thanks.

Operator

Thank you. Our next question comes from the line of Ivan Bokhmat of Barclays. Please go ahead. Your line is open.

Ivan Bokhmat [ph]

Hi. Good morning. I've got two questions, please. The first one, on the UK, would you be able to talk about the rate that you achieved, perhaps separately, for the personal and commercial lines? And the other question will be on Scandinavia. I've noticed you've returned to premium growth on commercial lines. Could you give a little bit more colour as to what is driving that? Thank you.

Stephen Hester

Sure. So, in the UK, let's see. We probably have got mid-single digit rate in personal lines, and in commercial lines in our domestic commercial lines, we would be more like 3% rate. And, in our international commercial lines we would be between 4% and 20% depending on the line, if that's helpful. On your question on Scandinavia - I would say that the-- obviously, the growth in commercial lines is reasonably modest: 2% that primarily came from Sweden where we had a very good increase in retention rates, a couple of larger schemes in there, but it was generally just a good experience. We've actually-- we seem to have got the best SME digital offering that we've got in the company in Sweden which is growing nicely, a few other wins, but it's not a drama, but it was mostly Sweden. Denmark was more flat year-on-year.

Ivan Bokhmat [ph]

Thank you.

Operator

Thank you. And our next question comes from the line of Andrew Crean of Autonomous Research. Please, go ahead. Your line is open.

Andrew Crean [ph]

Good morning, Stephen. A couple of questions, or one clarification first. When you say that the underwriting has improved, does that include the exit portfolios? And, would you still say the same thing if you added in the high-single digit loss from the exit portfolios? Then, secondly, just picking up, mid-single digit rate increases in UK personal looks pretty strong relative to what we were seeing from the ABI which is a flat rate in motor and slightly down in household, so I'm wondering how you're achieving that growth in rate there?

Stephen Hester [ph]

Sure. So, on the underwriting, in terms of our qualitative assessment, we have a whole range of different tools that we try to deploy to qualitatively assess our commercial underwriting. One of the tools is analysing large losses, which is what you might call 'after the event' tools that decide whether we would have underwritten them if we had our time again, and doing that on a quartile analysis, and that gives you some after the event trend. And, then, there's a series of other qualitative tools in terms of portfolio reviews that have different scores, but that are not based specifically on loss activity, and both of those types: causes, measures are showing significant increases. 2018 increased over 2017, and 2019 first quarter is increasing over 2018; increasing, as in improving. The exit portfolio-- as I say, there was really only one loss in the exit portfolio, which is something that was written a year ago and would not have been written today, and, therefore, would count as poor underwriting in our view, but wouldn't change the stats, frankly, of the overall improvement.

In terms of your question on UK rating, I must say --I've always found some possible risk that, I think, different companies and different releases talk about rating and calculate it in different ways, and I've never been confident that one's really dealing with apples and apples because, for example, you often get discounting of new business and, then, higher rate increases of renewal business, and, therefore, the rate increases that some people quote can seem higher than the whole book because it's just a renewal business because you can't do rate on the-- some people do average premium but that doesn't capture risk mix and so on, so I'm slightly cautious about what I'll call hard read acrosses of one rate to another as opposed to trending. But what I think is fair to say is that we continue to prioritise underwriting results over volume. The result of that was that UK personal lines shrunk a little in the first quarter in volume terms. Most of that was because we shrank the year before, and, therefore, the renewing portfolio was smaller because new business was not that much-- we had a weak January, but February, March, April have been closer to plan, and the place where we've been most cautious in volume terms has been motor until we get our act together there. Household and Pet has been more in line with our plans, and also we're quite strong improvements in attritional loss ratios.

Andrew Crean [ph]
Thank you.

Operator
Thank you. As a reminder, if you wish to ask a question, please dial 01 on your telephone keypads now. Our next question comes from the line of Greig Paterson at KBW. Please, go ahead. Your line is open.

Greig Paterson [ph]
Morning. Just some clarification: in the statement, you said prior year results was broadly flat, and, then, in the same sentence, it said it was down year-on-year, so broadly flat relative to what? I wonder if you can give us some colour in that regard? The second question is: the UK and international, excluding exits, was down 5% year-on-year. I was wondering if you could point to which business lines were the key factors driving that down. And, the third question: given that we've had some time, I assume you've looked at the governance at the Group centre that allowed the UK – let's put it politely - underwriting standards to deteriorate, which you're now taking actions against. So, what have you learnt on this? And, my key thought or concern is that, should we not have learnt those lessons in the Irish situation which sounds just from high level pretty much similar, in other words, things were going on at the micro that wasn't being controlled at the macro. So, I was wondering what lessons you've learnt and what new controls or strengthening you've done to prevent], for instance, a third-type event like this happening in another region?

Stephen Hester
Thank you for your questions, Greg. So, on the prior year-- when we say broadly flat we mean it doesnt make a profit, it doesn't make-- we aren't reporting a profit, and we aren't reporting a loss from the prior year. In 2018, we produced a profit from prior years, and, so, going from a profit to zero is a reduction from prior year, if you see what I mean, but it's zero from prior year.

Greig Paterson [ph]
I understand.

Stephen Hester
Sorry to-- hopefully, that's as clear as mud.

Greig Paterson [ph]
No, that's clear.

Stephen Hester
On the premium decline in the UK: I would say our domestic commercial lines businesses have got a small premium increase, and, therefore, the decline lies entirely with the international business lines where a number of the portfolios-- if you recall the slide I showed in February, it shows that we were going to exit a number of entire portfolios that we would report separately, but we were also taking an axe to a number of portfolios that we were not exiting entirely, and, therefore, the portfolios that we're not exiting entirely get reported as continuing business, even though we are trimming their size. So, the international businesses have a reduction in premium from size-trimming beyond the specific sector exits, and the domestic commercial lines businesses slightly up year-on-year, and, then, Personal Lines I commented on, as being down year-on-year, as well.

Greig Paterson [ph]
--Those partial exits: do they come into the circa 150 premium loss from exits?

Stephen Hester

Yes, so, again, if you refer to the slide I presented in the February results, which is still on our website, hopefully it's well-labelled there as to which element relates to specific whole-exit portfolios and which element relates to trimming of overall portfolios. And, obviously, we will try and give you disclosure on that when we do full results in the half-year and the full-year.

Greig Paterson [ph]

Cool. And just the corporate governance lessons and changes that have been made?

Stephen Hester

Yeah, I've got it. --I think that there's some important apples and oranges. The problem the Group had in Ireland, which, as you know, I wasn't there for, so I'll be cautious in talking about it, but, was at its heart driven by fraud, which obscured claims patterns which, then, led to lack of underwriting reaction to data which, then, led to exaggerated losses. And, so, the sorts of governance changes that were made in a very dramatic way were really designed to make it much harder to commit fraud and to obscure claims patterns and to reserve properly. And, those issues have not recurred anywhere in the Group since then, and - touch wood - never will again, but the issue wasn't really underwriting *per se*.

The issues in our commercial lines businesses which are biggest in the UK and international, but were also true of our other commercial lines businesses, I would say, are a function of two different things: one is market trends, as a whole. We are certainly not the only insurer to have had disappointing commercial lines results. In fact, most insurers have, especially, in the London market, and even in the first quarter this year you'll notice, for example, Swiss Re's Corporate Solutions business had a combined ratio of 115 or something like that. You'll see the results from the reinsurers from Munich Re, from Swiss Re overall and a whole series of other results, so I think that there are-- that by far the biggest issue in commercial lines and in the London market--- you saw Lloyds was loss-making for the second year running, and the worst of it being in the marine lines - is a market issue which is why it's good that the market is getting its act together in terms of underwriting and pricing. So, I don't know that we were radically worse than the market. In fact, we may not be worse at all, but, nevertheless, that doesn't mean to say we're just shrugging our shoulders, we're taking a lot of action in respect of what the market does. I think it is fair to say, though, that because personal lines is 60% of what we do, and commercial lines is only 40%, and because the arms race of technology and insight and expertise is more marked in personal lines, we probably did, with the benefit of hindsight, spend more time improving our personal lines underwriting capabilities in the last few years and less time on commercial lines, and part of the result of that is the positives, namely the strong performance of our Personal lines businesses in the aggregate, the outperformance of our personal Lines businesses in the aggregate - though, not every one - but the flipside of that was that we realised, Ii would say, at the end of 2017, that we needed to catch up with our own ambitions in commercial lines, and we've been trying to do that through 2018 and into this year, and I believe we're making progress, but these things obviously take time, first of all to do, and, secondly, for it to impact and earn through your book. So, I don't think that there is a governance issue; there is a market issue and there is a balance of time focus and concentration on personal lines versus commercial lines issue, and we're trying to react to both.

Greig Paterson [ph]

Cool. Thank you. That was useful.

Operator

Thank you.

James Shuck [ph]

Good morning. Three questions from me, please. Firstly, just around the expected losses on the exit portfolios that you refer to in the press release. Can you just confirm what the outlook is for that over the rest of the year, if you're able to do that? It looks like you’re going to be booking that outside of the core operating profit number. I just wanted to be sure that that was the case. It’s going to be booked as discontinued and therefore, there’s some closing down-type of expenses to expect - just some clarification on that point. Secondly, on the investment income: you do mention the tighter spreads, lower investment yields. Just wondering what that means for your investment income guidance both for 2019 and for 2020; I think, 2020, you're guiding for 270-290, so if rates stay where they are, are you still able to achieve that kind of level? And finally, I just wanted to drill down a little bit on the UK commercial business, but less on the global risk solutions business and more on the commercial risk solution business. Could you just talk a little bit about some of the competitive dynamics in the regional open market business, the mid-market business and the delegated broker business, please? Thank you.

Stephen Hester

So, in terms of the exit portfolios, we were asked and we said we would give separate disclosure of them and so, they're part of our total financial statements, but we will show you separately the exit portfolio component and, let's call it the continuing portfolio component, so you'll have a separate line, but it will be part of the total financial statements. --There may be some expense charge in relation to them, but that will be small. The other area that could be larger, although I'm not specifically flagging it; it may not even occur this year is, at some point, we have to take a bigger axe to structural costs in the UK to reflect the lower top line, and so a part of Scott's job is to come forward with a better cost programme in the UK, but for this year we're prioritising underwriting and so, I suspect that will be a 2020 item, although some bits might slip into 2019. Again-- but obviously we'll report on that as we get it, and I think we have pretty good credentials on spending any cost monies well. So, in terms of other expected losses during the year: in a sense, the nature of these portfolios is you don't get much attritional loss from them; they tend to be large loss, volatile-type things, and so, frankly, it just depends on the luck of the draw and how many hurricanes and bits and bobs you get as the year goes on. The good news is that the portfolio will be dramatically smaller by the time we get to hurricane season, so I'm hoping this isn't a big line in our financial statements for the calendar year, but we'll find out.

On investment income: we haven't done a formal re-forecast and I guess I will do for the half-year, but completely off the top of my head, I would say no impact this year on the ranges that we've guided to for investment income; maybe a 5-10 million sort of number for '20 and '21. That would be the best top-of-my-head impact if the yield curve stayed depressed.

And your third question was on the CRS, the domestic UK commercial lines businesses and I think the dynamics. To be honest, I'm not detecting - we're only, obviously, three or four months into the year - I'm not detecting any material changes. We've got modest growth, rating isn't particularly high, I'd say it's probably averaging about 3%, although it's higher than that in commercial motor, but property / liability about 3%. Commercial motor is high single digits because that's where-- certainly, for us anyway; I don't know about for the market. I'm not sure I'm seeing it dramatically different across different segments, so I don't have anything very dramatic to report, I'm afraid. Other than, I quite like things that aren't dramatic.

James Shuck [ph]

OK. Thank you very much.

Operator

Thank you. And as that was the final question, I'll hand back to Stephen for the closing comments.

Stephen Hester

Very good. Again, thank you all for joining us-- do contact IR if you have follow-up questions. Look forward to updating you again at the half-year. And pleased to note that we've had a strong start to the year and let's hope that continues. Thanks for joining us. Bye-bye.

Operator

This now concludes the conference. Thank you all very much for attending. You may now disconnect your lines.