



Transcription

2020 RSA Half Year Results

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30 July 2020



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PRESENTATION

Operator

Hello, and welcome to the 2020 RSA half-year results webcast. Throughout this, all participants will be in listen-only mode and afterwards, there will be a question and answer session. And just to remind you that this webcast is being recorded. Today, I am pleased to present Stephen Hester, Group CEO, and Charlotte Jones, Group CFO. I will now hand you over to Stephen Hester, Group CEO of RSA. Please go ahead with your meeting.

Stephen Hester

Good morning, folks. Thank you very much for joining us for the first-half 2020 RSA results. The format is conventional. Obviously, myself and Charlotte are presenting the slides that you can hopefully all see on your screens to you, and then we will take as much Q&A as you would like to have.

Of course, I'm sorry that we're doing this virtually rather than in person, as we normally do, but hopefully all of the technology will work well, as it has been in so many other cases in recent months. So, what we will do if we may is dive straight into the slide presentation. And we will start on the introduction page which is numbered slide five.

I think that it's important, in a sense, before getting into the specific results to pay regard to the environment that we've all been living in this last half year: unique global challenges of all kinds. And, in that context, of course, like many other companies, RSA's priorities have been first and foremost to sustain customer service and support to make sure that we safeguard our people and operate well from home, which we have been doing, and to make sure that the company stays strong for all of its stakeholders.

But as you will see as we go through the results today, in addition to doing those three very important things, what I'm delighted about is that the company has demonstrated clearly that we've remained focused on delivering our plans, if you like, our 'business-as-usual' plans, and on performing well and taking the actions that will ensure we do so into the future.

So, moving then into the financial results that we have presented today on page six; a summary, obviously, will unpack all of these as we go through. The headlines, I think you'll agree, are very strong, particularly when we think that they are compared to 2019, which itself was a record year for RSA. So, underwriting profit up 33%; a



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record for us. Another record in combined ratio of 92.2%; underlying earnings per share, 23.5p; and a return on tangible equity near the top end of our target range, just under 17%.

And these are underwriting-led results, and you can see that in the first half we have a combined ratio in each of our three regions, which for the first time ever has beaten our best-in-class ambition targets. I'm not in any way saying that that will happen in every half, or that job done or anything like that, but it is a notable feature of these results. And that is despite the fact that weather costs were higher than the prior year and is driven by more controllable items, in particular, large and attritional losses being better, even excluding Covid.

We are, of course, continuing to focus on delivering our plans and improving on these results. That means not just underwriting improvement, but also cost control as we all face into what will probably be a slow economic environment.

I'm sure we will have plenty of discussion on a dividend, but you will have seen that we're not proposing an interim dividend. We simply felt that it was too soon after the May decision to suspend the final dividend to restart. However, I think that you'll find some reasonably confident language in our press release, and that is to say that we believe we will be paying dividends. We have the strength to do so and the intent to do so. We're simply trying to manage through regulatory and public opinion items.

So, if we can move again to a summary of the Covid impact, which, obviously, no company presentation is complete without. And we'll unpack these again as we go deeper into the presentation, but on page seven you can see that, overall, COVID-19 has had a neutral impact on our operating profit. And that is to say that there have been some costs, reduced premiums, claims costs, reduction in investment income, and we've also put away, tucked away some money as a cushion for the future. And offsetting those, broadly, equally, are the frequency benefits from lower economic activity, leading to less claims, particularly in auto lines. We're also in a number of other lines, and so that means that, if you like, the headlines of our result are neutral to Covid.

I think it's worth saying that our premium trends and our claims frequency started to normalise in June, has continued through July, although, of course, there remains uncertainty for the second half. And today is the last day of the UK BI test case, although we don't expect a verdict until later in the quarter.

Although the impact of Covid at the operating profit level was neutral, below the line there are a series of charges from, if you like, the market turbulence, and Charlotte will unpack them. But, notwithstanding those charges, I think we're producing a very healthy Solvency II ratio. On a stated basis, 172%; well above the beginning of the year, and our targets and even post-dividend accruals are reflecting our intention to catch up in the future: 158%. The impact of COVID-19 on our ratios is about eight points in the first half.



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So, let's move beyond that summary, and go into what the company's been trying to do and how we've been doing, and we'll move on to slide nine.

When we started the year, obviously, not knowing about Covid, we had a series of business-as-usual priorities, and they could be simplified into saying, 'We want to keep going in the business areas that are already operating at or around best in class and we want to improve the areas that are not yet doing that.' And, very crudely, that split into personal lines versus commercial lines, and, then, cost efficiency continued to be a cross-cutting theme.

And, so, you will see, and, again, we'll unpack that. Our personal lines combined ratio has improved yet again - that's 55% of the company - and is exceptionally attractive levels. Our commercial lines underwriting is now getting back to more respectable levels and has improved, and, in particular, the controllable aspects of it have improved.

And cost efficiency continues to be a hallmark of RSA. In particular, the £50 million UK cost programme announced just less than a year ago. We have now completed that £50 million of cost saving on a run rate basis, but we intend to extend and expand the programme and go further than that. And we'll talk about that some more later.

So, we can flip onto, if you like, the two reminder slides that we put in on 10 and 11. And that is to say that the improvements that RSA has been making to its performance, its profitability and, hopefully, its value are being enabled by a settled strategy; one that's been settled for a number of years, one that has allowed consistency in pulling of the levers to improve our performance. And, so, I won't go through the slides, but slide 10 and slide 11 sets out again that consistent strategy, the levers that we pull in every single period, and the targets that we are aiming to achieve on page 11, which are unchanged from those that you have seen before.

Moving onto slide 12, and going through, if you like, the outputs of the different areas we are concentrating on. I think the principle thing we should say about our customer metrics in the first half is they're broadly stable. Of course, COVID-19 has created some noise because, in some lines, there have been premium givebacks, in other lines, we were closed for business for short periods of time - for example, in UK telematics, when no-one was doing driving tests, and so on. So, there's a bit of noise in there, but broadly we believe we see a stable picture, and indeed the top line was flat, ex-COVID-19, which was growth in our most profitable areas offset by, hopefully, the fag end of the repositioning in some of our commercial lines businesses.

So, moving from customer onto underwriting, and to slide 13. Clearly, the, if you like, engine of our underwriting performance is the attritional loss ratio, which normally has less volatility than others, and you'll see on this slide,



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presented as we have done in the past, the group's progression of attritional loss ratio and that of each of our three regions, and indeed the division between personal lines and commercial lines.

And what we've done to try to help you here is also put in shading the COVID-19 impact, where frequency benefits have helped us so that you can see that, while our attritional loss ratios have improved in every region and for the group as a whole, and for each of personal lines and commercial lines, that improvement is true whether you look at it, including Covid effects or excluding Covid effects, but clearly, over time, as Covid falls away, we will be looking at the ones that exclude as we manage our business.

Moving onto slide 14: costs. Simply to say that it remains an important part of our strategy. We believe, to be a best-in-class performer, we need cost ratios as we define them: controllable cost ratios below 20% in every business. We've gone slightly backwards at the Group level in the first half of this year. That's mainly a Covid premium impact because the absolute cost line came down slightly. However, in every one of our regions, we have a series of cost actions that will accelerate in the second half of the UK region, in particular. And I do believe that we will hit that controllable cost ambition in all of our regions within the next couple of years.

So, if we could move onto slide 15. This is trying to, if you like, unpack with a personal lines lens our performance. And you can see personal lines being like the engine of the group, 55% of premium. The numbers are all very good and better than last year.

Clearly, there are some Covid effects. I won't go through it in detail, but Scandinavia remains a very, very strong area for us. Canada also very, very strong, in particular, our direct business, Johnson. UK and International, I would say both household and pet doing well for us, motor still not doing so well. And then we give at the bottom of this slide the COVID-19 impacts. And broadly I would say that the personal lines areas have benefited more from frequency than commercial lines, and commercial lines have suffered more from claims than personal lines, and so that's why you have some, if you like, different benefits as you look at the business and those different components, benefits and costs.

Let's move onto slide 16: the commercial lines underwriting. Again, you'll see a combined ratio improving from 98.8% to 96.8%, and that's despite, if you like, the Covid impacts. And, in particular, first of all, this is improvement that we need to have and wanted to have. What I'm pleased to say is, you'll recall that there were some things that we needed to achieve in the turnaround of commercial lines. Those achievements are coming through and I believe will continue to come through.

Denmark has moved from loss into profit, Danish commercial lines that is. Canada commercial lines, still made losses in the first half, but that was because of an unusual weather skew. In fact, both large losses and attritional



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losses improved significantly in Canada, and I believe the hard market will show that continuing, and the UK kept its large losses in control and achieved better attritional loss ratios.

So, let's unpack Covid a little bit more on slide 17. And as we go through it, as I said, in the first instance, there has been roughly 110 million premium impact, which is across all regions. Some regions have had coverage changes, have had refunds, price capping and also volume impact. The net earned premium impact of that, some of it is in the second quarter when the premium back was through refunds, for example, and some won't be seen until the second half as the premium goes into earned.

On the claims line, we are reporting net Covid claims provisions of 56 million, and you can see the gross number, and, obviously, that's in the main instance because of travel reinsurance. And you'll see the breakdown between BI, travel and wedding beneath it, and the great majority of the claims are arising in our UK and International division.

For those of you who might remember our last disclosure in May was of the, I think, claims in the high-20s for BI, and say, 'How has it now got to 47?' And the answer to that is the actual validated claims have only climbed about 5 million or something like that since we last reported. But we bunged a bunch of IBNR onto it in order to give cushions against either further claims development or further claims.

And in addition to that, when we look at the frequency benefits, we've booked frequency benefits of 129m. There probably are more frequency benefits than that, but we've been quite conservative in how much to recognise since, obviously, there are some risks about timing being changed of claims, and so on. And in addition to not booking all of the frequency benefits that we could have booked; we have increased the group margin by 25 million as a further reserve.

And, so, when we look both at the IBNR, at not booking all of the frequency benefits, and at the margin increase, we believe we've given ourselves some cushion should that be needed in the second half. The cushion is not there for anything that we think we'll need it for, but, obviously, we're in an environment where we think it is better to be conservative than not.

In terms of the outlook for the second half, clearly, none of us have perfect crystal balls. In our own planning, we're expecting continued top line pressure from soft economies, although, I don't think worse than we've seen in the first half. Obviously, there could be some lower level of further claims from second waves or local lockdowns, and, indeed, frequency benefits should still be present in Q3, but at a lower level and be normalising. And, so, I would say we're cautious, as you'd expect us to be about the second half, but not, if you like, alarmed.



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So, let's move then from the Covid slide into the normal regional update that I give you, and we'll start on slide 19, which is the Scandinavian slide. Very good combined ratio at 83%, and even if you took out the Covid impact, the combined ratio is better than our target level of under 85%, and I think we can now say that our Scandinavian business is performing in the good part, in the best part of the Scandinavian capacity universe, which doesn't mean to say there aren't many things we can improve, but does mean to say that we've closed some important gaps.

And, within that, the things that were great continue to be great. In particular, our Swedish business and our Danish personal lines. As I mentioned, Danish commercial lines has shown a significant turnaround, although we've got more work to do, and Norway's very, very small; improving, but more work to do. The costs are flat; they're still too high, and I expect us to take more action in the second half of next year to address that.

Turning to the next slide, which is our Canadian business on slide 20. Again, we're really pleased with these results, and I think that they will show that we, and when all the results are in, and intact, continue to lead the pack in Canada in terms of financial results. Again, you'll see the results are better than our ambition number, and roughly on our ambition number if you take out the Covid impact. And, in Canada, normally, the first half is worse than the second half. The costs have jumped a bit, but I think there's a series of unusual and timing issues in there, so I'm not concerned about that; they'll get back into shape as we go into the second half, I believe.

In particular, the hard market in Canada is showing through, both in terms of our, if you like, achieved price increases. But that is driving strong improvements in attritional ratios, even excluding Covid, which is, of course, giving us a great deal of funding, either for profits or for weather volatility or whatever reason it is needed. As I mentioned, it is driven by personal lines and, in particular, our direct business, Johnson, which is the biggest of our Canadian businesses.

Although commercial lines still is not producing good financial results, again, as I mentioned earlier on, we're showing good progress in attritional and large losses. The weather burden for the first half, for some reason, I guess it's just luck, didn't seem to hit personal lines very strongly and did seem to be concentrated in commercial lines. Obviously, that can flop around in different ways. So, while weather in the first half was OK in Canada, much worse in the second quarter than the first quarter, it has a skew between our divisions.

Moving then to our final region on slide 21: our UK and international region. I'm pleased with the progress that Scott and his team are making in returning our UK and International business to good shape. I say UK and International business. Of course, it is the case that the international elements of this division have in the last



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couple of years performed very well, and in the first half this year continue their standout performance in Ireland, the Middle East and, ex-Covid, also our European branches.

Our domestic UK business also is getting better. It's slightly masked at headline level by much worse weather in the first half this year than the second half. If you equalise the weather, we have something like a 40% improvement year on year and profitability. And, obviously, we're pleased with that.

Attritionals are improving, including and excluding Covid. Large losses seem to be in a sensible place, and so one of the key actions remains costs. Despite the higher than expected premium reduction because of Covid, as I've mentioned, we're very pleased that we've completed phase one of the UK cost programme, but it's clear that we are not yet at the better-than-20%-expense ratio, although we do expect we can grow this business next year and the year after and so on. We do need to take out more cost and we will be expanding and extending the programme in the second half, although we're not able today to give you metrics about that since, obviously, we talk to our people first.

And the exit portfolios, Charlotte will talk to, but they are substantially run off, although as you can see, still capable of causing us some tail losses.

So, when we summarise all of that on slide 22, RSA's ambition remains very focused on trying to achieve both best-in-class capabilities as a company and then best-in-class performance. The financial expression of that, broadly, has not changed, and you can see it below, although those of you who have eagle eyes will see that we brought forward by a year our expectations of when the UK and International division can achieve it. And, of course, as I noted, actually, in the first half of this year, each of the three divisions achieved that number, although that may not be completely sustainable.

So, when I summarise all of that, and before handing over to Charlotte, looking at page 23, I think we could summarise RSA's position in the first half as follows:

The top priorities were serving our customers in difficult times, were keeping our people safe and making sure the company was resilient to all of the different uncertainties that could hit us, and to support the people who rely on us. And that will be our highest priority also in half two. But we haven't in any way neglected delivering for our shareholders and delivering our plans to improve the company. And we are very encouraged by half one trends, which, of course, have built on the work of the last few years. You can see the numbers in underwriting terms, a record, and good numbers and earnings per share, and a return on equity levels despite lower investment income.



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Covid is neutral to us, although not neutral in terms of effort. And, clearly, there is some uncertainty remaining. The financial markets impact of Covid, however, did hit both capital and below the line, albeit, I think, within tolerable bands, and we see the outlook as being positive with uncertainty. But, as I say, our focuses remain on customers and resilience and people, although we are determined to sustain strong delivery this year and beyond.

So, with that, if you like, canter through the qualitative aspects of our results, perhaps I could hand over to Charlotte to continue the presentation.

Charlotte Jones

Thank you, Stephen, and good morning, everyone, from me, as well. I will follow the normal pattern, starting on slide 25 with an overview of the numbers before walking through the P&L and capital in more detail.

For RSA, our journey towards best in class continues, and I am pleased to be able to present strong first half results for 2020. Underwriting profits, combined ratio and underlying EPS were all better compared to the prior year, and the business performed well. The constant FX Group net written premiums of £3.1 billion pounds were flat, excluding the Covid impacts. These impacts were around £110 million, or 3% of net written premiums. This included customer relief measures such as price reductions, refunds, and coverage changes. In addition, there were some top-line disruptions to specific business lines in the first phase of the crisis.

Group underwriting profit was £240 million, excluding exit portfolios, with a combined ratio of 92.2%. All regions' underwriting results are better when compared to last year, with Canada and Scandinavia significantly better. Business operating profits were £349 million, excluding exit portfolios. Within this, investment income decreased as bond yields fell further.

Statutory profit after tax of £164 million was down 10% compared to last year. This was impacted by significant other charges below the business operating profit line, predominantly relating to COVID-19 volatility in financial and property markets. Underlying EPS was 23.5 pence, and underlying return on tangible equity was 16.7%, towards the top end of our target range of 13 to 17%. And, finally, tangible equity was up 9%, driven by profits, foreign exchange, and fair value gains, partly offset by investments in intangible assets.

I'll now go through the regional results in more detail, and unless otherwise stated, the UK and I and Group results are presented on an ex-Exits basis. I will start with premiums on slide 26.

As I said, premiums of £3.1 billion were down 3% at constant exchange, but flat, excluding Covid-related impacts. Scandinavian personal lines premiums of £563 million were up 1%. In Sweden, the most profitable portfolio



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within the Group, premiums grew 2% to £367 million. Household and personal accident were both up, driven by strong new business trends, and retention was ahead of our plans in all classes.

In Denmark, premiums were flat at £171 million, with rate offsetting slightly lower retention, while premiums in Norway were down. Both were impacted by lower household premiums. In Scandinavian commercial lines, premiums were down 4% to £450 million. Rate was ahead of H1 last year and plan across the majority of business lines.

Danish commercial lines premiums were down 9% at £218 million. Volumes were down 13%, partly offset by rate. And, as a reminder, about 60% of the book renewed at the start of January, and we were pleased that the renewal round went to plan. Swedish commercial grew 1% to £190 million, driven by strong new business levels. Rate and new business were both ahead of the prior year and our plans.

Personal line premiums in Canada grew 4% to £570 million. This is after including about £22 million of COVID-19-related customer relief measures, which reduced written premiums in the second quarter. We expect these relief measures to have a further similar-sized impact on premiums in the second half as the business adjusts its rates in line with these measures.

Pricing conditions continue to be favourable. Rate increases range from high single-digit to double-digit rate increases across our portfolio. Premiums grew 12% in our most profitable Canadian business, Johnson, to 345 million. This included 5% of organic growth, as well as the full run rate benefit from the partnership with Scotiabank. Despite applying strong rate, retention remain robust at around 90%. Commercial line premiums in Canada increased by 1% to £225 million, where a 7% reduction in volumes was more than offset by rate increases of 10%.

Personal line premiums in the UK and International were down 11% to £578 million. This included an estimated reduction of £40 million related to COVID-19. Excluding this impact, the reduction was around 4%. UK Household premiums were broadly flat at £270 million. This exceeded our expectations, delivering positive new business growth, strong retention and good levels of rate.

UK motor and pet premiums contracted again in the first half of 2020. While retention improved, new business was impacted as we continued to hold our discipline on rate. UK and International commercial lines premiums were down 6% to £714 million. This included an estimated reduction of £38 million related to COVID-19. In the UK, rates were ahead of plan as we achieved double-digit increases in London markets and mid-single digit rate increases in our UK regions business. Furthermore, our UK regions business continued its positive momentum



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with premiums up 14% on the prior year. This was supported by strong new business retention and rate, all of which are ahead of plans.

Now, turning to slide 27 to look at the drivers of the underwriting results.

The Group underwriting result of £240 million was delivered at an excellent combined ratio of 92.2%. The COVID-19 impacts for the group were broadly neutral. Overall, the group attritional loss ratio improved four points compared to the first half of 2019. Of this, 2.5 points were COVID-19-related, which has several drivers that I will explain.

Firstly, there are claims frequency benefits, and we have taken a conservative approach to recognising these. This benefit is partially offset by loss contribution from lower premiums, direct Covid-related claims and associated IBNR reserves. Plus, we have recognised the £25 million precautionary margin reserve.

The Group expense ratio increased slightly, as expected. This was due to lower premiums from the COVID-19 impacts. Volatile items, which include weather, large and PYD impacts, were one point worse than in the first half of 2019. This development was dominated by Covid impacts, and I will unpack the components of this in more detail shortly.

Looking at the headline underwriting performance in each of our regions: in Scandinavia, the underwriting result was £141 million, up 49% on 2019, at constant FX with a combined ratio of 83.2%, inclusive of a favourable Covid impact of about 1.5%. Personal lines remained excellent with a combined ratio of 78%, with the attritional loss ratio improving year on year.

The commercial lines combined ratio improved by over 13 points to 90.5%, reflecting improved attritional and large loss performance in both Denmark and Sweden. The Danish commercial lines underwriting result was £10 million, and we welcome the improvement in the Danish commercial lines, and it is important we build on this success of the first half as we go forward.

The Canadian underwriting result was £58 million, more than treble the result at the same stage a year ago. The combined ratio improved by nearly five points to 93.7%, of which Covid impacts provided a 1.1% benefit. Personal lines combined ratio improved by over seven points to 87%. This was supported by better attritional performance and lower weather losses. Commercial lines performance remains challenged with a combined ratio of 109%. Current year performance improved by four points to 103.4%, supported by better attritional and large loss performance, though still adversely impacted by weather. This was further offset by prior year reserve strengthening.



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Finally, the UK and International underwriting result was £89 million, with a combined ratio of 93.6%, inclusive of a 1.1% Covid impact. Within this, the UK domestic business delivered a combined ratio of 96.1%, despite weather being more than one point higher than plan expectations. The European business delivered a core of 95.2%, and Ireland and Middle East, again, reported excellent results, with combined ratios of 82% and 83%, respectively.

Taking a closer look at the loss ratio movements by region on slide 28.

On this slide, we show regional loss ratio performance, both including and excluding the impacts of COVID-19. The attritional loss ratio improved in all regions compared to a year ago on both these bases. In Scandinavia, the loss ratio of 66.3% improved by 5.6 points, or 4.1 points excluding the impacts of COVID-19.

This was driven by several factors. The attritional loss ratio was two points better than the prior year, or 0.4 points better, excluding the impacts of COVID-19. Weather was 0.8 points better than the prior year and 0.3 points better than the five-year average. Large losses improved by about a point but remained elevated compared to the five-year average, driven by Danish commercial lines. Prior development provided nearly three points of benefits to the combined ratio, supported by performance improvements in Danish commercial.

In Canada, the loss ratio improved by nearly seven points to 64.1% or 5.2 points, excluding the impacts of COVID-19. This was driven by strong improvements in the current year performance. The attritional loss ratio improved by nearly six points at a headline level, or four points excluding Covid. This was better across the great majority of business lines. While weather was nearly two points better than the prior year, it was 0.7 points above the five-year average. This included the Alberta hailstorm in June. Just a note, for the industry, this was the fourth most expensive, insured natural disaster in Canadian history, at \$1.2 billion Canadian.

The large loss ratio was 1.5 points better than the prior year, driven by improved performance in commercial property. And prior development was adverse and 2.3 points worse than last year, driven by liability classes in accident years 2016 and earlier.

Finally, the UK and International loss ratio also improved on 2019 by 1.7 points to 58.2. However, it was 1.6 points adverse, excluding COVID-19 impacts. The attritional loss ratio improved by about six points, the majority of which was driven by COVID-19-related frequency benefits. Weather was 1.9 points higher than the prior year, and nearly a point higher than the adjusted five-year average. This was driven by the UK February floods, which cost us nearly £35 million.



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Large losses, excluding COVID-19, were in line with our expectations, showing continued progress. However, the impacts of COVID-19 mean the headline ratio was 1.9 points higher than last year. Prior year development was 0.4 points worse than last year impacted by adverse experience in the UK, which included claims inflation in certain lines.

Now, let's turn to the overall impact of the volatile items, specifically, weather, large and prior year development on slide 29.

At Group level, the weather loss ratio was 3.4%, slightly elevated compared to last year, mainly reflective of the UK floods in February. Compared to five-year averages, weather experience was slightly worse. Large losses were also higher than last year at 9.9% but were impacted by direct Covid claims. Excluding these impacts, large losses were about a point better than last year at 9.0%. Prior year development was positive, and 0.6 points was lower than recent years, primarily driven by the UK. It does include a £6 million Covid-related charge, without which, PYD would have been a 0.8 point benefit.

Finally, just to note that our reserve margin was above our target range target level of 5% of best estimate claims reserves, and this follows the addition of the £25 million from the current year result to this margin, as mentioned earlier.

Now, moving to costs on slide 30.

Written controllable costs of £680 million was slightly down on the prior year. This comprised 3% cost reductions offset by 2% inflation. The earned controllable cost ratio of 21.8% was about a half a point higher than last year, driven predominantly by the COVID-19 impacts on the top line, though the absolute controllable cost amount was down year on year, at £670 million.

At the regional level, firstly, in Canada, the cost ratio increased 20.1%. This was a reflection of both planned higher software amortisation costs, as well as lower premiums as a result of COVID-19 relief actions. The cost ratio is expected to trend back below 20% for the rest of 2020.

Secondly, the UK and International controllable cost ratio improved by about half a point, despite the premium shortfalls driven by COVID-19. This reflected the actions taken under the UK cost programme, which has seen £45 million of charges booked since the programme began, achieving a £50 million run rate benefit compared to the 2018 baseline.



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With anticipated lower premiums driven by the recessionary impacts of COVID-19, the UK cost programme is being increased further this year to address economic challenges and bring the business to where we need it to be. The UK continues to target a controllable cost ratio of 20% or better, which we have plans to achieve by 2022.

Thirdly, in Scandinavia, the higher controllable cost ratio was driven by the underwriting actions on top line, so it should be noted the absolute controllable costs were down year on year. And, as a reminder, we remain focused on progressing towards achieving or bettering our 20% target in each of our regions.

Now, moving to the investment portfolio impacts on slide 31.

Gross investment income of £134 million was 13% lower than a year ago. This reflected the impact of reinvestment at lower yields but was also negatively impacted by lower cash rates and reduced property income, primarily from the REITs portfolio. COVID-19-related impacts on investment income were estimated at around £6 million. There has been no change to our strategy. The portfolio remains dominated by high-quality fixed income, with around 90% of our bonds rated 'A' or above.

Average book yield on the bond portfolio was 1.9%, while the average re-investment yield on the bond portfolio was 0.7%. Based on current forward yields and FX, our investment income estimate of between £255 million and £270 million for 2020 remains unchanged. However, income is likely to be at the low end of the guided range.

2021 and 22 are also included on the slide for your information. These projections currently remain unchanged, but we continue to review in light of the pressures created by a falling yield environment. Balance sheet unrealised gains increased by around £55 million year to date to £428 million on a pre-tax basis. This is mainly driven by positive mark-to-markets on the bond holdings of around £125 million to £495 million. If yield curves stay as they are, we estimate that the gains on the bond portfolio will take around seven to eight years to fully unwind, with about 50% of this being within the next three years.

In terms of the numbers, we estimate this to be about £40 million post-tax for the second half of 2020 and £80 million for 2021, impacting capital generation by a little less than these amounts. Of course, this profile assumes current market yield curves, and, clearly, further yield development will impact this trajectory.

Moving now on to other charges and the statutory measures of profit on slide 32.

A few items to highlight here. Losses on the UK and European exit portfolio were £33 million. This reflected one large claim, some international construction policy claims that are COVID-19-related, and some increase in the prior year reserves. Items below the business operating result were relatively noisy in the first half and



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significantly impacted by Covid effects on the financial and property markets. So, other charges of £88 million included about £54 million of losses due to these market impacts. And this is broken down as follows:

£14 million related to writedowns on the UK property holdings; 12 million of unrealised losses on inflation swaps which are held as hedges against the inflation risk in the Scandinavian long tail portfolio; offsetting benefits to which we would expect to see in lower claims costs over time, depending on the long-term inflationary trends; £20 million of impairment on Scandinavian REITs portfolios; and £8 million from a reduction in the discount rate on long-term insurance liabilities in Denmark. As a reminder, the change to Danish discount rates did not have an impact on capital.

The business also recorded an £18 million charge for UK restructuring costs in line with the guidance relating to the UK cost reduction programme. A £5 million goodwill impairment related to the Norwegian business, and recurring other charges such as amortisation, pension costs and FX movements make up the balance. Results of these impacts mean statutory profit before tax was £211 million, which was 7% down versus a year ago. The effective tax rate increased marginally year on year, from 20% to 22% due to profit mix and the impact of the exit portfolios.

Now, turning to slide 33 to talk about capital.

Our capital position and quality remains strong, with a coverage ratio of 158%, including the accrual for the 2019 final dividend and six months of accrual of a notional 2020 dividend. Excluding these dividend accruals, the coverage ratio was 172%.

Our capital quality remains strong, albeit it down from the year end with core tier one capital at 100%. We generated 14 points of capital from earnings in the first half, with net Capex and pension contributions absorbing five points of this. Both major UK pension schemes remain above their caps at the half year. This means that contributions into the schemes are not fully eligible from a capital perspective, and act as a drag on the solvency ratio. However, for each scheme, the surplus over the cap acts as a shock absorber for future market movements, and the unrecognised pension buffer was about eight points of capital at the half year.

In terms of the other movements, I'd highlight the impact of bond pull to par, which absorbed about two points of capital generation, and UK exits and restructuring costs, which together absorbed three. Finally, the impact of negative market movements cost eight points of coverage, driven by COVID-19-related financial and property market volatility. We've provided a breakdown of the significant moving factors.



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Impact of lower yields costs around five points of coverage, and the valuation impacts on the REIT's portfolio, UK property and preference shares cost four points of coverage, offset slightly by positive FX and bond values.

And, so, finally, to sum up: on slide 34, we are pleased to report a strong set of numbers for the first half of 2020, and the trends continued to be encouraging. Underwriting profit was up 33% compared to the prior year, with COVID-19 impacts being broadly neutral within this result. Underlying EPS of 23.5 pence was up 12% compared with a year ago, and underlying ROTE was 16.7%, which is at the upper end of our 13% to 17% target range.

Financial and property markets impacted negatively on our bottom-line profitability and capital position, but both within tolerable bands. And, importantly, our service to customers remains strong, and business operations showed resilience as our people stepped up to the challenges of the significant disruption.

We remain focused on delivering our plan commitments and will remain vigilant to react to the residual impacts from COVID-19 in the second half of 2020 and beyond, and our ambitions from the group remain high and unchanged and we are focused on continued progress.

Thank you. And with that, I'll hand back to Stephen.

Stephen Hester

Thank you very much, Charlotte. Operator, do you want to start the Q&A process, please?



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Q&A

Operator

Thank you. Ladies and gentlemen, if you do wish to ask a question, please press 01 on your telephone keypad now. If you wish to withdraw a question, you may do so by pressing 02 to cancel. And our first question comes from the line of Freya Kong from Bank of America. Please go ahead. Your line is now open.

Freya Kong

Hi. Good morning. Thanks for taking my question. Could you please give us some colour on your thinking behind when you set your IBNR for business interruption? To what extent does this reflect future potential claims or local lockdowns?

And, secondly, given you've taken a pretty conservative view on Covid losses today and claims notifications are looking like they're slowing down, should we be expecting minimal charges in the second half? Thanks.

Stephen Hester

Hi, Freya. The IBNR is one of those actuarial arts which has got many moving parts in it, and it is partly to cushion in case existing claims get worse, partly as a cushion against claims we haven't had yet and might get in the future. And, obviously, with something like Covid, both of those are rather speculative in quantum. So, we regard the IBNR as reasonably conservative.

And, as I say, there's additional conservatism in not having recognised all of our frequency benefits. As to what the balance in the second half would be, obviously, it would be pretty foolhardy of me to make a forecast, because it doesn't lie in our hands, but we do expect more frequency benefits in the second half albeit less than the first half. We have those different cushions that we've talked about, and, so, hopefully, all of that is adequate, but only time will tell.

Freya Kong

Great. Thanks.



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Operator

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

Jonny Urwin

Hi. Good morning, guys. Hope you're well. Just two from me, please. So, firstly, just to follow up on the BI claims, that's where the majority of investors' focus appears to be this morning. I think people are just keen to get a sense of whether this is a pretty prudent assumption. What's the scope for this to keep creeping higher after additional claims potentially arising? Your comments just now were reassuring, but if you could just maybe flesh it out a bit more, I think people would welcome the reassurance. This question does not relate to the BI claims potential from the FCA case. Obviously, we don't expect any comment there.

And, then, secondly, the attritional loss ratio improves pretty nicely, and I'm just wondering, is the clean 150 basis points improvement ex-COVID, is that a reasonable run rate, given the turnaround and the pricing versus claims inflation jaws, Any thoughts there would be great. Thank you.

Stephen Hester

Thank you very much for those two. Just on your second one first, I don't think we regard there as being anything unusual in what I'll call 'the clean number in the first half on attritional', and, indeed, I think that there is a good likelihood of some further gains in the second half as some of the pricing continues to earn through strongly, and so it might get better than that in the second half. But, clearly, that may be offset by some contribution impacts from lower earned premiums as the net written premium impact comes into the earning. And, so, at the moment, we're taking a conservative view that these sorts of things offset each other. If they do better than that, then so be it.

On the BI, in effect, you're inviting me to talk about things that I can't know, i.e. what will happen in the future. As you say, away from the court case, which obviously I can't talk about, the flow of new BI claims is very, very low today, and I suppose you would have expected that if there were going to be lots more, then we'd be seeing them right now, and we're not, and most economies are coming out of lockdown, although clearly there can be more that arise from local lockdowns or second waves or anything like that.



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And, so, at the moment, we have no reason to believe, again, not commenting on the court case, away from the court case, that we're going to have an ugly second half in terms of BI, there's no trends or notifications or anything that's telling us that, but, obviously, maybe your crystal ball is as good as mine on that.

Jonny Urwin

Great. Thank you.

Operator

Thank you. Our next question comes from the line of Edward Morris from JP Morgan. Please go ahead, your line is now open.

Edward Morris

Hi. Thank you for taking the questions. The first one relates to the reinsurance protections that you have an. In particular, I'm thinking about this BI exposure. Can you just remind us in the UK how the attachment points work for the regional cat cover, which I think may be a 75 million attachment point? And, then, also, what is and is not qualifying for the group volatility cover? And, I suppose, the way I'm thinking about this, I appreciate you might not want to comment on the court case, but presumably you can give us an indication of what would and would not be protected by the reinsurance protections that you have.

And, then, the second question is really a strategic one. When I look at how you improve the attritional loss ratios in the three divisions, you're getting to a point where even excluding the Covid benefits, you are there or thereabouts in all of the geographies. Maybe a little bit more work to do in the UK, but you're at the level that you set out to achieve many years ago.

So, thinking about the medium-term future for RSA, what happens next? Is it a case of you continue to focus on cost efficiencies or improvement, or can we expect a bit of a strategic shift? Obviously, the growth is still relatively low, and the cash conversion into sort of 'dividendable' cash and capital is still a little bit low, but I'm just interested as to how you think about that and what comes next now that you are at the level that you set out to achieve. Thank you.



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Stephen Hester

Good. Thank you, Ed, for those questions. On your first one, on reinsurance protection, yes, you're right that if we look at the UK business, the CAT cover kicks in at £75 million, but below that, any claims that aggregate to 10 million or above are GVC eligible. And since, in a normal year, from BAU claims we get more plus or minus to the GVC threshold, I'd therefore expect incremental Covid claims that come into the GVC to be largely covered. And, so, I think that the reinsurance provides us good protection there.

Obviously, I have to put a caveat to that. Although we haven't put in a reinsurance claim other than on travel, and, obviously, the reinsurance market is adjusting to Covid and the different sorts of reinsurance that there is out there - I understand there are a couple of claims have already been made on Covid that that are in the pressures of being paid - but reinsurers are still working through their position. We believe our policies do cover Covid, and, therefore, if you like, the leakage, if there is a leakage, is going to be in how the aggregation works, which will depend on what kinds of Covid claims they are and whether they can be aggregated within periods, and so on. But when we stand back and take it altogether, our belief is that reinsurance will be an important cushion for us should it be that claims experiences is worse than we're expecting.

On your second point on strategic issues, which is a thoughtful and good one, I would say that the core strategy of best in class is unlikely to change, and that is to say that by far the most valuable thing we think we can do is to operate the company at the best levels that competitors achieve in each of our markets, and most more adventuresome strategies have as good a chance of destroying shareholder value as of creating it.

And, so, I think you should expect our primary strategy to be to continue what we're doing, and that is, I think, that there are many, many things we can still do to improve this company. Some of that will show through in further profitability; I expect all of our targets are 'better than' targets as opposed to 'at this level' targets. So, obviously, we will keep driving 'better than'.

Some of what we're doing is to make sure that we can beat our targets, not just once, but every time, and so the more cushion we give ourselves on expense efficiency, for example, the more that allows it to be sustainable. And, but what I think is also correct is that the period of time when we've had noise below the line should be coming close to an end as, if you like, the restructuring process is more or less close to an end. And, so, that allows more to flow to the bottom line. And as each, and you'll see already in our businesses, that when our businesses start hitting the best-in-class performance levels, we then shift emphasis, sustaining those performance levels, but shift emphasis to growth. And that's why we've been growing Johnson strongly.



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In Canada, we've been trying to grow in personal lines. In Scandinavia, we have been growing, but not as strongly as Johnson, and, for example, in our regions commercial business in the UK, which is performing quite well, we've been growing there, in household in the UK, which is performing well. We've been growing there. And, so, you should expect more profitability, more sustainable profitability and more growth, assuming that we keep continuing to improve in these different ways, and I would expect those are the primary things that will go on at RSA. Clearly, we do look at opportunities in the market that are different than that, but we tend to look with a sceptical eye.

Edward Morris

Thank you. Very clear answers. Thank you.

Operator

Thank you. Our next question comes from the line of James Pearse from our RBC Capital Markets. Please go ahead. Your line is now open.

James Pearse

Morning, everyone. Thanks for taking my questions, and I hope everyone's keeping well. So, first question is just, as a result of the Covid-19 pandemic, are there any lines of business which you now plan on exiting or writing more of, for example? And do you see any risk of heightened claims on liability lines going forward in the longer term?

And the other question is just on costs. So, obviously, the Covid-19 impacts on premium means that there's more to do on costs now. Can you provide more colour on the main areas where you expect to achieve those cost savings please? Thank you.

Stephen Hester

In terms of exits, I think the only thing I can think of right now is that we are putting through Covid exclusions on everything. And, so, those areas that have given rise to Covid claims this time around won't in a year's time. And,



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secondly, the only specific business line that we would be exiting would be wedding insurance, where I think it's most unlikely we'll do more of that, since the risk reward doesn't look very good to us. But, obviously, that's a tiny business line.

In terms of writing more, I can't think of anything right now that it is right that we would write more of as a result of Covid, if I could put it that way. On your question on liability claims, which I assume was a Covid-related question, clearly, we are alive to risks of Covid liability claims. I think there are quite a lot of obstacles to making them in terms of companies being able to demonstrate that they have abided by government recommendations. And, so, I would say it's something we're watching out for rather than especially fearful of at the moment.

And, then, finally, on costs. I would say, the way we're going to save money is exactly the same way we have over last six years. Obviously, there's a people element to that. And then there's a productivity simplification technology. I'm sure we'll have less space, some of which will arise from flexible working, and so on. So, it's all the same stuff that we've been doing before and will keep doing.

James Pearse

That's great. Thank you.

Operator

Thank you. Our next question comes from the line of Andrew Crean from Autonomous. Please go ahead. Your line is now open.

Andrew Crean

Good morning, all. Three questions, if I can. Firstly, could you say in broad terms whether, in the second half, you expect premium falls to be offset by frequency. So, are we looking at a balanced picture for the second half?

Secondly, could you talk a bit about whether you've actually - I know you haven't put claims into your reinsurers yet - but have you actually talked to them as to whether they think there would be cover when you put claims in?

And, then, thirdly, on your statement on dividend payments, you say, 'We expect to resume dividend payments as soon as prudent, and aim to catch up on missed dividends over time on the same basis.' Can we have a bit



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more clarity around that? Obviously, the FCA case will -- the judgement will come perhaps September time. If it goes against the claimants and they appeal to the Supreme Court, which could be about January. Within those framings, when would you be looking to catch up on dividends from the past? Is it post-September/October finding out the first ruling?

Stephen Hester

Andrew, thank you very much for those questions, and let me try and address them. In terms of second half, at the moment, I think we would expect things to be reasonably balanced, and, therefore, to have a balanced picture on Covid in the second half, and, therefore, for the second half results to be mainly driven by business as usual, as the first half has been. But, obviously, we'll have to see whether that is a correct projection or not.

In terms of the reinsurance position, yes, we have been very actively engaging with our reinsurers, keeping them abreast of everything that's going on. While we haven't made a claim, and so we haven't got specific responses, it is our belief from those engagements that the reinsurers accept that Covid is covered and, therefore, that the principle issue is around aggregation of claims. And that depends on what specific claims come in and what periods they relate to, and so nothing has happened in our engagement with reinsurers to make us question whether the reinsurance will do what it's supposed to do.

Finally, on dividends, I would say that the challenge in giving you a good steer is that our suspension of dividends has not been driven by financial considerations; either current financial considerations or, indeed, fear of future financial events. It's been driven by, if you like, a subjective judgement of what's the best way to navigate public and regulatory opinion through this period.

And, so, because it's a subjective judgement, which maybe we're wrong about - I know you think we are, but you're entitled to that, of course - it's hard to know exactly how that will change. The statement that we put out suggests that we find it highly likely that we will recommence dividends by the year end, and we've said by the year end, which leaves open a possibility that we could recommence earlier. We'll certainly think about it, but I think that the highly likely is best applied to the year-end position.

Andrew Crean

Does that mean March of next year?



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Stephen Hester

Yes. With our year end results, but that doesn't mean to say we won't think about fourth quarter, for example, doing something then. We will think about that, but I think, at this stage, I don't want to apply high probabilities to that. I just don't know.

Andrew Crean

And the regulator pressured people into suspending dividends because of significant uncertainty around BI. Does not the resolution of the FCA case reduce that uncertainty and, therefore, reduces baulk on dividends?

Stephen Hester

As I say, we do not have any ban from regulators on paying dividends. Indeed, we have in the first half up-streamed dividends from both Scandinavia and from Canada. And, so, those regulators haven't banned that. And my understanding is that the PRA is not banning it, but, obviously, what the regulators are doing is, if you like, trying to exercise some moral suasion and using - and we have a particularly - I've got to be careful as I'm sure the regulators are listening to this call - there is a particular position in the UK where, obviously, some of the regulators are in court with us at the same time as regulating us, and so what we're doing is reaching judgments in the round, as I say, both on public opinion and regulatory opinion to be restrained in this area, but we do not have a dividend block, as we understand it, from any regulator.

Andrew Crean

Thank you.

Stephen Hester

Sorry, one thing I should have just said Andrew, because you wouldn't focus on it. As to the catch-up element of dividends, I think that, in addition to all my comments that I've just made applying to the catch-up elements, as well as the restart element, I suppose the pace of catch-up will be, primarily, to my mind, governed by our solvency II capital ratio, and to the extent it is higher than the ones we are comfortable with - and the start of the



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year is a good example of something we were very comfortable with - that leads you to catch up faster. If market movements were to put it lower, that would lead you to catch up slower, but the intent is to catch up over time.

Andrew Crean

Thank you.

Operator

Thank you. Our next question comes from the line of Oliver Steel from Deutsche Bank. Please go ahead. Your line is now open.

Oliver Steel

Good morning, everyone. Can I just follow up quickly on that dividends question: the catch-up? You talk about catching up over time. How long a time? That's question one.

Question two is: thinking about your use of reinsurance. So, not just a short-term question, but really looking out over the next couple of years, reinsurance pricing is going up quite a lot. Your model is very heavily reliant on reinsurance. And I'm wondering whether that that creates a sort of viability question, or whether at some stage you have to reduce the amount of reinsurance you buy to how then that changes the way you write business.

And then the third question is on the eight-point buffer over and above your solvency from the pension fund. I guess what you're saying there is that a pension fund, actually, or any hit to the pension fund, doesn't come through to the solvency for the first eight points. Does that change your view about the solvency ratio target range that you've set?

Stephen Hester

Thank you very much, Oliver, for those points. In terms of catch-up, as I say, obviously, it's a judgmental issue. But my previous answer was trying to say that I think the pace of catch-up sharp will be best seen by our solvency II ratio, and, at the moment, our ratio's being dented by eight points of market movement. If that eight points reduced, that leads to a faster catch up, or if our performance remains strong and we produce more capital from organic reason basis than we originally were thinking, that makes the catch-up happen faster.



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So, those are the two variables which are hard to be sure about. In my own mind, I would think it might be over a couple of years, but if it can be faster, then it would be faster - the catch up, as opposed to restarting. Obviously, restarting will do. And I don't think it will all have been one amount. I think it's likely be in several amounts.

In terms of your question on reinsurance, although we are expecting reinsurance prices to go up, we also, in the lines that are most affected by that, have hard markets, and they're achieving pricing ahead of inflation, and we are calculating our plans for next year, including an assumption of higher reinsurance prices. And we believe we can still make progress next year, notwithstanding that. It's not my understanding that our business model relies more on reinsurance than others. Obviously, there's a range of others out there, but, certainly, when we look at things, we think we're middle of the pack in terms of use of reinsurance. And I certainly don't worry about viability of our business in the light of reinsurance.

And, then, your final question on pension buffer: I would say that, of course, it is in our mind when there's a pension buffer as it relates to the capital ratios that we're happy with, but probably, if you like, the pension area can be one of the more volatile of our capital ratios because the IFRS pension position is driven by 'AA' credit spreads, and those jump around a lot, as one can see over the last few years. And, so, I would say, we don't take for granted that it's a stable number, and, therefore, it has some, but only limited impact on our, if you like, solvency II ratio thoughts.

Oliver Steel

Thank you very much.

Operator

Thank you, our next question comes from the line of Jonathan Denham from Morgan Stanley. Please go ahead. Your line is now open.

Jonathan Denham

Good morning. Thank you for taking my questions. Firstly, could you just touch on the impact of Covid on underlying price changes in commercial and personal lines in the UK and Canada? Are you excluding things like rebates? And I thought I heard you say that you're still in the hard market in Canada, but also Charlotte saying that a reduction in rate will impact premiums in Canada in 2H.



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And, secondly, how do you expect frequency benefits in 2H to vary by country? I think some of your Scandinavian peers have flagged higher than usual frequency in line, such as auto, of late. And, just finally, Ireland and the Middle East have produced some very strong combined ratios for a number of periods now. Are these levels sustainable? Thanks.

Stephen Hester

Why don't I not dominate too much? Charlotte, do you want to pick up on those?

Charlotte Jones

Yeah, sure. So, I think, in terms of the pricing, as you say, it is still a hard market in Canada, and we're still pushing rates through really ahead of plan. I think the point that I was making on the rebates and customer relief is, some of it will just take some time to earn through. It depends on our precise relationship with the customer as to whether it's done as a rebate or a temporary rate reduction. So, some of it will come through in the second half, and it's just the exact same measures that we've announced just earning their way through. So, it's nothing more than that.

I think on frequency, it depends which area of the business you're talking about and it depends on the extent to which the business has emerged from lockdown. So, for example, in Scandinavia, which always experienced a shorter, sharper lockdown in some cases, and not much at all, the frequency levels are returning much more to normal. In the UK we've seen, certainly, on the motor and home, a more return to normal, as well, but Canada is probably the most locked down still, and so we're not seeing that through.

But to reiterate the point that the recognition of frequency benefits so far has been conservative, so to the extent that the data patterns are distorted by the frequency changes and, therefore, how much we completely can see and reflect, we've taken a conservative, cautious approach to that now, so there could still be some, as it proves to be the case, comes through and provides some additional production in the second half.

And, then, I think, on Ireland and the Middle East, they're small businesses, they're good businesses. The levels of COR ratio, as you say, are very strong. We are seeing some patterns. Our top line impacts in the Middle East are a little bit more challenging at the moment. The Covid impacts in Ireland have been quite strong, as well. So, I think they are good businesses and they are very profitable businesses, but, being small, actually, some trends on top line can have negative impacts. But our ability to respond and get rate through is also good. So, yes,



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sustainably good businesses, are the levels, the precise level sustainable? I think that you'll see some normalisation, but they are still strong businesses.

Jonathan Denham

Brilliant. Thank you.

Operator

Thank you. Our next question comes from the line of Dom O'Mahoney from BNP Paribas. Please go ahead. Your line is now open.

Dom O'Mahoney

Good morning. Thank you for taking my questions. Three, if that's all right. The first one: I'm afraid, just to return to reinsurance and business interruption. And, of course, I appreciate you can't comment on the potential outcome of the case, but for those of us who don't have underwriting backgrounds, could just explain how aggregation will work. You specify in the press release that it works on a weekly basis. Is there essentially a trigger for recognising the timing. Is that the initial calls? So, for instance, the government lockdown? Is it notification which might indicate that you get claims in multiple weeks? Or would it be the decision of the courts, in which case again it would all come into one event? Clearly, whether this is one event or multiple events is going to impact any sort of worst-case scenario. Any help you could give us on that would be great.

And, then, just two questions on solvency, if it's all right. The first is: I see that you've had the volatility adjuster approved. Can you give us some sense of the percentage point benefit from that? I'm afraid I can't see it in the release. Forgive me if I've missed it. The second is: thank you for the disclosure on the buffer from the pension scheme. Do you have an idea of what the solvency ratio for the group would be if you excluded the pension scheme as a whole? And, indeed, what the pension scheme solvency would be on a standalone basis? Thank you.

Stephen Hester

I'll ask Charlotte to answer your second two, but on the reinsurance one, the principal way that reinsurance works is when a claim is triggered rather than when it's notified and therefore, what's important is the trigger event. And, so, if you like, a court case *per se* wouldn't be considered a trigger event, because what the court would be



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ruling would be that a trigger event had occurred in the past that we don't currently consider to be a trigger event. And, so, the most likely scenario is that the trigger event for losses is a lockdown, because that's what causes the business interruption. And since, obviously, the great majority of lockdowns were clustered in a very short period of time, that's why the aggregation is likely to work.

But, however, it's likely to be difficult to aggregate a Brazilian claim with a UK claim because the lockdown in Brazil occurred at a different time than the lockdowns in the UK. And, similarly, if the local lockdown in Leicester gave rise to any losses, which so far it hasn't to us, that wouldn't be able to be aggregated with the lockdown that went back to March in the nationwide lockdown. So, it's when the event is triggered. But why that's a positive for Covid is a great majority of Covid claims would have been triggered by lockdown, and the lockdown, at least in the UK, was all at the same time. Charlotte, do you want to take the second question?

Charlotte Jones

Yeah, sure. So, I think on the volatility adjuster: as you say, we got approval from our regulator to use that. That was granted in Q1. At the first half point, that's worth around three points, and it's included within the market movements in the walk that you can see as an offset to the widening of credit spreads. So, that's a positive thing.

It is designed to protect from artificial volatility in your own funds, and the effect is it adjusts the discount rate applied to the technical provisions. So, its impact is all on the credit spread volatility. So, it reduces it if spreads widen, but it dampens, also, as they narrow. So, the idea is it reduces some of that. So, it has given us over this period, to this date around a three-point benefit.

I think, if I were to try and do an 'ex-pensions' view of solvency, it's probably in the 10 points range. It's a little bit difficult because, within the overall capital calculation, we have a number of drivers, and you get diversification allowances which add some complexity, but I think it's probably in that 10 points better on a fully 'ex-pensions' basis.

Dom O'Mahoney

That's very clear. Thank you very much.



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Operator

Thank you. Our next question comes from the line of Ming Zhu from Panmure Gordon. Please go ahead. Your line is now open.

Ming Zhu

Hi. Good morning, everyone. Just two questions, please. The first is on the UK motor claims inflation. What's your outlook on that, please? And, second question: what is the current rate environment outlook you are seeing or expecting on the UK personal and commercial lines? Thank you.

Stephen Hester

I'm afraid I don't know the answer on UK motor. It's a pretty small line for us, and I don't know. I'll ask Charlotte in a second if she knows. In terms of rate outlook generally across the UK, I would say somewhere between 5% and 10%, depending on business line. Charlotte, do you know anything more specific about UK motor inflation?

Charlotte Jones

No, not off the top of my head. I think we'll have to come back to you through the IR desk, but probably mid-single digit, I would think.

Ming Zhu

OK. Thank you.

Stephen Hester

Thank you.



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Operator

Thank you. Our next question comes from the line of Greig Patterson from KBW. Please go ahead. Your line is now open.

Greig Patterson

Morning, everybody. Can you hear me fine?

Stephen Hester

Yes, we can. Thank you, Greig.

Greig Patterson

Yes. One outlook question and two technical ones. One on the outlook for downgrades: asset migration, there was no reference to that in the presentation or the text. I wonder if you'd just update us on that.

The second one is: in terms of moving your staff to a remote working status, I wonder what sort of one-off impact that would have been on the expense ratio, and if we could have that number, that would be useful.

And, then, finally, just explain prior year development. My understanding is that it's all earned before the beginning of this year, so I'm puzzled to why it would have a Covid-19 impact on prior year development.

Stephen Hester

Thanks, Greig. Asset migration: Obviously, there are more downgrades than upgrades, but because our book started so strong at the moment, it has not given rise to any impairment charges for us or any meaningful sub-investment grade exposure.

In terms of remote working, I would say the only identifiable expense we have in relation to remote working is about £3 million in the first half for additional computer-related costs. On the other hand, you could say that we probably travel less, which offsets that.



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And, on PYD, there is a precautionary reserve, I think, of £6 million that's been added to PYD, and we can debate whether it's needed or not. Personally, I don't think it is, but the actuaries thought it should be there. And that's in case some claims from the past which haven't yet been notified, or which have been notified, end up being more expensive to settle because of disruption to supply chain or repair workshops or whatever than we would ordinarily have thought. So, it remains to be seen whether that's needed, but that was the rationale.

Greig Patterson

Perfect. Thank you.

Operator

Thank you. Our next question comes from the line of Abid Hussain from Credit Suisse. Please go ahead. Your line is now open.

Abid Hussain

Hi. Morning, all. I've got three questions left, if I may. The first one, I appreciate, might be difficult to comment on. It's on your Covid exposure. I'm just wondering if you could provide any colour whatsoever on your gross loss estimates should the FCA case go against you. I guess what I'm really thinking of is, you must have thought through what your worst-case scenario is, should that case go against you, and I'm just trying to get a sense of where that gross loss estimate lies? I think it might be helpful for the market. I appreciate it's difficult. It's an ongoing court case going on at the moment.

And, then, the second question is on frequency benefits. I'm just wondering if you saw that there might be a medium-to-long term benefit from lower claims frequency, just given changes in behaviour, more people continue to work from home post-Covid in the new normal. Just wondering if you think there may be some benefits to be had there. Thank you.

Stephen Hester

I'm really sorry. I can't help you on the first. This is a public forum. It's one where the lawyers who are suing us are listening. There's all sort of issues around it, and so I can't. I'm afraid I can't give you any guidance as to the



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court case of any kind beyond, if you like, the non-court case-related guidance associated with our view of the second half and reinsurance and so on and so forth.

In terms of whether there are long-term frequency changes, I think the truth is it's got to be speculative at the moment. Obviously, using your example, if more people work from home, maybe that means they use their cars more and less on trains and buses commuting into city centres. And maybe that creates more accidents. Or maybe it creates less. So, at the moment, from a pricing standpoint, we're not baking anything different into the future, but, obviously, all of us are on a voyage of discovery on these things.

Abid Hussain

Understood. Thank you.

Operator

Thank you. Our next question comes from the line of Andreas van Embden from Peel Hunt. Please go ahead, your line is now open.

Andreas van Embden

Hello, good morning, I just have one question, please. It's really about the customer relief measures you're providing, the 110 million Sterling. First of all, could that be split between personal lines and commercial lines? I appreciate regulators have been putting more pressure in the UK on insurers to provide customer relief in motor, in particular, but just wondered whether we are seeing the same impact also in commercial lines?

And continuing on that same theme, you mentioned that you're monitoring the credit risks arising from customers with difficulties. I just wondered, when you assess this credit risk, how do you go about setting aside the provisions? Obviously, we're now 90 days past the March kick-off of the Covid-19 crisis and lockdowns. And, particularly in the UK, the regulator is extending customer relief measures all the way until the end of October. So, by that time, what are your thoughts about setting aside potential provisions? And how would that work? Thank you.



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Stephen Hester

Thank you very much. On slides 15 and 16, we gave the split commercial lines/personal lines. Personal lines was 67 million of 110, and commercial lines was 42. I guess there's a round one rounding somewhere in there. The impact of bad debt so far has been negligible on us. But as to how we look at that and calculate it, Charlotte, can you illuminate us?

Charlotte Jones

Yes. So, we go through the usual process that you would expect. So, where things fall due, where they fall overdue, we get the MI on that very quickly and we look at the trends and the patterns and how that is developing. And, at this point, we always have an element of that, but it depends, across our portfolios, how much credit is provided, and we haven't extended huge amounts more credit, and that's not really been the driver of the relief measures, particularly. But our normal credit control process is on it, and we do take provisions when things fall overdue by a certain period.

What we haven't seen is any significant uptick. Now, could we see more of that later, post-furlough, all of that? Don't know. At the moment, we provide for the exposure on the book, and that's what we've done at the end of the quarter. And it's very much in line with normal levels at the moment.

Andreas van Embden

Thank you very much.

Operator

Thank you. Our next question is a follow-up from Freya Kong from Bank of America. Please go ahead. Your line is now open.

Freya Kong

Hi. Thanks. So, of the 56 million booked so far valid BI claims, how much do you expect can be aggregated and treated as eligible losses under your GVC or cat retentions? And just a second question on investment income: given how far yields have fallen since the start of the year, are you confident with your outlook?



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Stephen Hester

I would say on the investment income question, confidence is a difficult word, but at least as it relates for the next six months, I think that we're likely to be right. As it relates to one and two years out, we've had quite a lot of recent volatility. If you just look, spreads have actually come in a lot in the last two months, including in July. And, so, if they stay in, that will bring us towards a lower ends or may even challenge that range. If they pop back out again in some way, that makes it easier because it's about does spread widening help offset lower risk-free rates. So, I guess, to some extent, your guess is as good as mine on some of those things.

And, on the aggregation, I don't want to say more than I've said already in terms of how we regard the aggregation.

Freya Kong

OK. Thanks.

Operator

Thank you. Our next question is a follow-up from Andrew Crean from Autonomous. Please go ahead. Your line is now open.

Andrew Crean

Stephen, sorry to follow up on this. It is on the dividend payments. To be clear, next March, when you consider resuming dividend payments, would you be considering paying one dividend for the whole of 2020? So, would the interim dividend be seen as part of that decision, or would it be a catch-up of missed dividends?

And, then, on the catch-up of missed dividends, it seems quite hard for me to understand why you might take two years to catch up on dividends which you promised earlier this year, when you've already said there's no financial impact from Covid because of the frequency benefits and your solvency is already at the top of its 130-160 range. Now, I know you've still got this Tier 3 caveat, but it does seem hard to understand or could you explain what the trigger would be to catch up on a payment which you've already promised to your shareholders?



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Stephen Hester

Yeah. Andrew, it's difficult because what I don't want to do is to tie the hands of the board in what decisions it makes in the future, and those decisions will be made, as I say, were with a lot of subjectivity associated with them, according to the environment that we're in.

I think, whilst we are in an unusually uncertain environment - and, obviously, we'll have to see how much that has settled down and clarified as we go through the second half of the year - we are more likely to want to be at conservative levels, and, as I say, we were quite happy with the levels we were at the beginning of the year, but we would be less likely to want to be operating a lot below the levels we were at the beginning of the year if we were in a very uncertain environment. And, so, that's why, as I said, if you took our beginning of the year solvency ratio as something was a place that we were happy with, the pace with which we might catch up will not be mathematically associated with that. But that will be one of the fixed points in our mind, and the willingness to pay out dividends to go below that would require a less uncertain environment than we would have if we were having that conversation right now.

And, as you've remarked, that's above the range, but, I think, in uncertain environments you want to be above a range, and we also have the tax asset that you correctly mentioned. But, obviously, the market impact of Covid, the eight points on solvency ratio may change during the second half, and, indeed, the amount of capital that we've generated, we may have a stunning second half and that generates more, or vice versa, and generates less.

And so, all of those will be the considerations that the board has as to how big a dividend to declare, assuming we do one at the end of the year, and at what pace to catch up. And, so, I know that may be unsatisfactory, but it continues to be our contention that the thing that will drive shareholder distributions over time is quantity and quality of profits, which comes from quality of business.

And I hope that you will agree that the way we are managing this company is producing impressive improvements in its ability to generate profits and sustainable profits and good return on equity. And I have every confidence that that will be to shareholders' benefit, and the precise timing of that, given risk-free rates, shouldn't be a big driver of value. But we have to navigate - all companies have to navigate, uncertain times with a level of judgement and subjectivity, and we're doing our best to do that.

Andrew Crean

OK.



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Operator

Thank you. We have one last follow-up question, and that is from Greig Patterson from KBW. Please go ahead. Your line is now open.

Greig Patterson

Hello, Greig here. Can you hear me?

Stephen Hester

Yep, we can hear you.

Greig Patterson

Stephen, sorry to draw this out a bit. Typically, CEOs stay for circa five years on FTSE100 companies, especially if they have achieved their goals, which, I think, in your case, you're largely have. You've set the targets, and you've moved towards them, and you're largely there. And, then, at that point, we often have a new CEO and there's a change of strategy. So, I think, a change of the guard is an important criteria for investors. I was wondering what your current views on your future - I'm not suggesting you should leave; I think you're doing a good job. I'm just suggesting if you could give us some insight on how long you plan to stay in the CEO role at RSA.

Stephen Hester

Thank you, Greig, for that question, which also requires a crystal ball, I'm afraid, to which I don't know the answer, but I think the first thing I'd say is that what I'm delighted about is that the improvements in RSA are happening in every region and on every line, and in doing that, I've got a really talented and impressive top team who are proving themselves in the way they manage the business. And I believe that that will add to the continuity, whenever it is that I ever decide to hang my boots up, or someone hangs them up for me.

So, I don't think people should worry about RSA with or without me. As to my own future, I would say I do not think that there's anything imminent, any imminent change in my future. I'm on a rolling 12-month contract. It's



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still rolling, and I don't have a definitive departure date. In any event, I certainly don't have a planned departure date within that context.

Greig Paterson

Thank you. Keep well. Cheers.

Operator

Thank you. And as there are no further questions registered at the moment, I will return the word to you, Stephen, for the final comments. Please go ahead.

Stephen Hester

Terrific. Thank you very much for joining us. Given we're all virtual and so on, we thought it was worth letting the questions go on, and they are uncertain times and we wanted to make sure we were answering all of the detail, but if anything hasn't been answered, you, obviously, know where to find our teams during the rest of the day and thereafter.

So, it simply leaves me to thank you for spending time with us. I do believe that RSA is in good shape. I do believe the future is bright for us and that we can reward shareholder patience in all the different ways we do that, whilst, at the same time, keeping our people safe, serving customers well, and being good citizens. So, we're focused on performing well. I believe we can continue to do that. Thank you for listening.

Operator

This now concludes today's webcast. Thank you for attending, and you may now disconnect your lines.