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First-half financial performance

Turning the corner or lucky break?

Analysis of the 2013 year-to-date results of UK insurers, global groups, Lloyd's players and brokers

Lead analysts:
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First-half financial performance: Turning the corner or lucky break? is the third in the *Insurance Monitor* series of reports published by *Insurance Times*, which is part of Newsquest Specialist Media Ltd, 30 Cannon Street, London EC4M 6YJ.

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BEN DYSON, ASSISTANT EDITOR, FINANCE, INSURANCE TIMES
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Ben Dyson has been a financial journalist for 16 years, spending 13 of those covering the insurance and reinsurance markets in the UK and globally.

Ben graduated from Lancaster University in 1997 with a degree in modern English language. He began his career in journalism later that year, joining Euromoney Institutional Investor's flagship (re)insurance title *Reactions* as a trainee reporter in December.

Ben spent almost 10 years at *Reactions*, taking on increasingly senior roles, and was appointed editor in 2006. During his time at the publication, he travelled the world covering the latest developments in global (re)insurance markets, for print and online.

During this time he also developed a specialism in (re)insurer financial results, compiling regular special reports analysing performance using a variety of measures.

He then took a three-year break from the insurance industry, writing about equities trading for London-based journal *The Trade* between March 2007 and May 2010.

Keen to return to the insurance industry, Ben joined Newsquest Specialist Media to head the finance coverage across *Insurance Times* and sister international brand *GR*.

For the past three years, Ben has reported extensively on the results of insurers, reinsurers, brokers and service providers, analysing both the widely available accounts of listed companies as well as Companies House filings and FSA returns.

He has also continued to focus on broader issues facing the global (re)insurance markets. He won the trade feature prize at Biba's 2012 Journalist of the Year awards for his coverage of the 10th anniversary of the World Trade Center attacks in New York.

MATTHEW SCOTT, DATA AND FINANCE ANALYST, INSURANCE TIMES
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Matt Scott started his working life as an actuarial associate consultant after completing an undergraduate degree in mathematics and statistics at the University of Bath, with a heavy focus on real-world applications, finance and research.

During his four years in the actuarial field, Matt completed a two-year master's degree in actuarial finance at Imperial College Business School. Some of the topics covered were enterprise risk management, healthcare economics, corporate finance, economics, investments, insurance and pensions.

The course also involved a year-long research project for the actuarial profession. Matt's was titled *The Effect of Solvency II Type Regulations For UK Pension Schemes: Valuing The Sponsor Covenant*, and focused on Solvency II regulations and the impact the introduction of similar legislation would have on defined benefit pensions in the UK.

In his role as an actuarial consultant, Matt gained expertise in actuarial calculations, financial modelling and compliance. He completed professional examinations set by the Institute of Actuaries on topics such as probability, insurance and pensions. His actuarial career also took him to India for two months, after which he managed an offshore team performing specialist actuarial calculations.

Matt then decided to leave the actuarial profession to pursue a career in journalism, acquiring a postgraduate diploma in multimedia magazine journalism from PMA Media Training in partnership with the Press Association. During this time, he took up the position of editor on a launch magazine, as well as reporting breaking news stories.

At the beginning of 2013, Matt joined *Insurance Times* as a data and finance analyst. His role focuses on the creation of data-driven content and the analysis and reporting of financial results.

INTRODUCTION

Half-year figures offer a glimpse of the way ahead

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'The results have thrown up some new questions'

The insurance industry's full-year 2012 results posed many questions.

How would UK general insurers tackle persistent underwriting unprofitability in commercial lines and the reforms in personal lines motor?

Could UK, global and Lloyd's insurers cut their dependence on investment returns to counteract the effects of interest rates?

Would global brokers be able to continue growing despite the competitive and economic pressures in many of their key markets?

With the companies operating in such challenging global economic conditions and coping with so much internal and external change, it makes sense to take a health check at the half-year stage.

As this third edition in *Insurance Times' Insurance Monitor* series shows, the half-year 2013 results have begun to provide some of the answers to the questions that emerged at year-end, and some indication of where the market is going.

For example, we have a good idea about UK general insurers' responses to difficult commercial lines and how legal changes have affected personal lines motor rates.

The results have also thrown up some new questions. On the UK general insurance front, for example, are we about to witness a resurgence of AXA after its motor cutbacks over the past few years?

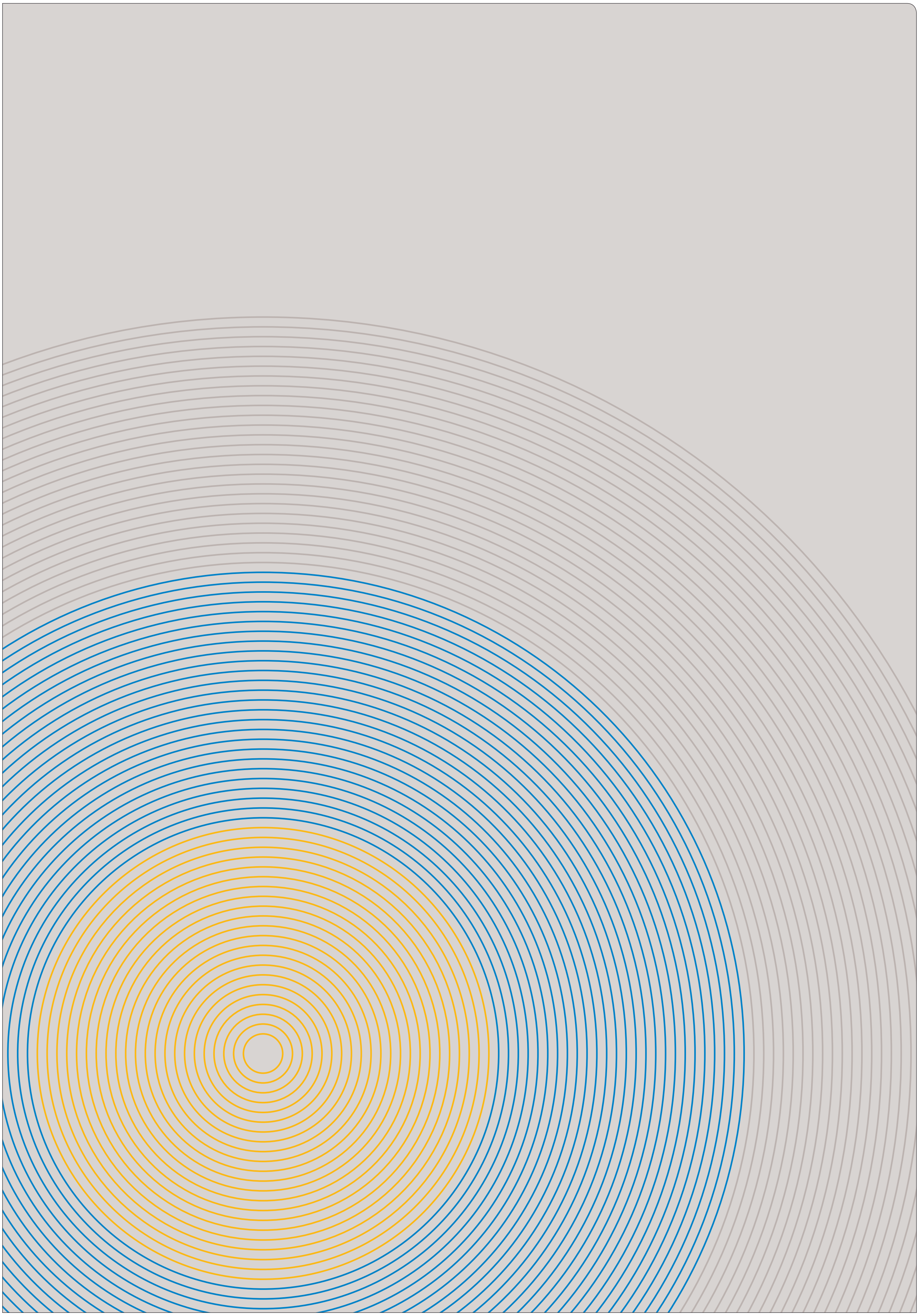
Will reserve strengthening for commercial motor bodily injury claims start blighting results in the same way that similar actions in personal lines did three years ago?

There is still a half-year to go, and six months can be a long time in insurance.

The US hurricane season is in full swing, which could generate losses for those, such as the Lloyd's firms, writing international property catastrophe business.

UK insurers could be hit by winter freeze claims in the next half-year. Brokers could lose a big client or haemorrhage business after sudden staff defections to rivals.

Even so, the half-year stage is very revealing about the market's progress.



EXECUTIVE SUMMARY

KEY POINTS

- The industry had a good first half in 2013
- Insurers have adapted to weak investment returns and put more emphasis on underwriting profits
- UK general insurers are raising commercial rates, but face motor challenges
- Weather and other natural phenomena were a big driver of results
- Lloyd's insurers are facing new competitive threats and flat rates
- Brokers are doing well but feeling the effects of the tough environment

Overview

By many measures the first half of 2013 was a success for all involved. UK general insurers, global groups, Lloyd's players and the big five brokers grew their profits and, in the main, also their revenues. Where growth was curtailed it was usually for good reason – exiting poorly priced lines to restore profitability.

While rises in interest rates in some countries have lowered the value of insurers' bond-heavy investment portfolios, prompting sharp cuts in investment returns, underwriting profits have generally made up for this.

The first-half results also revealed several challenges for each of the industry segments studied, some sector-specific and others affecting the whole industry.

Heavy competition in key business lines such as property and motor is also affecting most of the industry, putting pressure on premium rates, commissions and, ultimately, profitability.

Regulation is a theme running through the challenges, from specific legal reforms in the UK to Solvency II, affecting insurers Europe-wide. But with a strong first half under their belts, the companies studied have a good chance to tackle the difficulties they face head-on.

UK general insurance

The UK's top general insurers had a great first half, with all but one of the 12 companies here showing improvements in combined operating ratios (CORs) and operating profits. The average COR improved by four percentage points to 92.1% (H1 2012: 96.1%).

Gross written premium fell slightly, but this is good news for future profitability as the drop was caused by exiting unprofitable lines or scaling back where the price is not right. The industry also made strides in combating commercial lines unprofitability with rate rises.

But some of the good performance is down to better weather, and many doubt that the commercial rate increases seen so far, while encouraging, are enough.

The industry is now also facing a double motor problem. In personal lines, rates have fallen in anticipation of the claims-reducing effects of legal reforms that came into force in April. But they have done so before strong evidence of falling claims has emerged. In commercial motor, Aviva's £45m reserve hike against rising bodily injury claims suggests that companies could be in for trouble in this line despite recent rate increases.

Global groups

The global groups also had a positive first half, though not as strong as the UK general insurers.

The collective COR of the seven firms studied fell by 0.7 of a percentage point to 96.4% (H1 2012: 97.1%) and the average operating profit was up 13.5% to £1bn (H1 2012: £888.8m).

The global players were not so lucky with the weather as their UK counterparts. The industry was hit by floods in Canada and central Europe as well as hail storms in France and Germany. But even so they managed to improve profitability – if only modestly.

It is just as well that the global groups are making underwriting profits, because their investment returns took a beating in the first half of 2013. Investment income dropped 4.5%, as rising interest rates cut the value of bond portfolios.

The groups also face regulatory hurdles. In addition to tackling Solvency II, the nine companies on the Financial Stability Board's list of global systemically important insurers will face even tougher scrutiny than their smaller peers.

Lloyd's insurers

Internationally focused Lloyd's insurers, like the global groups, suffered from a higher level of natural catastrophes in the first half of 2013 than they did in the same period last year.

But, also like the groups, they have taken them in their stride, and most had limited exposure. The collective COR for the six Lloyd's insurers studied fell 2.3 points to 85.9%. »

EXECUTIVE SUMMARY

» The average profit before tax dipped slightly to £99.6m from £100.3m, but this is a good result considering the steep drops in investment returns the companies have suffered.

But prices across the globe are generally flat. The steepest falls have been seen in US property catastrophe reinsurance, owing to competition from alternative sources of coverage.

Another challenge is competition from outside Lloyd's. Warren Buffett's US (re)insurance powerhouse Berkshire Hathaway has launched a two-pronged attack on Lloyd's. It struck a deal with broker Aon that gives it an automatic 7.5% share of any business Aon places into Lloyd's. It has also formed a US excess and surplus lines business, pushing into one of the key territories for Lloyd's underwriters.

Brokers

The Berkshire/Aon deal is a challenge for Lloyd's insurers but a coup for Aon. The audacious deal guarantees its clients a 7.5% participation from one of the world's most highly rated insurance groups.

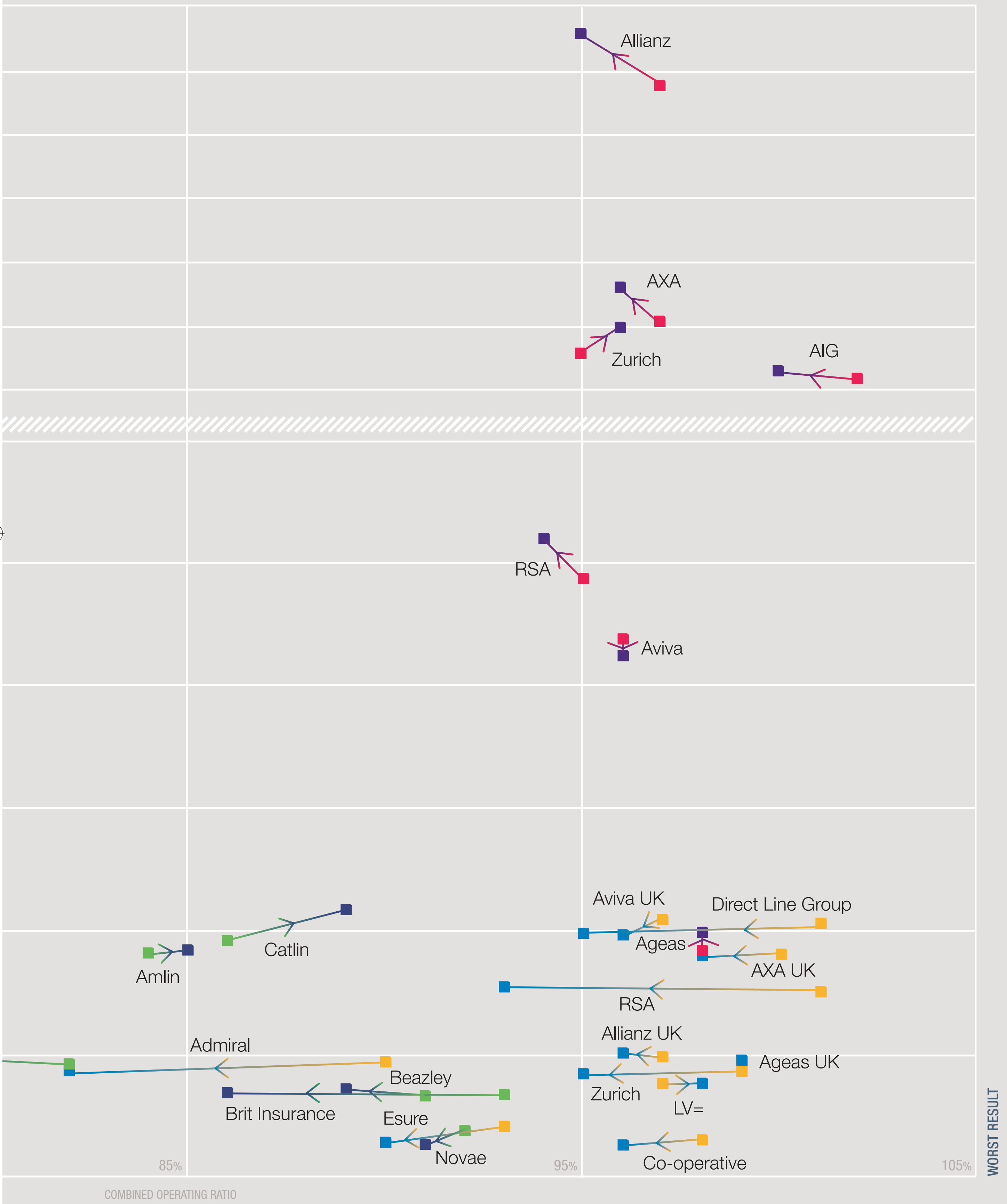
Aon was not the only broker to do well. The average operating profit from the broking divisions of the big five increased by 8.9% to £318.3m (H1 2012: £292.4m).

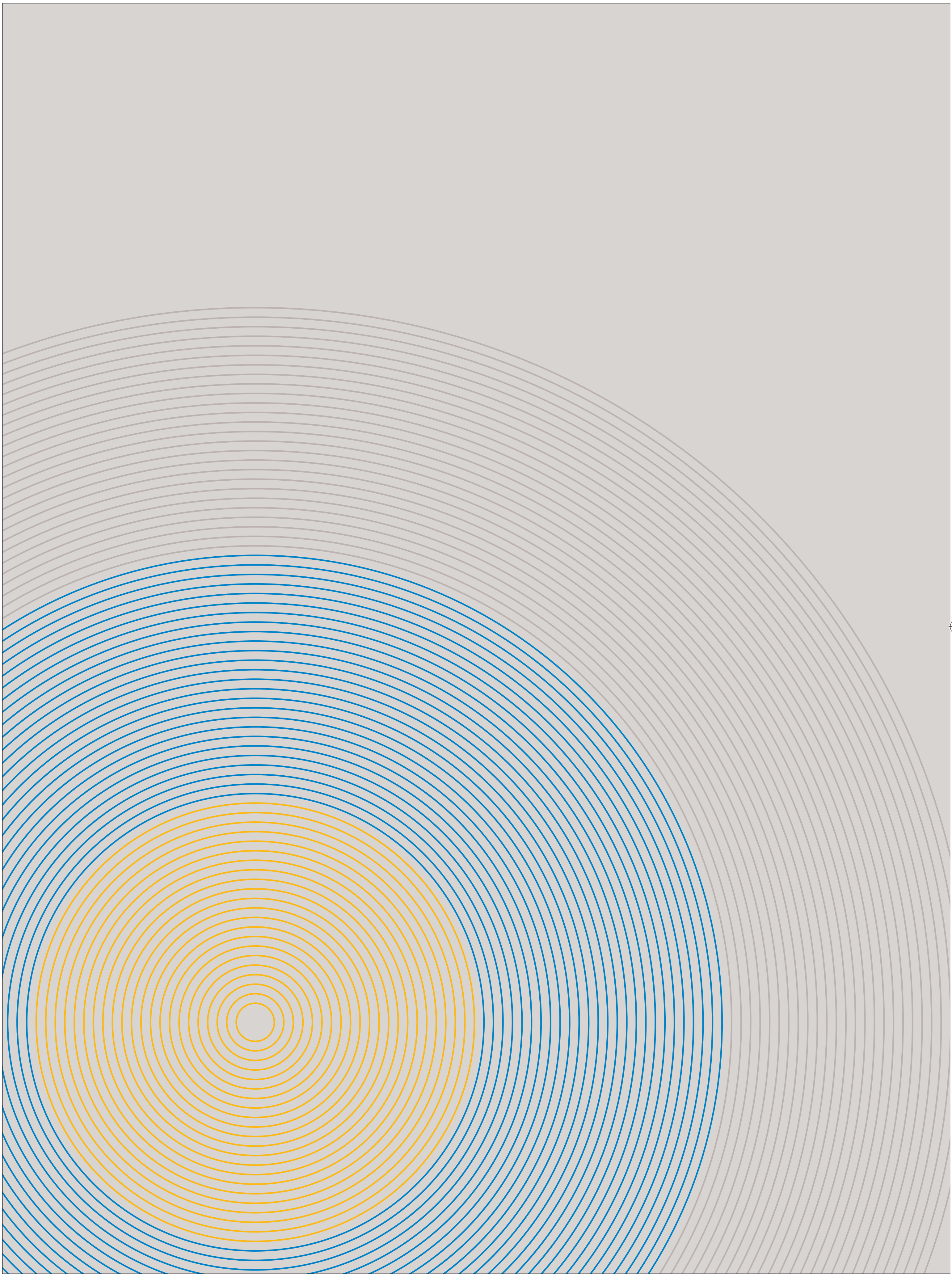
But these powerful broking houses face tough times. They are growing faster than the economies they serve, but the difficult economic environment and intense competition are taking their toll. Average organic growth across the big five dropped to 4.6% from 4.8%. Acquisitions, restructuring and staff pay aimed at improving operations are also eating into profit margins. The average margin slipped to 21% from 22%.

Summary

All sectors studied made encouraging progress in the first half of 2013. But the results produced and the events during the half have given executives a clear to-do list for the future.

Fig.1 **INSURERS' COMBINED OPERATING RATIO VS GROSS WRITTEN PREMIUM: 2012 AND 2013 COMPARED**





UK General Insurance H1 Analysis

UK GENERAL INSURANCE H1 ANALYSIS

ADMIRAL

NOTES:
UK motor only; profit before tax. GWP includes amounts written by co-insurers/reinsurers

The market keeps waiting for Admiral to make a mistake, because despite its heavy focus on the unprofitable UK private motor business, it continues to report enviable results.

While many have predicted its downfall, Admiral has always confounded its critics. The first half of 2013 was no exception.

Despite falling UK motor rates, group profit before tax increased 6% to £181.4m (H1 2012: £171.8m) and UK motor profit before tax was up 5% to £192.7m (H1 2012: £183.3m). The UK motor combined ratio (COR) improved by 7.5 percentage points to 82.2%.

A big reason for the improvement was a spike in reserve releases from old underwriting years to £29.7m in the first half of 2013 from just £9m in the same period last year. This was augmented by a further £22.5m of releases from business that was originally ceded to Admiral's panel of reinsurers but has been transferred back to the company.

But Admiral is not short of challenges. As chief operating officer David Stevens admitted after the release of the first-half results, Admiral is not immune to falling UK motor rates, and profit margins in new business will be eroded.

The company's ancillary income is under threat from regulatory changes. Admiral expects the referral fee ban under the Legal Aid, Sentencing and Punishment of Offenders Act 2012 to reduce its non-motor insurance revenue by £3 a vehicle by the end of 2013. In addition, the Competition Commission's review of sharp practices in UK personal motor threatens the £7.3m in credit hire fees Admiral made in the first half of 2013.

Admiral expects that lower claims costs will make up any shortfall, but this remains to be seen.

COR

82.2%

2012 89.7%

-7.5pp
2012

OPERATING PROFIT

£192.7m

2012 £183.3m

5.1%
2012

GWP

£851.7m

2012 £922.8m

-7.7%
2012

RATE MOVEMENTS

UK motor: **-7%**

ADMIRAL VIEW

'I'm really pleased with our results in the first half of 2013. Any time you can increase profits by 6% when competitors are cutting prices you've got to be happy'

Henry Engelhardt, chief executive, Admiral

MONITOR INTERPRETATION

Admiral continues to outperform its peers, thanks in part to its unique business model. However, the company is heavily exposed to UK personal motor, and legal reforms have started to take their toll.

UK GENERAL INSURANCE H1 ANALYSIS

AGEAS UK

NOTES:
Net profit. Non-life insurance only

Ageas UK has continued to perform well overall since Andy Watson took over as chief executive from Barry Smith in January, though not without difficulty. In the first half of 2013, the company's non-life net profit grew 20% to £42.9m from £35.7m in the first half of 2012.

The company's combined operating ratio (COR) was 98.5% which, although only a slight improvement over the 98.8% it reported in the first half of 2012, is a consistent result in a tough market.

A particular bright spot has been its November 2012 acquisition of Groupama UK which, despite its former French parent Groupama SA's woes, is a well-run, profitable UK non-life insurer. Not only did Ageas bag Groupama UK for £94m less than its net tangible asset value, but the acquisition also contributed £166.4m in gross written premium (GWP) and £7.1m in net profit to the first half of 2013.

The first half of the year was clearly not all plain sailing for Ageas UK. The company hacked back its commercial and special risks book by 29.3% to £57.9m (H1 2012: £81.8m). And Ageas's 50.1% share of the profit generated by Tesco Underwriting, a personal home and motor joint venture with Tesco Bank, fell by 74% to £1.7m (H1 2012: £6.5m) amid heavy motor competition.

Unlike its peers in this study, Ageas has a retail broking arm that includes high street broking brands such as Kwik-Fit Financial Services, RIAS and Castle Cover. This unit is also exposed to the fierce rivalry in the personal lines insurance market, as shown by its 11.6% drop in revenues to £93m in the first half of 2013 (H1 2012: £105.1m).

Although it faces tough times, Ageas UK as a whole has turned in another creditable performance.

COR

98.5%

2012 98.8%

-0.3pp 2012

OPERATING PROFIT

£49.1m

2012 £41.9m

17.2% 2012

GWP

£936.5m

2012 £906.3m

3.3% 2012

RATE MOVEMENTS

Andy Watson: "Our [motor] prices are stable as we speak and that is our priority, so we have no plans to cut prices further"

AGEAS VIEW

'The positive trend in profit and overall improving performance in our combined ratio has continued to half-year and underlines that Ageas remains in good shape'

Andy Watson, UK chief executive, Ageas

MONITOR INTERPRETATION

Ageas continues to perform well and its acquisition of Groupama UK is clearly paying off. However, personal motor competition and commercial lines challenges are starting to bite.

UK GENERAL INSURANCE H1 ANALYSIS

ALLIANZ UK

This was the first set of results reported by Jon Dye after he took the reins of Allianz UK from long-standing and highly respected chief executive Andrew Torrance in June.

Luckily for Dye, Allianz's enviable record of consistent profitability continued in the first half of 2013, despite Torrance's departure to head US sister company Fireman's Fund. Operating profit rose 14% to £86m from the £75.3m Allianz UK reported in last year's first half.

The combined operating ratio (COR) of 95.7%, a 1.1 percentage point improvement over the comparable 2012 period, was in line with what the market now expects from Allianz UK: comfortably below 100% and not moving much in either direction. It also succeeded in growing gross written premium (GWP) by 3.2% to £996.3m in a tough market, and boosted rates by an average of 5.4% across its commercial book.

Allianz's results are a clear example of the differing fates of commercial and personal lines in today's UK general insurance market. The improvement in underwriting profitability was driven by the commercial division; GWP growth was mainly down to personal lines.

The commercial COR improved by 1.9 percentage points to 96.7% (H1 2012: 98.6%), despite the company still wrestling with rising employers' liability claims. The personal lines COR was static at 94.8%. Commercial lines GWP grew by a relatively modest 1.6% to £534.4m, while personal lines GWP jumped 5.2% to £469.1m.

The proof of a smooth handover will come with future results, so Dye cannot afford to rest easy. But he has been at Allianz for 10 years and, as personal lines general manager for the past six, he will have played a key role in delivering them.

COR

95.7%

2012 96.8%

-1.1pp 2012

OPERATING PROFIT

£86m

2012 £75.3m

14.2% 2012

GWP

£996.3m

2012 £965.1m

3.2% 2012

RATE MOVEMENTS

Overall commercial **+5.4%**

Commercial liability **+9%**

Personal motor: "Very modest reductions"

ALLIANZ VIEW

'We should be able – with the usual caveats about weather and catastrophes – to take these numbers and pretty much double them'

Jon Dye, chief executive, Allianz

MONITOR INTERPRETATION

Allianz rarely falters, and the evidence at the half-year stage suggests it will continue to perform well and absorb any shocks the second half throws at it.

UK GENERAL INSURANCE H1 ANALYSIS

AVIVA UK

NOTES:
Net written premium

Aviva has been making headlines all year with job cuts and restructuring at group and UK level. It is thought that the group-wide 2,000 job losses put 650 UK roles at risk, and 200 jobs in Manchester were outsourced to Bangalore, India.

Then Aviva revealed plans to close 13 of its 30 UK sites, putting 80 broker-facing jobs at risk. To compensate, the insurer is expanding its Broker Onsite Underwriting Solutions (Bonus) scheme, where Aviva underwriters are based in brokers' offices.

While these moves may have generated negative publicity for Aviva, its UK general insurance results have done the opposite. Despite the turmoil and change at group level, they have been solid. The first half of 2013 was no exception. The company's first-half UK GI operating profit rose 5% to £239m in 2013 from £227m in 2012, and the combined operating ratio (COR) improved by 0.9 percentage points to 96.3% from 97.2%.

A £17m UK-wide reserve strengthening, caused by the need to bolster commercial motor reserves by £45m, was not enough to put the general insurance business off its stride.

But the reserve strengthening is a concern. It pushed Aviva's UK commercial motor COR to 113% and, more worryingly, the reserves were strengthened to cover larger-than-expected bodily injury claims. Having tackled the problem in personal motor, the industry may face a second wave of bodily injury woes on the commercial side of the business.

And while it is winning the results battle, Aviva has to fight a perception battle. Its office closures and cuts in unprofitable lines such as SME professional indemnity may mean brokers are feeling unloved. Keeping a key distribution channel happy will be a challenge for Aviva.

COR

96.3%

2012 97.2%

-0.9pp 2012

OPERATING PROFIT

£239m

2012 £227.0m

5.3% 2012

GWP

£1,963m

2012 £2,087.0m

-5.9% 2012

RATE MOVEMENTS

Commercial motor **+9%**

Personal motor **-1%**

Aviva spokesman: "Rate increases applied at all lines in the first half of 2013 except personal motor"

AVIVA UK VIEW

'Overall, performance in UK GI was solid. The COR of 96.3% benefited from disciplined underwriting and relatively benign weather'

Pat Regan, group chief financial officer, Aviva

MONITOR INTERPRETATION

The numbers at the half-year stage look good overall, but the commercial motor reserve strengthening is a concern and the effect of its office closures is unclear.

UK GENERAL INSURANCE H1 ANALYSIS

AXA UK

NOTES:
Direct business only for UK and Ireland.
Taken from AXA group results and converted from euros at €1.00 = £0.8508 (2013) and £0.8226 (2012)

AXA UK has not had the greatest of runs over the past two years, largely because of its direct personal motor business. The business, the bulk of which is sold under the Swiftcover brand, expanded fast in a soft market and had to be cut back as the losses rolled in.

But the first-half 2013 results showed signs that AXA UK is moving away from past mistakes and onto the front foot. Direct motor is no longer shrinking. The AXA group as a whole grew its direct personal lines motor book by 6% in the first half of 2013 owing to "resumed growth in the UK, reflecting higher new business and improved retention". The growth in brokered commercial lines motor by 7% to £172.7m across the UK and Ireland, owing to UK rate increases and higher retention, was also encouraging.

AXA UK's commercial and personal lines intermediary chief executive Amanda Blanc oversaw the UK division's reporting of an 11% increase in commercial gross written premiums.

The growth would be meaningless without AXA's profitability improvement. The UK and Ireland non-life business, including health, reported a combined operating ratio (COR) of 98.7% in the first half of 2013, a 2.3 percentage point rise over the 101% COR it reported in the first half of 2012. The group results, which strip out direct business, give a better COR of 98.2% (H1 2012: 100%).

But just as AXA gets to grips with one challenge, another emerges. The UK and Ireland business cut its brokered personal lines property business by 22% to £199.1m, mainly because rate rises and exiting partnerships lowered premium volume. This runs counter to the experience of other firms studied, whose household business had good years owing to milder weather.

COR

98.2%

2012 100%

-1.8pp 2012

OPERATING PROFIT

£100.4m

2012 £76.5m

31.2% 2012

GWP

£1,794.3m

2012 £1,804.8m

-0.6% 2012

RATE MOVEMENTS

Personal lines **+3.6%**

Commercial lines **+4.3%** (UK and Ireland)

AXA UK VIEW

'In 2010 AXA UK launched a business transformation … These changes are delivering stronger results for our customers, brokers and shareholders. We will build on this success'

Paul Evans, UK and Ireland chief executive, AXA

MONITOR INTERPRETATION

The changes AXA UK has made are bearing fruit, judging by the improving COR and return to growth in motor. But, as the cutback in personal lines property shows, there is still work to do.

UK GENERAL INSURANCE H1 ANALYSIS

THE CO-OPERATIVE

The Co-op's general insurance arm is in a state of flux. The unit is being sold to help raise funds for the group's ailing banking division. There are rumours that ex-RSA chief executive Andy Haste has teamed up with private equity house Advent to acquire the division.

The unit has not yet hired a successor for managing director David Neave, who left the firm in the first half of this year.

The company is also recovering from a poor full-year 2012 performance. It posted an operating profit of just £3m and a combined operating ratio (COR) of 110.9% after strengthening its motor reserves by £50m because of worse-than-expected claims experience. The picture at the half-year 2013 stage looked far rosier. Operating profit stood at £28.8m, while the COR was 96.2%.

But the Co-op may not be out of the woods. Its performance at the half-year stage of 2012 was good: operating profit was £26.5m and the COR was 98.4%. But with motor accounting for around 72% of its book, its general insurance business is likely to suffer at the hands of falling rates and increasing competition.

The Co-op has strengths. It was a first-mover in the telematics-based insurance market, which could make it a powerful force in personal motor. And though motor business has been the cause of the firm's underwriting losses for five years, its household book has been highly profitable. For the full year of 2012, the household business reported a COR of 78.9%.

The Co-op said in first-half results: "The home insurance business has again delivered a strong underwriting performance and retention rates remained high across own-brand channels." It remains to be seen if this is enough to maintain overall profitability.

COR

96.2%

2012 98.4%

-2.2pp 2012

OPERATING PROFIT

£28.8m

2012 £26.5m

8.7% 2012

GWP

£243m

2012 £284.5m

-14.6% 2012

CO-OPERATIVE VIEW

'The Co-operative Insurance has delivered an improvement against the [2012] year-end performance, as we benefit from management actions taken to strengthen our underwriting approach, particularly in the motor portfolio'

The Co-operative statement

MONITOR INTERPRETATION

The Co-op's general insurance business remains a curate's egg: a highly profitable home portfolio spliced onto a volatile motor book. The half-year performance is encouraging, but so was last year's.

UK GENERAL INSURANCE H1 ANALYSIS

DIRECT LINE GROUP

The Direct Line Group of 2013 is barely recognisable from the RBS Insurance of 2010, when the company was battling with rising bodily injury claims.

In the first half of 2010, the then RBS-owned insurer reported a combined operating ratio (COR) of 120.2% and an operating loss of £253m after pumping £320m into its motor reserves. Cut to the first half of 2013, and the now listed and independent Direct Line Group reported a COR from continuing business of 94.6% after releasing £239.2m from reserves. Operating profit from continuing operations was up 27.8% to £286.6m (H1 2012: £224.2m).

The firm's cost cutting, while unpopular with the 2,000 staff who could soon lose their jobs, is helping the insurer close the expenses gap between it and its rivals.

But the company faces many challenges. Having been criticised for under-reserving, it now faces accusations that its results are over-reliant on reserve releases.

Also, as the UK's largest personal motor insurer, it is more exposed to the number of challenges facing this line of business, in particular the effects of the new Legal Aid, Sentencing and Punishment of Offenders Act 2012 in April 2013.

Rates are falling as the industry anticipates the expected lower claims volume, and revenues are dwindling owing to the act's ban on personal injury referral fees. Direct Line Group has begun to suffer here: the 'other income' in its motor book fell by £12.2m in the first half, owing to falling business volumes and the referral fee ban.

And Direct Line Group is still shrinking. Overall gross written premiums were down 4% in the first half. The lower the premium volume, the easier it is for a sudden spike in claims to marr the COR.

NOTES:
Operating profit from continuing operations

COR

94.6%

2012 101.1%

-6.5pp 2012

OPERATING PROFIT

£286.6m

2012 £224.2m

27.8% 2012

GWP

£1,975.9m

2012 £2,058.4m

-4.0% 2012

RATE MOVEMENTS

Personal motor **+1%** in Q1 and **-3%** in Q2

DIRECT LINE GROUP VIEW

'It was great insurance weather for the first half and that was fortuitous. But if you take that out, a lot of things giving us performance will continue to give us performance'

Paul Geddes, chief executive, Direct Line Group

MONITOR INTERPRETATION

Reserve releases are a huge part of Direct Line Group's profitability, but that is not necessarily a bad thing. Its high exposure to UK motor, on the other hand, could put pressure on future results.

UK GENERAL INSURANCE H1 ANALYSIS

ESURE

NOTES:
Trading profit

Esure's first-half 2013 results plunged the car and home insurer's share price below the 290p-a-share initial offer price from its stock market flotation on 22 March. Before that point, Esure had been trading comfortably above the 300p-a-share mark.

The stock market was spooked by Esure's expectation that full-year premium growth would be lower than in the first half, owing to the tough market.

The company said: "The UK personal lines motor market has seen an increase in price competitiveness as demonstrated in the recently published indices which show significant rate reductions."

Esure's 2.5p interim dividend was also much lower than analysts' expectations, according to Shore capital analyst Eamonn Flanagan.

But the results themselves were no cause for complaint. Esure's profit after tax was £44.3m in the first half of 2013, up 17% on the £37.9m it made in the same period last year, despite suffering from a 34% drop in investment returns.

The combined operating ratio (COR) improved by 4.8 percentage points to 89.6%, putting the company within reach of Admiral's enviable 82.2% COR.

Esure's motor and home units showed improvements at the half-year stage. Motor underwriting profit was up 11.6% to £18.3m (H1 2012: £16.4m) and the home book returned to profitability, making an underwriting profit of £6.6m in the first half of 2013, compared with a £3.2m loss in the same period last year.

Analysts and stock market investors may want faster growth and bigger dividends, but peers and rivals will judge Esure on its ability to hold the line on profitability, which it shows every sign of doing.

COR

89.6%

2012 94.4%

-4.8pp 2012

OPERATING PROFIT

£65.2m

2012 £60.8m

7.2% 2012

GWP

£265.4m

2012 £248.8m

6.7% 2012

ESURE VIEW

'The first half of 2013 has yielded good results for our business, with some expected developments starting to bear fruit for the group'
Stuart Vann, Esure chief executive

MONITOR INTERPRETATION

Investors may be unhappy about slower growth, but from a profitability perspective, better that than pile on business when rates are softening fast.

UK GENERAL INSURANCE H1 ANALYSIS

LLOYDS BANKING GROUP

When most people think of Lloyds Banking Group's insurance operations it is in the context of the payment protection insurance (PPI) debacle that has dogged the industry for three years.

It is easy to see why. The banking group hit the headlines in 2011 for setting aside £3.2bn to compensate policyholders for mis-selling PPI. The company continued to bolster this coffer, and by November 2012 the mis-selling reimbursement fund had risen to £5.3bn.

But Lloyds Banking Group's general insurance business has put PPI behind it. The insurer stopped underwriting the business back in 2010 and is now almost a pure household insurer. While this slashed the division's gross written premium (GWP), exiting the PPI line of business greatly improved the insurer's loss ratio and underwriting performance.

Fast-forward to the first half of 2013, and the company had reported a combined operating ratio (COR) of 69% – which would even turn Admiral green with envy. This was a big improvement over the 80% COR it reported in the first half of 2012. But more benign weather played a big role in the improvement. As a household insurer, the Lloyds general insurance business was hit hard by 2012's floods.

Also, the business is continuing to shrink. GWP dropped 16.5% to £401m in the first half of 2013 from £480m in the same period last year.

Focusing on the profitable UK household market is clearly a good move. Even when claims hit, the COR remains comfortably below 100%. But more companies are seeing the potential of the home market, so rivalry will intensify.

Craig Thornton, Lloyd's general insurance director, will need all his wits about him.

COR

69.0%

2012 80.0%

-11.0pp
2012

GWP

£401m

2012 £480m

-16.5%
2012

LLOYDS BANKING GROUP VIEW

'The significant reduction in general insurance claims to £148m primarily reflects the benign weather in 2013 relative to 2012, which was the second-wettest year on record'
Lloyds Banking Group statement

MONITOR INTERPRETATION

Lloyds Banking Group's general insurance results may have been flattered by the weather, but it will have a cost advantage over its peers after the bank's insurance operational functions were transferred up to group level.

UK GENERAL INSURANCE H1 ANALYSIS

LV=

Intense competition in personal motor business is a theme running through UK general insurers' first half 2013 results. But its impact was perhaps most evident in LV='s general insurance performance.

The division's operating profit dropped 30.6% to £43m in the first half of 2013 from £62m in the same period last year. While this slump was mainly caused by a sharp drop in investment returns to £26m (H1 2012: £41m), underwriting profit also dipped 19% to £17m (H1 2012: £21m) and the combined operating ratio (COR) edged up 0.6 percentage points to 97.6%.

LV= general insurance managing director John O'Roarke found the first-half performance disappointing. The profit dip meant the company's return on capital was 11.7%. O'Roarke said: "It is not where we want to be because we have a target return on capital of 15% and based on performance to date we are not getting that level of margin."

Despite falling motor rates and stiff competition, the first-half COR was comfortably below 100% and had not deteriorated much. O'Roarke said: "Overall, the performance against that backdrop is reasonably good."

Also, while personal lines motor gross written premiums (GWP) were down 10% to £222m, the company grew its commercial motor, SME and home insurance books. O'Roarke expects continued growth in SME and home in the second half of the year. The result was that LV='s overall GWP was almost unchanged at £748m (H1 2012: £747m).

LV='s book remains exposed to the rigours of the UK personal lines motor market, and there are few signs of investment returns growing to compensate. But if LV= can diversify further, it will perform well under pressure.

COR

97.6%

2012 97.0%

0.6pp 2012

OPERATING PROFIT

£43m

2012 £62m

-30.6% 2012

GWP

£748m

2012 £747m

0.1% 2012

RATE MOVEMENTS

Personal motor **-10%**

Overall commercial **+5-6%** industry-wide

LV= VIEW

'This is a solid performance against a backdrop of weakening motor rates, intense competition and low investment returns"'

John O'Roarke, general insurance managing director, LV=

MONITOR INTERPRETATION

LV= was the only company studied that reported an increased COR and a fall in operating profit. But the fact that it has remained profitable despite tough times deserves credit.

UK GENERAL INSURANCE H1 ANALYSIS

RSA UK

NOTES:
Net written premium

Like its biggest rival Aviva, RSA has been taking tough decisions and making big changes at its UK operation.

The insurer's determination to overhaul its commercial business, which was mainly responsible for the company reporting a £10m underwriting loss in the first half of 2012, prompted it to close its mid-market commercial hub in Horsham. This cut the insurer's number of mid-market trading hubs to three from four.

But, like Aviva, RSA's actions are bearing fruit. RSA's UK general insurance unit enjoyed an £83m turnaround in fortunes in the first half of 2013, reporting an underwriting profit of £73m. Accordingly, the combined operating ratio (COR) shifted to a profitable 93.1% from a just-unprofitable 100.6%.

RSA's UK commercial book enjoyed the biggest turnaround. The COR improved by 7.8 percentage points to 93.5% (H1 2012: 101.3%), driven by improvements in all three main commercial lines: property, liability and motor.

Commercial motor was still marginally unprofitable with a COR of 101%, but this was far better than the 110.5% it reported in the first half of 2012. There is also scope for improvement after the renegotiation of the loss-making contract with RSA's biggest commercial motor client, car lease firm Motability.

RSA's personal lines book also enjoyed a big improvement. The COR dropped 7 percentage points to 93% from a break-even position of 100% in last year's first half.

Some luck was involved in the better results. Fewer weather losses helped to improve the commercial property and home books. But a tougher stance on poorly rated business will not have hindered progress either.

COR

93.1%

2012 100.6%

-7.5pp 2012

OPERATING PROFIT

£1,537m

2012 £1,497m

2.7% 2012

RATE MOVEMENTS

- Personal household **+1%**
- Personal motor **-3%**
- Commercial property **+4%**
- Commercial liability **+5%**
- Commercial motor **+3%**

RSA UK VIEW

'Clearly weather has been better this year than last year and that has obviously helped us, but a lot of [the improvement] is about our underwriting and pricing discipline and that has shone through in the results'

Adrian Brown, UK and Western Europe chief executive, RSA

MONITOR INTERPRETATION

RSA has gone a long way towards addressing its commercial lines woes, and the Motability contract restructuring will bode well for future performance.

UK GENERAL INSURANCE H1 ANALYSIS

ZURICH

Luck and good judgment are insurers' best friends, and Zurich's UK general insurance business got a helping hand from both in the first half of 2013. The division's operating profit jumped 42% to £81m, and its combined operating ratio (COR) improved by 4.5 percentage points to 94.5%. Like its peers, Zurich UK enjoyed the effects of milder weather.

But general insurance chief executive Steve Lewis said good underwriting and cost control had also played a role. The expense ratio improved by 2.3 percentage points to 28.1%, owing to what Zurich described as "focused expense management actions across our business". The company also noted an improvement in its attritional loss ratio, indicating that it was not just a lucky escape from large one-off losses that produced the better results.

But though this performance was solid, many observers must be asking: "When will Zurich UK stop shrinking?" In 2010 Zurich wrote gross premiums of £961.5m in the first half of the year. Fast-forward to 2013 and it is writing £826m, having fallen 2.4% from the £846m it wrote in the first half of 2012. This reduction over the years has been down to Zurich paring back unprofitable business, in particular UK motor.

There is little scope for premium growth in the UK, with personal lines motor rates falling and commercial rates barely adequate despite the recent round of increases enjoyed by most of the UK general insurance industry's elite.

Lewis said the average 5% increase achieved across the UK commercial book in the first half of 2013 was "a minimum of what's required to stand still". But Zurich cannot shrink forever. Lewis said: "We're not here with a view of shrinking to greatness … We're taking the right decision to balance volume and profit."

COR

94.5%

2012 99.0%

-4.5pp 2012

OPERATING PROFIT

£81m

2012 £57m

42.1% 2012

GWP

£826m

2012 £846m

-2.4% 2012

RATE MOVEMENTS

Commercial **+5%**

ZURICH VIEW

'By sticking to our strategy and keeping a firm control on our expenses I believe we are positioned well for the rest of the year and beyond'

Steve Lewis, Zurich UK general insurance chief executive

MONITOR INTERPRETATION

Zurich's insistence on underwriting discipline is to be commended, but how much longer can the company carry on shrinking?

UK GENERAL INSURANCE H1 ANALYSIS COMPARISON

Cutting gross written premium (GWP) to maintain profitability has been the main theme of 2013 so far, with seven of the 12 companies studied reducing their premium volume and one reporting less than one percentage point of growth. However, the action seems to be working – all except one improved its combined operating ratio (COR).

1 Lloyds Banking Group's general insurance division has the lowest COR of the group and the most improved COR of the 12. However, some improvement was because of better weather, and the firm has a low cost base thanks to its integration with its parent group. The company also suffered the biggest drop in GWP, at 16.5%.

2 The highest combined ratios were reported by Ageas UK (98.5%) and AXA UK (98.2%). Ageas also reported the smallest improvement in COR, at 0.3 percentage points. However, Ageas was one of the few companies to grow GWP, by 3.3%, despite paring back its commercial and special risks book.

3 Only a few firms achieved the coveted combination of improved profitability and premium income growth. Of these, Esure topped the growth chart, with a 6.7% increase in GWP to £265.4m. Also on the profitable growth list are RSA, Allianz UK and Ageas UK.

4 Admiral did not report the lowest COR, but it was the lowest among companies with a heavy focus on the UK private motor insurance market. Its 82.2% COR beat Direct Line Group's 94.6%, Co-op's 96.2% and Esure's 89.6%. The company only retains 25% of the business it writes and cedes the rest to co-insurers and reinsurers.

5 Aviva's UK general insurance operations and Direct Line Group are the biggest companies in the market when measured by GWP. However, tough action on unprofitable business has pushed both below the £2bn GWP barrier at the half-year stage in 2013.

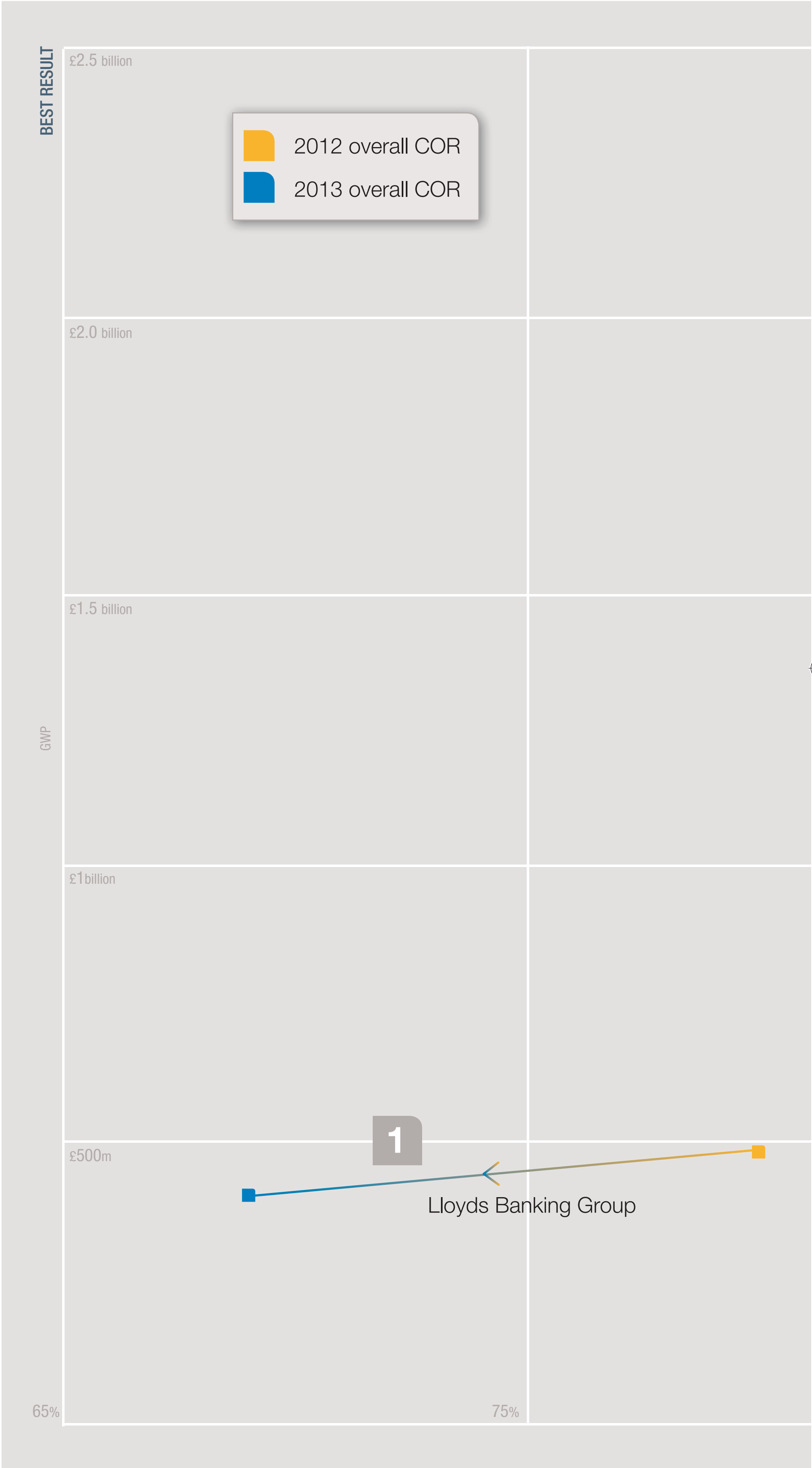
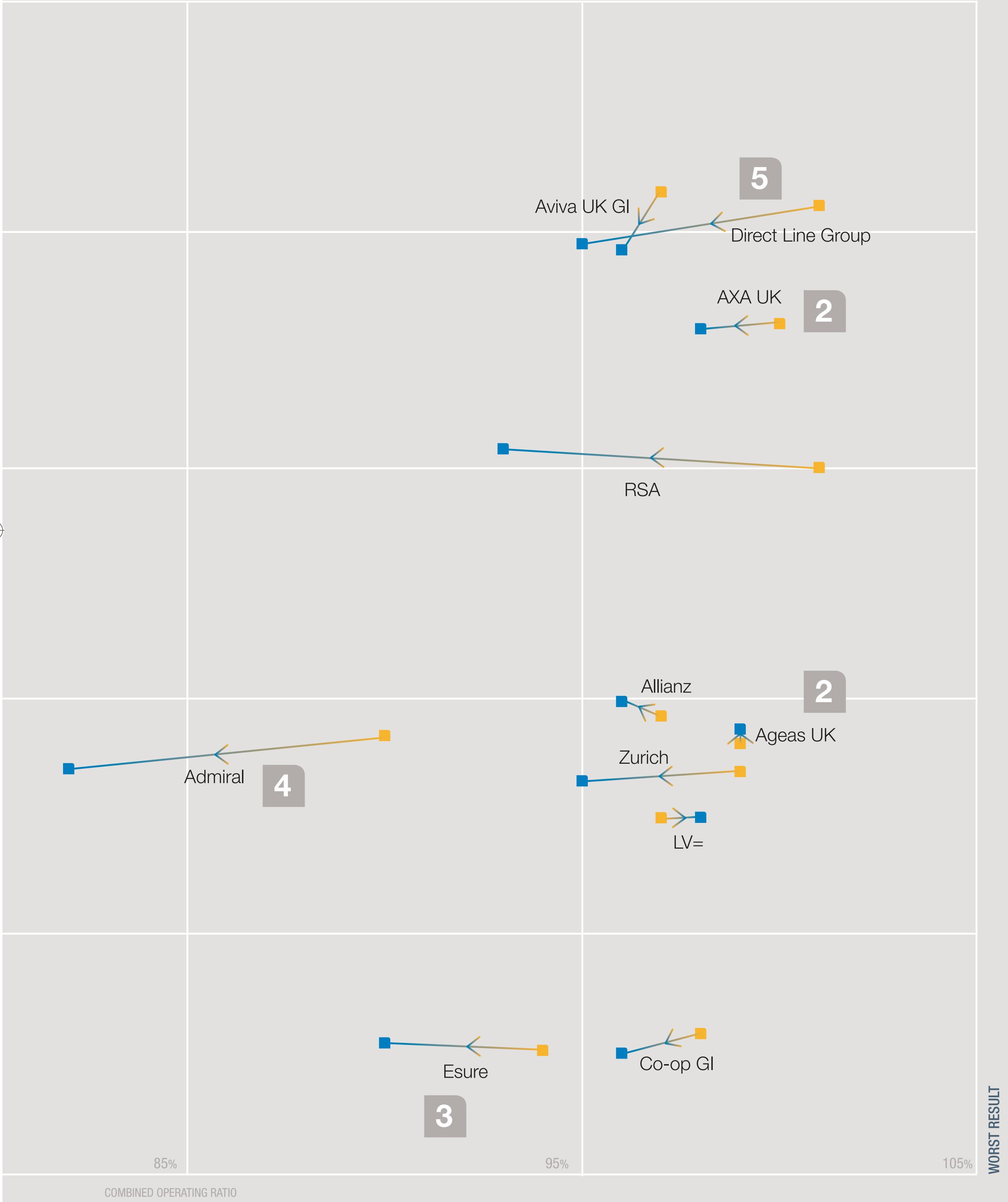


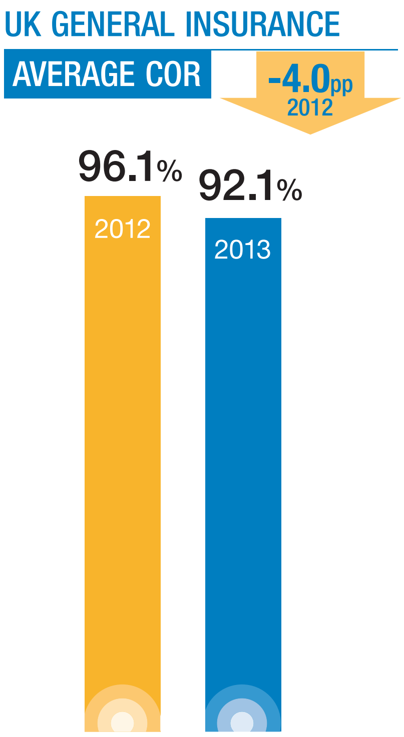
Fig.2 UK GI COMBINED OPERATING RATIOS VERSUS GROSS WRITTEN PREMIUM: 2012 AND 2013 COMPARED



UK GENERAL INSURANCE H1 ANALYSIS

Challenges

> 'The commercial property lines have been flattered by the weather in the first half, which shrouds the underlying position a little'



The UK's biggest general insurers had a strong first half in 2013 on almost all measures. They have also made a good start on tackling one of their biggest problems: the persistent unprofitability of commercial business.

But they would be unwise to celebrate yet. While there are encouraging signs, the commercial business is still far from fixed, and there are worrying signs in commercial motor. The return of severe price competition in private motor is both premature and unwelcome.

A good start

All 12 of the companies studied made an underwriting profit, reporting combined operating ratios (CORs) below the 100% break-even point. The average COR across the group was 92.1%, four percentage points better than the 96.1% reported in the first half of 2012.

Operating profit has also improved by 13.3% to £117.2m (H1 2012: £103.5m), despite several companies reporting a sharp deterioration in investment returns. This indicates that the positive results are being driven by underwriting performance.

The group's modest 2.4% drop in average gross written premium (GWP) to £1.04bn (H1 2012: £1.07bn) indicates that they are underwriting more selectively, but not pricing themselves out of the market.

A particularly encouraging sign is that companies are starting to get rate increases in loss-making commercial lines. As the first edition of ***Insurance Monitor*** *UK Insurer Financial Performance: Who is delivering in commercial lines?* showed, the UK general insurance industry's average COR for commercial lines in 2012 was 105.3%. Judging from the information available, commercial rates increased by between 5% and 7% in the first half of 2013 compared with its levels in the same period last year.

Flattery will get you nowhere

The 2013 first-half results may be good, but some of it is down to luck. The industry's first-half 2012 results were marred by flooding, after the second-wettest year on record in the UK. By contrast, the first half of 2013 was unusually devoid of weather losses, which gave a lift to the relative performance of household and commercial property in particular in the period under review.

Aviva's UK commercial property COR, for example, improved to a highly profitable 86% in the first half of 2013 from a loss-making 103% in last year's first half.

Aviva general insurance chief executive Robin Spencer said: "The commercial property lines have been flattered somewhat by the weather in the first half. That shrouds the underlying position a little, which is that we still need rate rises in those lines as well."

Despite the progress made in commercial rates, it is too early to declare the business line fixed. The rate increases are not enough for several chief executives, who said that while they were pleased with the rises, more would be needed.

LV= general insurance managing director John O'Roarke said: "Rates need to go up by 10%, but I suspect they will only rise by about 5%."

Worrying motor trends

There are threats to the commercial progress the industry has made. Aviva's results in particular revealed what could be the start of a worrying trend in UK commercial motor. The company had to strengthen reserves for this line by £45m, to counter rising bodily injury claims. This could show that the trend that blighted personal motor results in 2010 and 2011 is now making itself known on the commercial side of the business.

On the positive side, companies are clearly prepared for this, having been forewarned by the troubles in personal lines, and have been raising rates. The evidence available suggests commercial motor rates rose much faster than other lines in the first half of 2013.

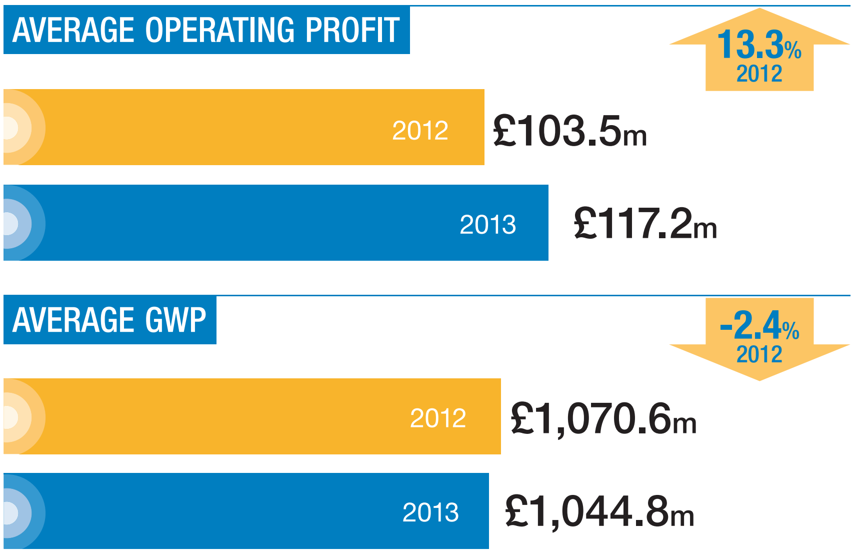
However, while rising prices might solve the problem for newly written business, there is a potential that problems could emerge from older years. If the trends in commercial motor were not worrying enough, the efforts insurers made in 2010 and 2011 to restore profitability to their personal motor books is starting to come undone.

Insurers have been slashing rates in anticipation of the claims-cutting effects of the legal reforms that came into force in April this year, including the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (Laspo) and the reduction in the RTA Portal's fixed legal costs to £500 from £1,200.

According to the AA's British Insurance Premium Index, personal motor rates had fallen 9.8% as of July 2013 compared with the same point last year. But the cuts are being made before there is any strong evidence that the legal reforms have been effective at reducing claims. Small bodily injury claims fell by 24% in May and 6% in June, according to Ministry of Justice figures, which looks encouraging.

However, it is unclear yet if this is a downward trend or just a reversion to normal levels. Small bodily injury claims levels spiked by 32% in March and 26% in April as lawyers scrambled to get claims in ahead of the reforms.

UK GENERAL INSURANCE



All chief executives are concerned by the premature drop in rates and all companies are likely to suffer, but the effect is most visible at recently floated motor and home insurer Esure. Its shares are trading well below the debut price of 290p a share after the company said in its first-half results that growth in the second half would be slower because of heavy competition in personal motor.

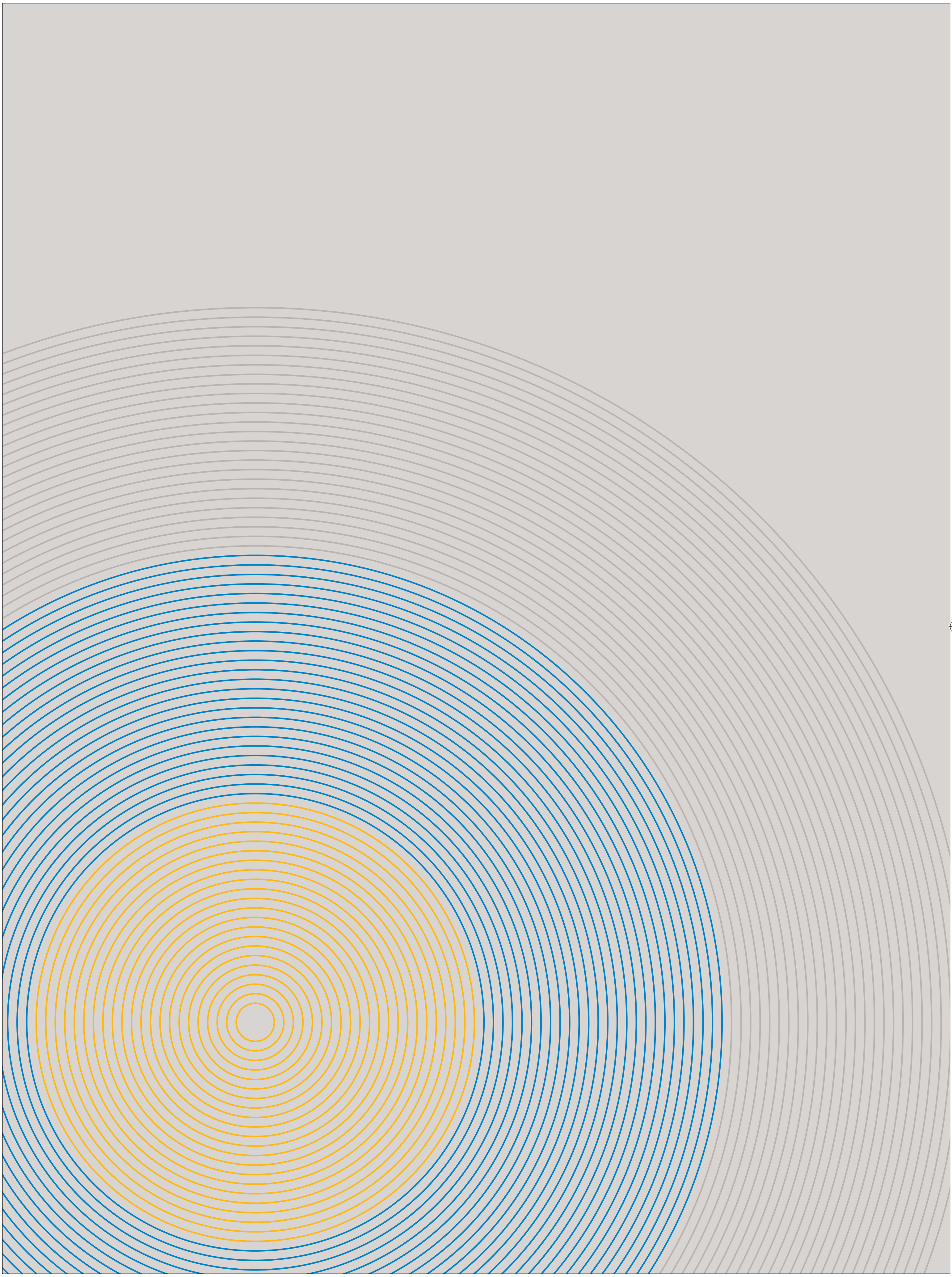
Not there yet

Perhaps the biggest challenge for 2013 is that there is still half a year to go.

Much can happen in six months, as the Co-op's general insurance unit knows. In 2012, it reported an operating profit of £26.5m at the half-year stage. But by the full year this had been whittled down to just £3m after the insurer had to strengthen its motor reserves.

And the final months of the year can bring freezing weather, meaning expensive burst-pipe claims.

Insurers can be encouraged by their progress, but there is still much to do.



Global General Insurance H1 Analysis

GLOBAL GENERAL INSURANCE H1 ANALYSIS

AGEAS

Chief executive Bart De Smet labelled Ageas's half-year results as a continuation of "five quarters of good, stable insurance results" and it is hard to argue with this assessment.

Operating profit grew 7.8% on the same period last year to £134.1m (H1: 2012: £124.4m) and gross written premium increased 12.8% to £1.2bn from £1.8bn in the first half of 2012 – the second largest increase of all the global insurers analysed. Ageas continued to grow premiums across all its lines of business despite a deterioration in the profitability of its motor book.

Ageas's motor combined operating ratio (COR) climbed into loss-making territory for the first six months of 2013, increasing 5.7 percentage points to 102.2%. Belgium was the main driver behind this deterioration, with the insurer citing a number of large individual claims for the reason behind the poor performance of motor in the country.

However, a return to profitability for Ageas's household book helped offset its lower performance in motor. The COR for household insurance fell 11.7 percentage points to 91.3% from 103% in 2012, making it its most profitable book of business.

This meant that the insurer was able to post an improvement of 0.5 percentage points to its overall COR, with the ratio coming in at 97.8% compared to 98.3% for the first half of 2012.

But like many other insurers struggling with motor, Ageas will have to find a way to steer its largest book of business back to profitable underwriting if it is to continue growing its group-wide operating profits.

COR

97.8%

2012 98.3%

-0.5pp
2012

OPERATING PROFIT

£134.1m

2012 £124.4m

7.8%
2012

SOLVENCY RATIO

206%

2012 209.0%

-3.0pp
2012

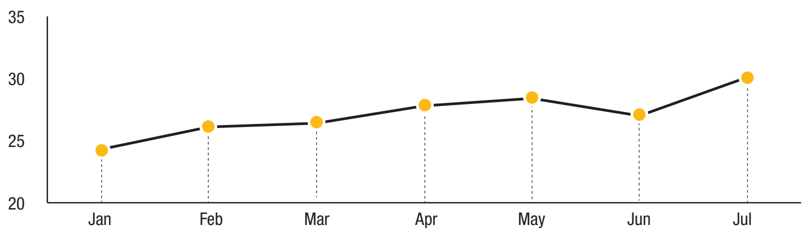
GWP

£1,983.5m

2012 £1,836.1m

8.0%
2012

SHARE PRICE (€)



GLOBAL GENERAL INSURANCE H1 ANALYSIS

AIG

NOTES:
GWP is NWP.

AIG delivered a surge in profit over the first half of 2013, with operating profit for its general insurance business up almost 40% on first-half 2012 levels. This was aided by a 2.3 percentage point improvement to its combined operating ratio (COR) – the biggest improvement of all the global insurers analysed.

The overall COR for H1 2013 was 100%, down from 102.3% in the same period last year. The first six months of 2013 also marked a return to underwriting profit for the New York-based insurer after a difficult couple of years dogged by lawsuits. Profit from underwriting totalled £3.9m after a loss of £252.8m for the same period last year.

This improvement came despite prior-year reserve strengthening of £101.3m, including a £93.4m loss reserve increase because of Superstorm Sandy. AIG attributed this to better risk selection and an intensified focus on more profitable lines of business.

The insurer was also able to grow net written premium (NWP) over the year to date, with premiums growing 2.1% to £11.6bn from £11.4bn for the first half of 2012. With the exception of Aviva, which cut its capacity, this was the lowest growth in premium witnessed over the first six months of the year, indicating that AIG is employing the strategy of focusing more on margin than volume.

A steadily growing share price over recent months means that this approach appears to be pleasing investors. However, AIG must look to increase its rate of growth if it is to capitalise on early signs of a resurgence.

COR

100%

2012 102.3%

-2.3pp 2012

OPERATING PROFIT

£1,758.7m

2012 £1,260m

39.6% 2012

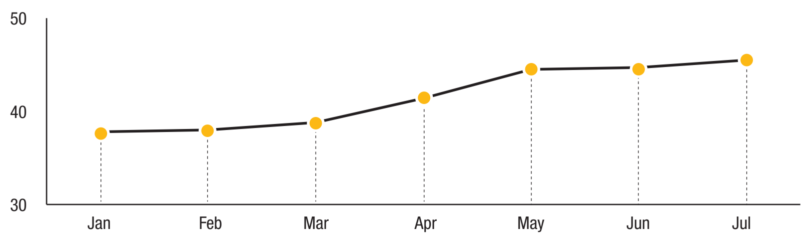
GWP

£11,641.3m

2012 £11,406.5m

2.1% 2012

SHARE PRICE ($)



GLOBAL GENERAL INSURANCE H1 ANALYSIS

ALLIANZ

Allianz has continued its tradition of strong performance and managed to grow profitably over the first six months of 2013, with operating profit and gross written premium (GWP) both significantly up.

Operating profit grew 18.7% to £2.1bn from £1.8bn for the same period last year, largely attributable to an increase in premium and improved underwriting performance. Allianz's combined operating ratio (COR) came in at a comfortably profitable 95.1% and was a 1.6 percentage point improvement on 2012's 96.7%.

This improvement was despite a catastrophe-heavy period of flooding in Canada and extensive hail storms in Germany and Switzerland. Record flooding in central Europe also led to losses of £282.4m net of reinsurance, and the total impact of natural catastrophes resulted in a 5.3 percentage point addition to the loss ratio.

The US delivered the biggest underwriting improvement for Allianz, with the country's COR falling 13.7 percentage points to a much more respectable 100.9% (2012: 114.6%).

Global GWP increased to £22.2bn for the first six months of the year, up 7.9% on the same period in 2012. A main driver of this growth was expansion in Australia, Latin America and Turkey, which offset a decline in business at Allianz's corporate and specialty division as well as a fall in crop insurance business in the US.

However, the US market fell back significantly to below £1bn GWP, posting premiums of £831.9m compared with £1.2bn for the same period in 2012. Allianz must be looking for this lucrative region to return to profit and growth so it can push on successfully into the second half of 2013.

COR

95.1%

2012 96.7%

-1.6pp 2012

OPERATING PROFIT

£2,138m

2012 £1,800.9m

18.7% 2012

SOLVENCY RATIO

177%

2012 186.0%

-9.0pp 2012

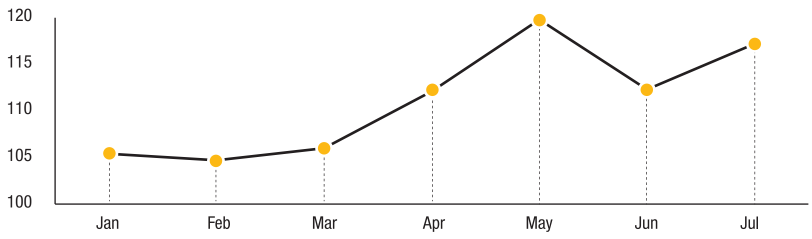
GWP

£22,211.5m

2012 £20,584.3m

7.9% 2012

SHARE PRICE (€)



GLOBAL GENERAL INSURANCE H1 ANALYSIS

AVIVA

To say Aviva had a tough year in 2012 could be seen as a bit of an understatement; its group loss exceeded £3bn. However, the cost-cutting measures that group chief executive Mark Wilson has put in place have started to take effect. Group operating profit exceeded £1bn for the first six months of 2013, up 5.1% on the £959m posted for the same period last year.

But these improvements have come at a price. In April, Aviva announced that it was axing 2,000 jobs worldwide – approximately 6% of its global workforce.

Although it was tough for some to swallow, the medicine appears to be working. Aviva's commission and expense ratio fell 0.8 percentage points to 32.3% from 33.1% for the first six months of 2012. Expenses were down to £1.5bn from £1.7bn in 2012 and Aviva will be hoping that the remainder of its planned £400m cost savings will continue to push its expense ratio down.

Meanwhile, Aviva must ensure that it does not lose track of underwriting performance. Its claims ratio for the first half of 2013 climbed to 63.9% from 62.4% in 2012. However, the insurer attributed this largely to flooding in Alberta, Canada, which added 1.8 percentage points to the group combined operating ratio (COR) of 96.2% (H1: 2012: 95.5%).

The combination of higher claims and lower investment returns cut the group's general insurance operating profit to £414m from £460m.

Aviva's share price jumped 7.6% because of these half-year results, which Wilson said were satisfactory, and the group has made a good start to turning round its fortunes. However, Aviva's chief executive is well aware there is still a lot to do if he is to return the group to its former glory.

COR

96.2%

2012 95.5%

0.7pp 2012

OPERATING PROFIT

£414m

2012 £460m

5.1% 2012

SOLVENCY RATIO

140.8%

2012 124.2%

16.6pp 2012

GWP

£4,248m

2012 £4,345m

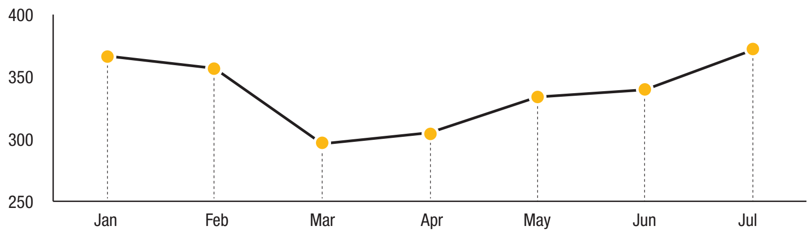
-2.2% 2012

RATE MOVEMENTS

Commercial motor **+9%**

Personal motor **-1%**

SHARE PRICE (£)



GLOBAL GENERAL INSURANCE H1 ANALYSIS

AXA

Positive rating action and an improvement to its underlying combined operating ratio (COR) helped AXA to grow its half-year profit by 12.2% compared with the same period in 2012.

The French insurer posted an operating profit of £1.4bn for the first six months of 2013, up from £1.2bn in the first half of 2012. AXA was able to push through rate rises of 3% for personal lines and 3.3% for its commercial business. This helped the insurer post an overall COR of 95.7%, down 0.8 percentage points on the already profitable 96.5% reported in 2012.

Reserve releases from prior years knocked 1.8 percentage points off the COR, and this was more than enough to offset the 0.7 percentage point increase attributed to a rise in the cost of natural catastrophes over the period. Flooding in Germany cost the insurer £19.7m over the first half of 2013.

But while revenues from emerging markets have increased 15% to £1.9bn compared with £1.6bn for the first six months of 2012, some of AXA's more established markets have struggled to grow. The benefits of rate increases for established regions were offset by a fall in volume from Germany because of increased competition, and cuts in Belgium and the UK household insurance market because of more selective underwriting criteria.

Once completed, the purchase of a 50% stake in Chinese insurer Tian Ping Auto Insurance should help to fuel growth from emerging markets, but to succeed over the long-term AXA must stop the growth slump in its more established regions.

COR

95.7%

2012 96.5%

-0.8pp 2012

OPERATING PROFIT

£1,379.7m

2012 £1,229.9m

12.2% 2012

SOLVENCY RATIO

218%

2012 207.0%

11.0pp 2012

GWP

£14,263.6m

2012 £13,196.8m

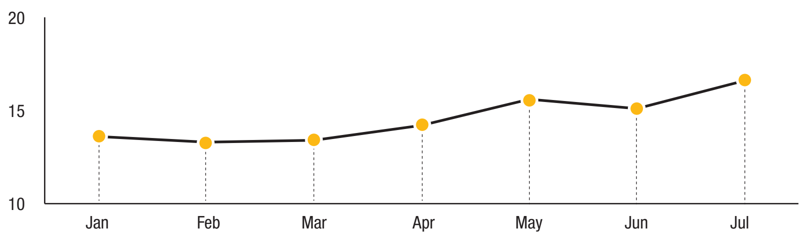
8.1% 2012

RATE MOVEMENTS

Personal lines **+3%**

Commercial lines **+3.3%**

SHARE PRICE (€)



GLOBAL GENERAL INSURANCE H1 ANALYSIS

RSA

While RSA might not have the premium volume of some of its competitors, the group's combined operating ratio (COR) was the lowest of all the global insurers analysed, helping it turn in an improved operating profit of £339m (2012: £305m).

RSA reported a profitable 94.2% group COR for the first half of 2013, an improvement of 1.2 percentage points on the same period last year.

This improvement comes despite higher weather-related claims in Canada, which dented RSA's COR as well as those of many of its rivals. Claims from flooding in Alberta cost RSA £48m and knocked 1.1 percentage points off the group's year-to-date COR. However, the insurer said its global weather losses were largely in line with previous forecasts for the period.

Scandinavia's performance dipped for RSA, with profit from underwriting falling to £98m, down 25% on 2012's underwriting result of £130m.
The insurer attributed this decline to unusually high levels of unrelated claims on its Swedish commercial property book, primarily relating to fire damage.

Acquisitions in Argentina and Canada contributed to RSA's 6.7% overall gross written premium (GWP) growth, with average rate increases of 3% helping grow premiums in the more established markets. Global GWP grew to £5.2bn, up from £4.9bn for the first six months of 2012.

Group chief executive Simon Lee said the company was making good progress against targets and also in turning round performance in the UK and Italian markets. But Lee admitted that there was still more to do in these regions, which he described as "the most competitive and challenging markets in which we operate".

COR

94.2%

2012 95.4%

-1.2pp 2012

OPERATING PROFIT

£339m

2012 £305m

11.1% 2012

SOLVENCY RATIO

170%

2012 190%

-20.0pp 2012

GWP

£5,208m

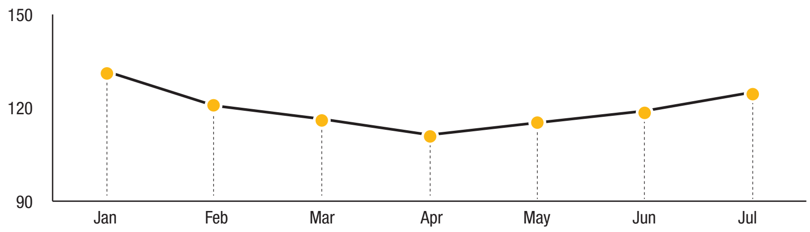
2012 £4,880m

6.7% 2012

RATE MOVEMENTS

3% average increase

SHARE PRICE (£)



GLOBAL GENERAL INSURANCE H1 ANALYSIS

ZURICH

NOTES:
All results in this section are non-life only

A headline earnings miss meant analysts were not impressed with Zurich's half-year results for 2013. Berenberg Bank described the results as "disappointing", especially as, it said, "Zurich has consistently missed expectations recently".

The Switzerland-based insurer generated an operating profit of £900.4m in the first six months of 2013, down 13.6% on the £1bn posted for the same period last year. Its combined operating ratio (COR), worsened by 0.8 percentage points, climbing to 95.6% from 94.8%.

The insurer said losses from weather-related events were a main driver of this deterioration in underwriting profitability, with flooding in central and eastern Europe costing an estimated £92.1m. Net losses from tornadoes in Oklahoma are estimated to reach £90.8m.

Poor investment returns, down 17% on the previous year, did little to help the insurer's profitability.

However, overall gross written premium (GWP) grew 6.6% to £13bn for the first six months of the year, up from £12.2bn in 2012, aided by average rate rises of 5% for Zurich's commercial business.

Favourable economic and market conditions drove growth in Latin America and its global corporate division. This meant the insurer could report premium growth of 9% in international markets and 10% for its global corporate book.

Chief executive Martin Senn knows all is not well at Zurich. He said: "It is clear from the headline numbers that we can do better and more has to be done." It now remains to be seen whether he has the tools at his disposal to improve the insurer's faltering fortunes.

COR

95.6%

2012 94.8%

0.8pp 2012

OPERATING PROFIT

£900.4m

2012 £1,014.6m

-13.6% 2012

SOLVENCY RATIO

185%

2012 178%

7.0pp 2012

GWP

£13,002.7m

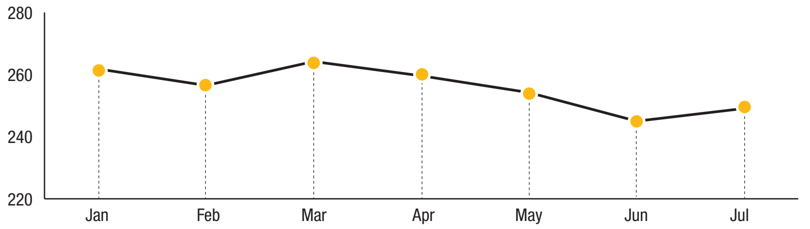
2012 £12,194.7m

6.6% 2012

RATE MOVEMENTS

Commercial lines **+5%**

SHARE PRICE (CHF)



GLOBAL INSURERS

Challenges

‘The uncertainty over Solvency II in Europe still hangs over the industry, with no one knowing when the regulations will come into force’

The global insurance market is always a difficult place in which to operate, but when the world is plunged into an economic crisis the task becomes significantly harder.

One of the biggest challenges facing the industry is the downward pressure on investment returns.

With many insurers investing heavily in fixed-income securities such as corporate and government bonds, the prevalence of low interest rates lowers bond yields and dampens insurers’ investment returns.

In this environment, insurers also take a hit when interest rates rise again, as this devalues the bonds they hold. This is what happened in the first half, mainly thanks to the rising rates in the US.

Investment income for the global insurers analysed in this report fell 4.5% to £6.7bn over the first half of 2013, from £7bn in the same period in 2012.

This means insurers can no longer rely so heavily on investment returns to generate profit, and instead must focus on underwriting proficiency.

Speaking at Lloyd’s in March, ACE European Group president Andrew Kendrick pointed out that a weakened economy meant combined operating ratios (CORs) of 100% could no longer be relied on to achieve profit. He said: “The industry needs to target a combined ratio in the low to mid-90s to generate adequate returns.”

But it is a challenge to achieve this. The US general insurance market has only had four years of underwriting profit since the start of the last decade, compared with CORs below 100% in 40 of the 60 years in the run-up to 1980.

However, the global insurers analysed in this report have managed to achieve sub-100% CORs in their most recent half-year results, albeit generally higher than the low to mid-90s Kendrick said was needed. All but two managed to improve their general insurance operating profit over the first six months of 2013 compared with the same period in 2012. This will be encouraging news for the market.

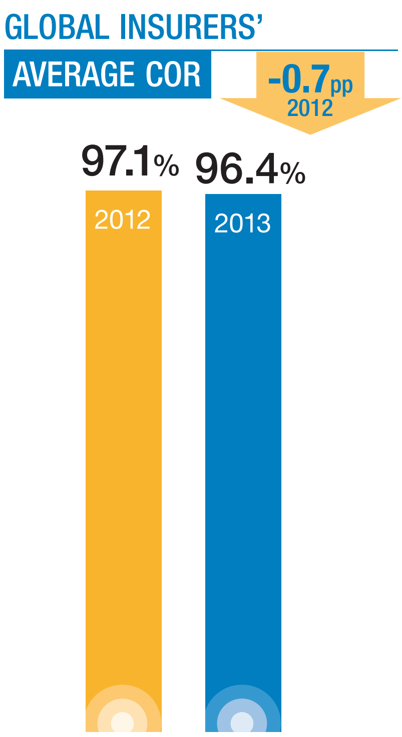
Regulatory change is another area that will cause concern. The uncertainty over Solvency II in Europe still hangs over the industry, with no one knowing when the regulations will come into force. The ABI recently said the implementation date was likely to be as late as 2017.

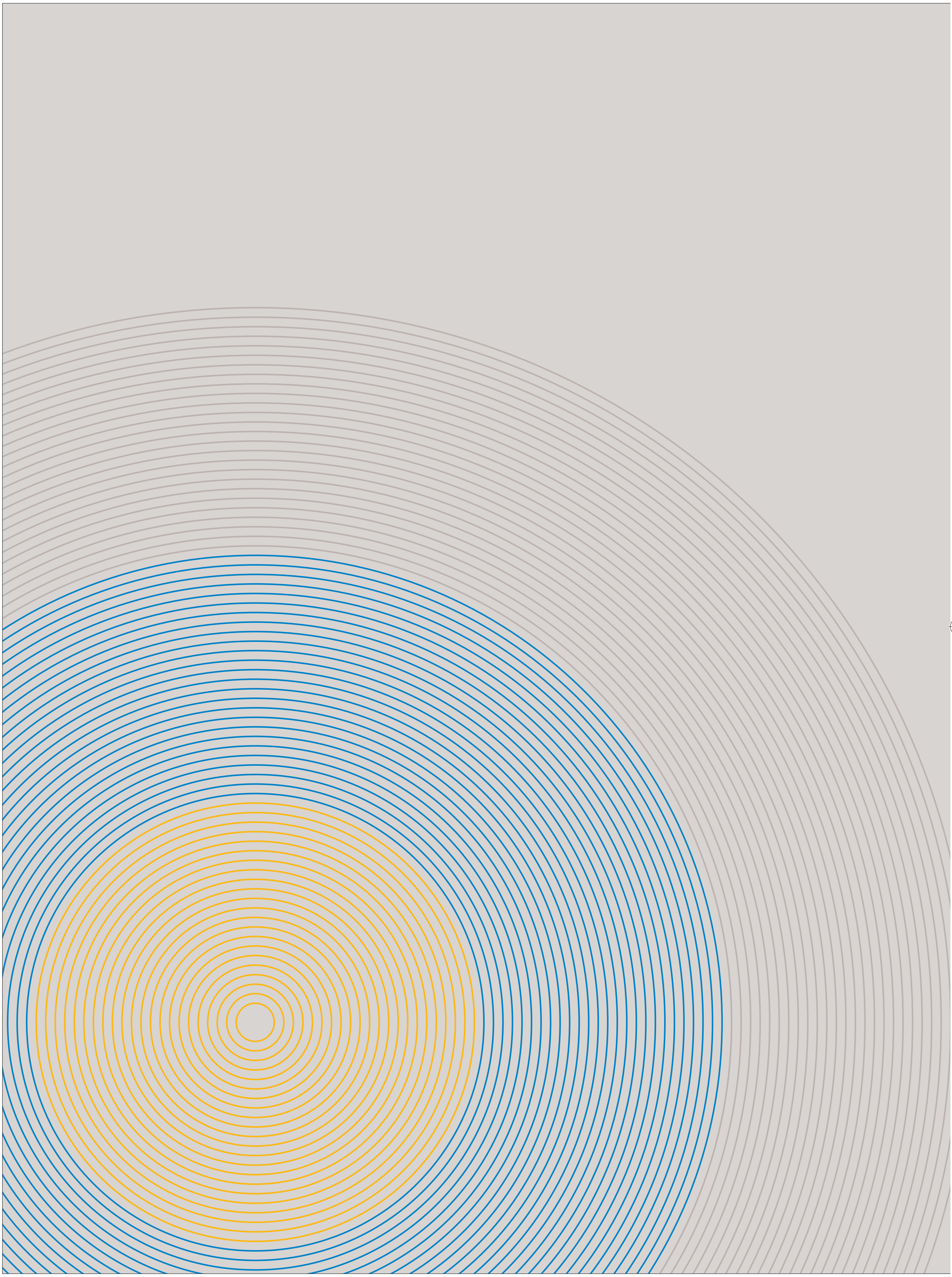
The Financial Stability Board (FSB) has named nine insurers it sees as vital to the financial stability of the global economy. Allianz, AIG, Aviva and AXA have been labelled global systemically important insurers (G-SIIs), whose collapse could substantially damage the global economy. This list will be updated annually from 2014.

The insurers on the FSB list will face increased regulation and supervision. To meet the requirements of the designation, they may be required to hold more capital or enhance the quality of their capital instruments.

Rating agency Standard & Poor’s said the new requirements would enhance the ability of the G-SIIs to detect and avoid potential risks, but the increased regulatory burden could constrain their freedom to manoeuvre in the market.

It also pointed out that the need to hold more and enhanced capital could lead to a higher cost of capital for the insurers, increasing the cost of financing their operations.





Lloyd's H1 Analysis

NOTES:
Beazley and Catlin results are converted from USD at the following rates:

2013: $1 = £0.6577
2012: $1 = £0.6367

LLOYD'S H1 ANALYSIS

AMLIN

If equity analysts' comments are anything to go by, Amlin had a good first half in 2013. Analysts hate surprises, so it was a big plus that the company's pre-tax profit of £161.4m was in line with their expectations. Westhouse analyst Joanna Parsons described Amlin's first-half performance as "good, solid results".

The company also reported a comfortably profitable combined operating ratio (COR) of 85%, which Berenberg Bank analyst Tom Carstairs said was better than his firm's forecast of 88.5%.

Amlin's first-half 2013 profit was down on the £184.4m it reported in last year's first-half results, and the COR marginally worse than the 84% it reported at the same time. But the company was forgiven because these followed increased catastrophe losses and lower investment returns.

Amlin paid out £32.2m in catastrophe claims in the first half of 2013, mainly from the European flooding in May and June. And while Amlin described its investment performance as "solid", returns were down 20% to £67.4m (H1 2012: £84.7m) – a 1.4% return on invested assets (H1 2012: 2%).

Even though these were negative points, they were better than analysts had forecast. Despite the positive response, Amlin's first-half results also contained evidence of the challenges facing the company and the industry as a whole.

Rates for renewal business were flat across Amlin's entire portfolio of business, compared with a 4% increase in the same period last year. Part of the reason was what Amlin chief executive Charles Philipps described as "intense" competition between traditional reinsurers and capital markets capacity for US catastrophe business at the June and July renewals.

COR

85%

2012 84%

1.0pp 2012

PROFIT BEFORE TAX

£161.4m

2012 £184.4m

-12.5% 2012

GWP

£1,838.9m

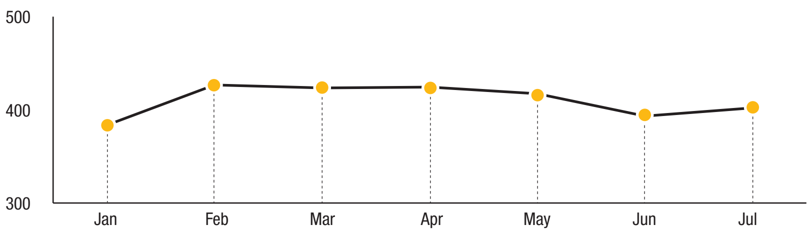
2012 £1,814.7m

1.3% 2012

RATE MOVEMENTS

Cat reinsurance renewal **-2.7%**, UK commercial **+3.5%**, fleet motor **+7.6%**, P&C **+1.4%**, liability **+7.2%**, yachts **+1.1%**, energy **-1.8%**, aviation **-4.5**%

SHARE PRICE (PENCE)



LLOYD'S H1 ANALYSIS

BEAZLEY

Low interest rates confound insurers' investment results because it means their bond-heavy investment portfolios generate lower returns. But the results also take a short-term hit when interest rates rise again, as the newly issued bonds out in the market yield more than the ones sitting on the insurers' books, meaning they will make a loss if they try to sell them.

This happened to Beazley in the first half of 2013. The typically strong-performing Lloyd's insurer posted a 24.7% drop in profit before tax to £54.1m from £71.9m in the same period last year.

This was triggered by a slump in investment returns to just £197,000 from £23m. Beazley will be unperturbed by this. The company is deliberately cautious on its investment portfolio, considering it more important to make money from taking underwriting risk rather than investment risk.

And it continued to do precisely that in the first half. Its combined operating ratio (COR) improved by two percentage points to 89%. This was thanks in no small part to a 32% boost in prior-year reserve releases to £40m (H1 2012: £30.3m).

A cynic might argue that Beazley is using reserve releases to prop up its results, but the insurer has a consistent record of prudent reserving. Its reserves were 7.1% above actuarial best estimates in the first half of the year. The company is also continuing to grow. Gross written premiums (GWP) were up 8.8% to £701.6m (H1 2012: £645m).

Like many of its peers, Beazley faces competitive headwinds, particularly in the US. But chief executive Andrew Horton believes the firm can cope. "We have managed competitive pressures before, and we feel relatively comfortable we can continue to do so."

COR

89%

2012 91.0%

-2.0pp 2012

PROFIT BEFORE TAX

£54.1m

2012 £71.9m

-24.7% 2012

GWP

£701.6m

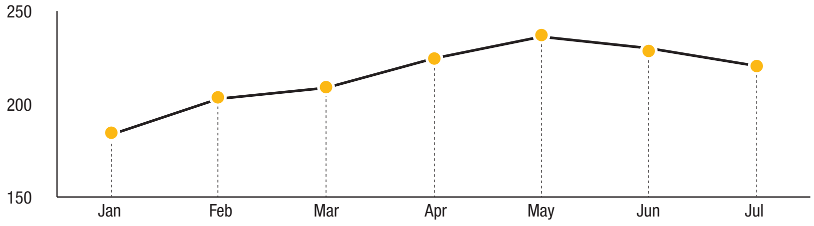
2012 £645m

8.8% 2012

RATE MOVEMENTS

Property **+3%**, reinsurance **-1%**, specialty lines **+4%**

SHARE PRICE (PENCE)



LLOYD'S H1 ANALYSIS

BRIT INSURANCE

NOTES:
Operating profit

Brit has made a strong start to 2013, as improvements to both its combined operating ratio (COR) and gross written premium (GWP) resulted in a 41.7% increase in its operating profit.

The only non-listed Lloyd's insurer in this report, it improved its COR for the first half of 2013 by 6.8 percentage points to 86% compared with the same period in 2012. This reduction was driven by lower catastrophe claims, with Brit's claims ratio falling 7.2 percentage points to 48% from 55.2% in 2012. The expense ratio has remained relatively stable at 38% (H1: 2012: 37.6%).

But the insurer has also improved its attritional loss ratio, which excludes the impact of large catastrophe claims, by 1.8 percentage points to 51.5% (2012: H1: 53.3%).

Group chief executive Mark Cloutier said this was a result of the changes Brit had been making to its underwriting strategy.

"While it has been a relatively benign period in terms of catastrophe losses, we see the continued reduction of our attritional loss ratio, down to 51.5% at the half year, as the best evidence of the material improvements that have been made to our core portfolio," he said.

However, growth in GWP at the insurer was harder to come by. It grew a modest 2.1% to £671m from £657m for the first half of 2012.

Brit's global specialty division was able to push through a small average rate increase of 0.7% over the period. Rate rises for its marine (5.8%), property facilities (2.3%) and professional lines (1.8%) business were partially offset by reductions for treaty North America (1.7%) and energy (1.6%).

COR

86%

2012 92.8%

6.8pp
2012

PROFIT BEFORE TAX

£85m

2012 £60m

41.7%
2012

GWP

£671m

2012 £657m

2.1%
2012

RATE MOVEMENTS

Marine **+5.8%**, property facilities **+2.3%**, professional lines **+1.8%**, treaty (North America) **-1.7%**, energy **-1.6%**

LLOYD'S H1 ANALYSIS

CATLIN

Like its rival Amlin, Catlin was hit with the one-two punch of higher catastrophe losses and lower investment returns in the first half of 2013.

But, unlike Amlin, the reactions from equity analysts were not all positive. Shore Capital analyst Eamonn Flanagan noted: "Catlin has featured on more or less each of the major cat events in 2013, raising concerns over the wisdom of its growth strategy."

Net catastrophe claims of £65m pushed Catlin's combined operating ratio (COR) up by 2.6 percentage points to 88.9%. The insurer picked up losses from a variety of events during the second quarter of the year, including floods in Calgary and in central Europe, and tornadoes in Oklahoma. Reserve releases of £36.8m (H1 2012: £19.1m) were not enough to offset the effect of the claims.

On the investment side, a drop in the value of Catlin's bond portfolio slashed returns to £10.5m in the first half of 2013 from £48.4m in the same period last year.

There are also signs that Catlin's push into the UK regional market is not going according to plan. It emerged in July that is was making around 10 job cuts and reviewing how it serves the UK regions.

But Catlin has strengths to draw on. Its 88.9% COR is still a good performance, particularly in a half-year marred by global catastrophe activity. The company was able to grow its business at a faster rate than several of its rivals. Gross written premiums (GWP) were up 13.2% to £2bn (H1 2012: £1.9bn). It also enjoyed greater rate increases than some peers. Amlin's renewal rates were flat, but Catlin reported rate rises of 1.6%, comprising 0.4% increases in catastrophe-exposed business and 2.5% rises elsewhere. Its performance may not have pleased analysts, but Catlin is a profitable firm.

COR

88.9%

2012 86.3%

2.6pp 2012

PROFIT BEFORE TAX

£95.4m

2012 £147.1m

-35.2% 2012

GWP

£2,169.8m

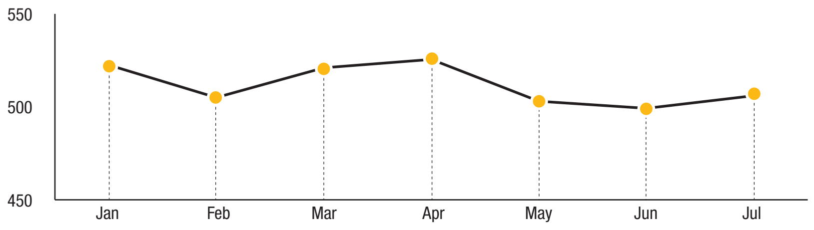
2012 £1,916.5m

13.2% 2012

RATE MOVEMENTS

Aerospace **-7%**, casualty **+8%**, energy/marine **+1%**, property **+3%**, specialty/war and political risk **-1%**

SHARE PRICE (PENCE)



LLOYD'S H1 ANALYSIS

HISCOX

Hiscox is the Lloyd's insurer everyone wants to be. It is a consistently solid performer by all measures and is renowned as a profitable underwriter that rarely gets caught out with underpriced business or big shares of losses.

To achieve profitable growth overall, the company aims to grow its retail insurance business by 5%-15% a year, achieving a 90%-95% combined operating ratio (COR) from the business, and flex the size of its global Lloyd's business, depending on market conditions.

Hiscox did nothing to tarnish its reputation as a consistent performer in the first half of 2013. Its 74.7% COR easily beat its rivals, and was a seven percentage point improvement on the 81.7% it reported in the first half of 2012. This was despite a 37% drop in reserve releases to £73.6m (H1 2012: £116.3m).

Pre-tax profit rose 44% to £180.7m (H1 2012: £125.8m). Although Hiscox did incur catastrophe claims in the first half like the rest of its peers, its net exposure was limited to just £14.2m.

While it has outperformed its peers, Hiscox is not immune to general market trends. Its investment return dropped 48% to £23.3m (H1 2012: £44.5m). This means that Hiscox's return on invested assets fell to 1.5% from 3.1%.

The company also appears to have had a worse pricing experience than some of its peers. While some reported flat to slightly increasing renewal rates across their books in the first half of 2013, Hiscox said rates across its entire portfolio were "down by a single-digit percentage".

However, given its standing in the market and ability to price business, Hiscox is likely to take these challenges in its stride.

COR

74.7%

2012 81.7%

-7.0pp 2012

PROFIT BEFORE TAX

£180.7m

2012 £125.8m

43.6% 2012

GWP

£1,017.9m

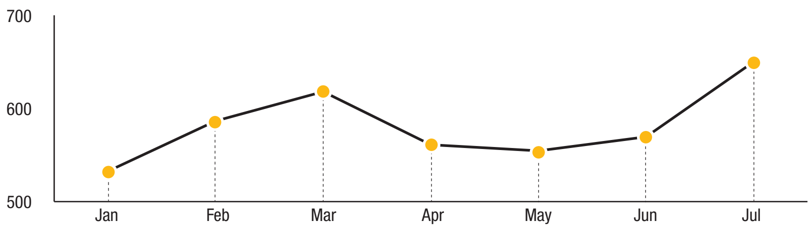
2012 £906.4m

12.3% 2012

RATE MOVEMENTS

US property **-15%** (June renewals) and **-10%** (July renewals), international business **-5%**

SHARE PRICE (PENCE)



LLOYD'S H1 ANALYSIS

NOVAE

Novae suffered a rocky ride in 2012. It began the year by reporting a full-year 2011 loss after tax of £7.4m, following the welter of natural disasters that year – New Zealand and Japan earthquakes and Thailand floods.

It then lost the bulk of the team at its Switzerland reinsurance unit, led by Gunther Saacke, to Qatar-based reinsurer Q-Re, which Saacke now leads.

The picture is far rosier now. Novae was able to replace its team in time for the annual reinsurance gathering in Monte Carlo in September. And lower natural catastrophe losses in 2012 led to a profit of £27.7m that year. Chief executive Matthew Fosh declared it "a defining year" for the smallest Lloyd's-listed group.

Novae's first-half results for 2013 show it is progressing well. It reported a 68.8% rise in pre-tax profit to £21.1m (H1 2012: £12.5m) and a profitable combined operating ratio of 91.6%. The half was not without its challenges. Like its peers, Novae suffered a sharp drop in investment yields, with returns down 67% to £4.4m (H1 2012: £13.4m).

The company was hit by catastrophes, including floods in Europe, India, Australia and Canada, and tornadoes in the US. But at £5.6m, the claims bill from these events was little to be concerned about.

Perhaps Novae's biggest weakness is its relatively small size, with a market capitalisation of £328m, making it prone to speculation that it will be bought. Private equity firms have a strong interest in Lloyd's, and Novae's size, listed status and performance could be tempting.

Fosh recognises the drawbacks of its size and is looking to grow the company. But as growth can be dangerous when rates are flat to down, he has pledged to do so carefully.

COR

91.6%

2012 93.2%

-1.6pp 2012

PROFIT BEFORE TAX

£21.1m

2012 £12.5m

68.8% 2012

GWP

£361.8m

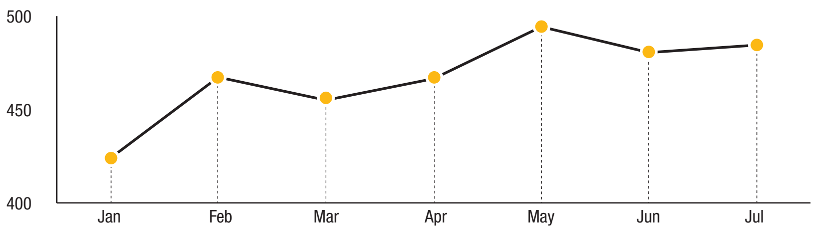
2012 £395.6m

-8.5% 2012

RATE MOVEMENTS

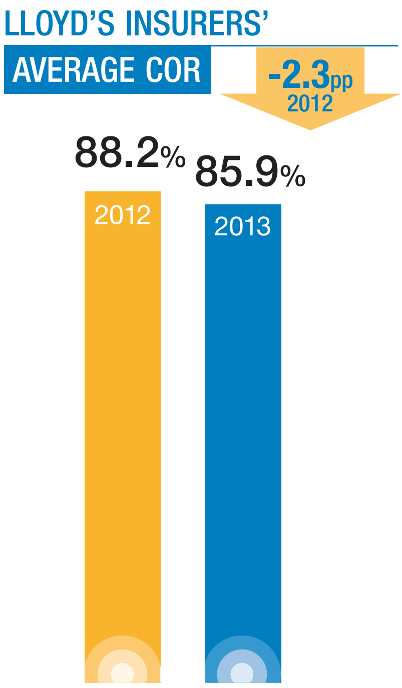
Renewal business **+1%**

SHARE PRICE (PENCE)



Challenges

> 'If the investment market remains volatile, more capital will flow into reinsurance, putting further downward pressure on prices and squeezing profitability'



The Lloyd's market is suffering from weak investment returns in a depressed economy – no different from the other insurers analysed in this report.

Over the first half of 2013, investment returns for the Lloyd's insurers analysed totalled £113.7m, down from £262.3m for the same period in 2012. The average fall in investment income across the insurers was 56.7% compared with 2012 levels.

Beazley fared particularly poorly on the investment front: it lost more than 99% of its investment income, reporting just £0.2m for the first six months of 2013 (H1 2012: £23m).

The low interest rate environment currently experienced by investment markets around the world in recent years has kept bond yields low. In addition, rising US interest rates have resulted in short-term losses for many.

This means that insurers can no longer rely on investment returns to prop up poor underwriting, but the good news is that the Lloyd's insurers appear to be getting their underwriting right.

The average combined operating ratio (COR) for the first half of 2013 improved 2.3 percentage points to 85.9% from 88.2% for the same period in 2012. This is comfortably in profitable territory, and the industry will be hoping this strong underwriting performance continues in the second half of the year.

However, the industry is suffering from flat and falling rates across the market as a result of intense competition and tough economic conditions. This will make maintaining such profitable CORs over the second half of the year and into 2014 much harder.

The reinsurance market is also suffering from poor rating conditions.

Non-traditional capital from institutional investors such as pension scheme trustees and life insurers is flooding the market, particularly in the US. Aon Benfield estimates show that global reinsurance capital has reached its highest ever levels, reaching £326bn for the first time in 2012. Willis Re estimates that £21.5bn of capital is coming from these non-traditional sources.

Many of these new investors are looking for investment returns that are not highly correlated with the rest of the market. If the investment market remains highly volatile, it could reasonably be expected that more capital will flow into reinsurance, putting further downward pressure on prices and squeezing (re) insurers' underwriting profitability.

Buying power

But it is not just underwriting that may be under pressure in the future.

Lloyd's insurers are finding it difficult to make acquisitions to support their organic growth, as there is a lack of suitable targets.

Novae in particular has wanted to grow and close the gap on its bigger rivals. Beazley chief executive Andrew Horton, whose firm missed out on buying fellow Lloyd's insurer Hardy last year, said finding the right company to purchase was proving difficult.

"The challenge is finding ones that hit our sweet spots, which are relatively small. The lines of business and the people who stay have to fit and should have the right level of profitability," he said.

Lloyd's insurers will also be losing out on capacity to Berkshire Hathaway after the insurer reached a capacity deal with global broker Aon. The agreement between the two means that 7.5% of all business Aon places through Lloyd's will be underwritten by Berkshire Hathaway, stealing a share of the market from established Lloyd's insurers.

Willis is another broker that is looking into the possibility of such a deal, and is looking for capacity providers to join up to its rival offering Willis 360.

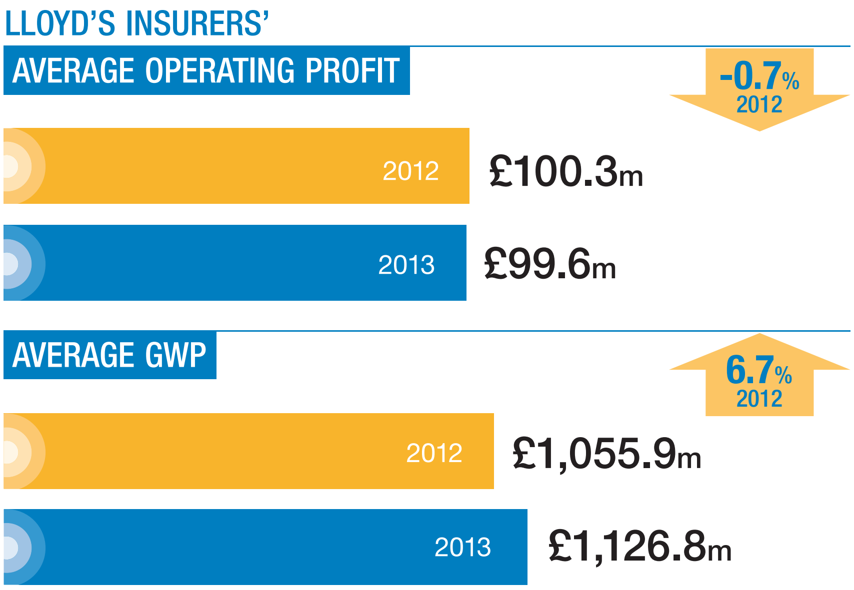
While these arrangements may not be a genuine threat to the biggest players in the Lloyd's markets, there are some who are worried by the threat of the agreement.

Lloyd's finance director Luke Savage said: "All credit to Berkshire Hathaway – it is going to be getting the return of Lloyd's without having to make the investment around underwriting expertise that the Lloyd's market does make. It's effectively a tracker fund on Lloyd's – it is a potential threat."

But Beazley's Horton is not so concerned about these passive underwriting deals, saying it was just another challenge that insurers had to rise to meet in a tough and challenging market.

"The broker-led initiatives increasing capacity in London – both Aon's initiative with Berkshire and Willis 360 – are going to affect us in some way. However, we have good trading relationships with those brokers and we are not expecting any material impact to us," Horton said.

"We have seen other quota share agreements that have been in the market for two or three years and they haven't



stopped us from growing profitably. We are hopeful we can work around them."

New capacity

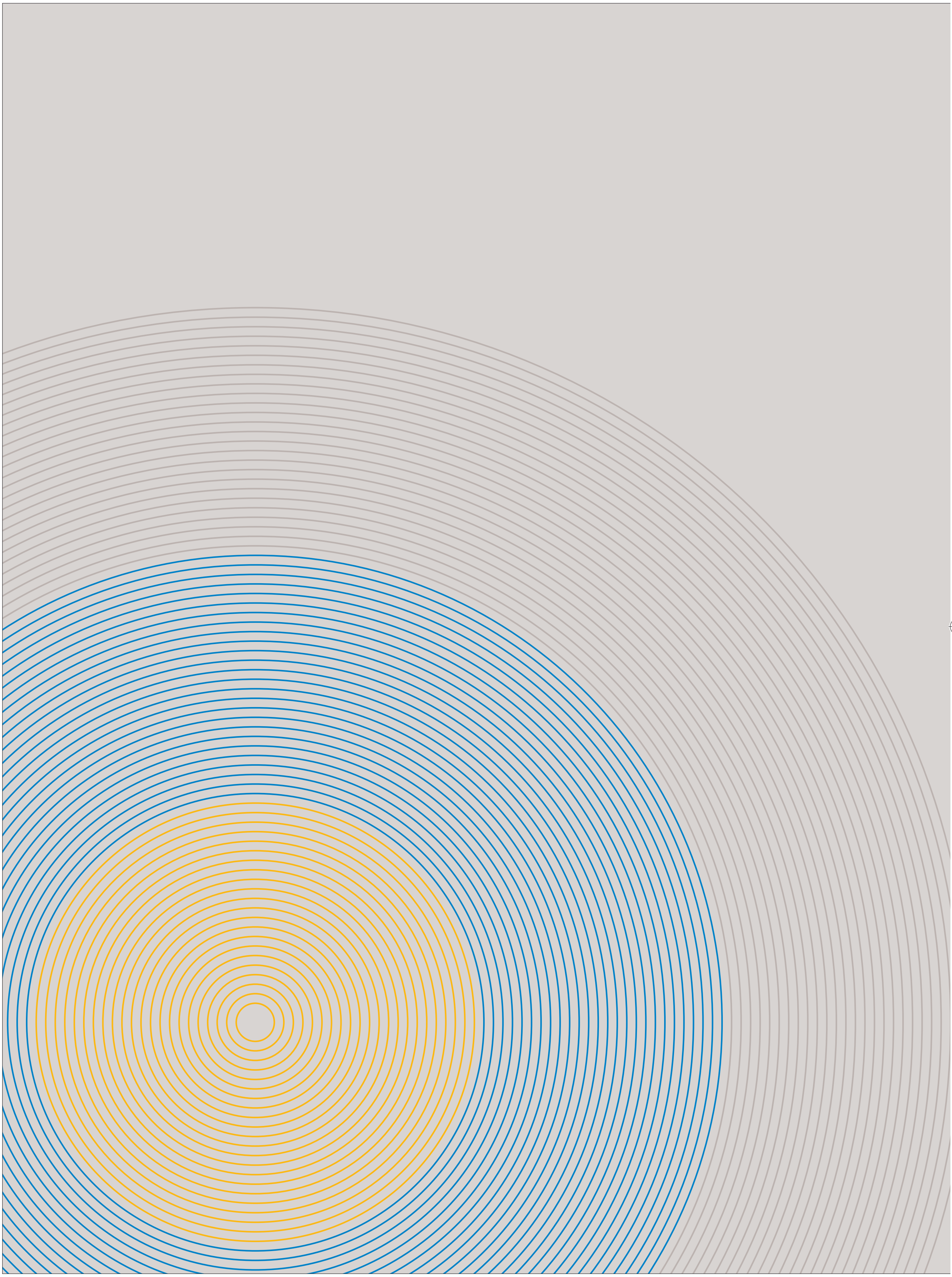
These broker deals are just one of the competitive headwinds currently facing Lloyd's insurers.

Another is new capacity entering the US excess and surplus lines (E&S) market.

The most notable new entrant here is Berkshire Hathaway, which announced that it was setting up a new US E&S division, called Berkshire Specialty.

About 40% of Lloyd's business comes from the US, and much of it is specialist E&S business. Increased capacity from outside the market, especially from such a big player in the insurance world, is likely to put strain on the volumes of business being placed at Lloyd's.

The increased competition that will result from this will also put further downward pressure on rates and put a dent in the underwriting profitability of Lloyd's insurers.



Global brokers H1 Analysis

NOTES:
All figures except JLT's converted from dollars at the following rates:

2013: $1 = £0.6577
2012: $1 = £0.6367

GLOBAL BROKERS H1 ANALYSIS

AON

Along with MMC, Aon experienced the smallest organic growth over the first half of 2013, achieving just 3%, four percentage points behind growth leader JLT.

This means that, with the exception of Willis in 2012, the chasing pack have closed the gap in each of the past three years.

However, the broker still remains the second most profitable player in the market. It has managed to grow half-year operating profit over each of the past five years, reporting profit of £522.2m for the first half of 2013.

It also managed to consistently improve its profit margin over that period, posting a 20.3% margin for 2013, up from 19.7% in 2012.

As a result, chief executive Greg Case remains upbeat, saying: "We're fully on track to deliver greater scale and increased operating leverage in 2013 and 2014."

ORGANIC GROWTH

3%

2012 4%

-1.0pp 2012

OPERATING PROFIT

£522.2m

2012 £477.5m

9.4% 2012

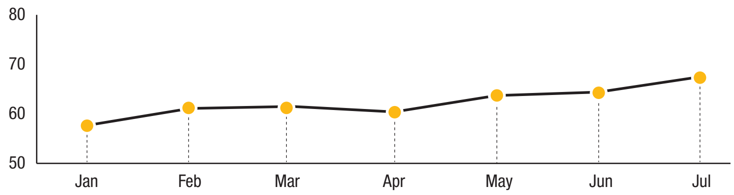
PROFIT MARGIN

20.3%

2012 19.7%

0.6pp 2012

SHARE PRICE ($)



ARTHUR J GALLAGHER

Acquisitions are a fundamental part of Arthur J Gallagher's strategy, and in 2012 the company made 60 acquisitions worldwide.

The company has continued that trend into 2013, snapping up nine smaller brokers over the first half of 2013. Chief executive Pat Gallagher told analysts to expect further acquisitions during the second half of the year.

But the broker has not just relied on acquisitions to fuel its growth over the past couple of years. Arthur J Gallagher reported organic growth of 5.1% for the first half of 2013, following on from 4.2% growth in the same period last year.

However, the company's acquisitive nature has dented its profitability. With a profit margin of 15.2% in its most recent set of results, Gallagher is more than five percentage points behind its closest rival. It has consistently had a lower profit margin than the other four brokers analysed in this report for each of the past five years.

ORGANIC GROWTH

5.1%

2012 4.2%

0.9pp 2012

OPERATING PROFIT

£100.8m

2012 £77.6m

29.9% 2012

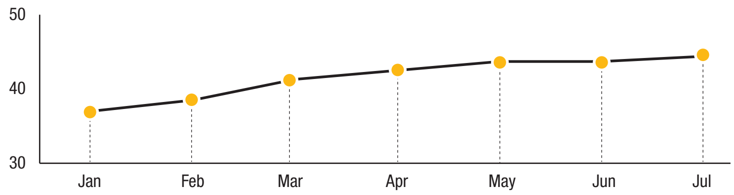
PROFIT MARGIN

15.2%

2012 14.2%

1.0pp 2012

SHARE PRICE ($)



JLT

Of the five brokers analysed in this report, JLT has consistently reported the biggest organic growth for each of the past five years.

Panmure Gordon analyst Barrie Cornes believes that JLT's acquisition strategy has allowed it to grow more quickly than its rivals, as it has not had to deal with the hassles of integrating legacy organisations.

Cornes said: "While some have been busy integrating large acquisitions, the likes of JLT have been acquiring individuals and teams, which has enabled them to avoid huge disruption."

However, growth in operating profit has slowed down since hitting a 30% five-year high in 2010. Operating profit for the first half of 2013 grew 3% compared with the same period last year, while its profit margin fell back two percentage points to 22% from 23% in 2012.

ORGANIC GROWTH

7%

2012 7%

0.0pp 2012

OPERATING PROFIT

£82.7m

2012 £80.3m

3.0% 2012

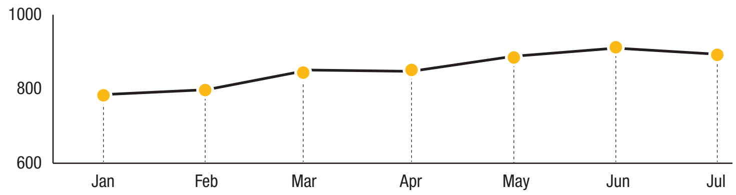
PROFIT MARGIN

22.2%

2012 24.2%

-2.0pp 2012

SHARE PRICE (£)



MARSH & MCLENNAN COMPANIES

Dan Glaser is the new man at the helm for Marsh & McLennan Companies (MMC) after he took over from long-standing chief executive Brian Duperreault in January this year.

It has not been an easy start for the American. Organic growth fell to 3% over the first half of the year from 7% for the same period in 2012.

But it is not all negative for MMC, with both profit measures still ahead of its competitors. Operating profit grew 14.5% to £584.7m for H1 2013 and its profit margin increased 1.6 percentage points to 25.7%.

This meant it overtook Willis to lead the margin rankings, and put it more than two percentage points ahead of its closest rival.

However, MMC's broking division faces being squeezed by flat or falling rates across the market. Glaser will have to be on his toes to make sure his tenure is a success.

ORGANIC GROWTH

3%

2012 7%

-4.0pp 2012

OPERATING PROFIT

£584.7m

2012 £510.6m

14.5% 2012

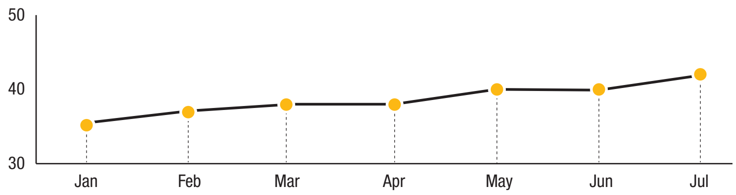
PROFIT MARGIN

25.7%

2012 24.1%

1.6pp 2012

SHARE PRICE ($)



GLOBAL BROKERS H1 ANALYSIS

WILLIS

There are early signs of a resurgence at Willis. Its half-year results showed organic growth of 5.1%, following a lacklustre couple of years when it lagged behind its main broker rivals.

However, despite this marked improvement in growth, profit has been harder to come by at the broker.

Operating profit fell 4.6% over the first half of the year to £301.2m from £315.8m in 2012 and its profit margin has dropped back to 23.6% after leading the pack with a margin of 26.7% in 2012.

Increasing costs seem to be the main problem behind this dip in profitability. In the first half of 2013, costs were up 9% to £1bn from £920.8m, and the second quarter alone saw costs jump 8.4% to £472.9m.

ORGANIC GROWTH

5.1%

2012 1.8%

3.3pp 2012

OPERATING PROFIT

£301.2m

2012 £315.8m

-4.6% 2012

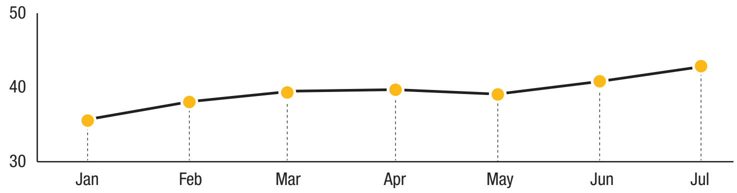
PROFIT MARGIN

23.6%

2012 26.7%

-3.1pp 2012

SHARE PRICE ($)



ANALYSTS' COMMENTS

'If you look at the last four years, JLT has outperformed organically. The big ones largely got big because of acquisition. Ten to 15 years ago there was a dash for growth and they were all acquiring each other to be crowned the largest. It took a long time to integrate those businesses and some is still taking place. Generally speaking, organic growth goes with gross domestic product (GDP), so the fact that all the brokers are outperforming GDP growth is positive. They're all, if you like, winning.'

Panmure Gordon analyst Barrie Cornes

'Brokers feel like they have to acquire or die in many cases, some of them feel that acquiring is a central part of their DNA and that they've got better at it, and there's some debate mostly around the question of are they paying out too much for this growth over time. [The big two] probably should be competing more for organic growth – they haven't really started yet, but you listen to what management are saying and they do recognise that they need to do that.'

Sandler O'Neill & Partners analyst Paul Newsome

'In many cases [growth is from] existing businesses that are already clients that are simply increasing their insurance spend, so they're not necessarily choosing one firm from another but they're staying with the firm they've been with for a while and just growing their insurance expenditures. Their [Gallagher and Willis] significant focus is on smaller commercial lines, where we're seeing more of a rebound. The external catalyst of the economy provides [them with] a bit of a boost.'

Stifel Nicolaus analyst Meyer Shields

GLOBAL BROKERS

Challenges

> 'Brokers feel like they have to acquire or die in many cases. Some of them feel that acquiring is a central part of their DNA and feel like they've become better at it'

It is a tall order to achieve organic growth while the global economy is struggling to throw off the shackles of a recession, and the big global brokers may be struggling more than most.

The likes of Marsh & McLennan Companies (MMC), Arthur J Gallagher and Aon have all been on the acquisition trail in the past, and this has limited their ability to grow organically. Integrating legacy organisations into existing frameworks is a costly and time-consuming process, and this has hit the organic growth of many of the global brokers analysed in this report.

Sandler O'Neill analyst Paul Newsome says: "Brokers feel like they have to acquire or die in many cases. Some of them feel that acquiring is a central part of their DNA and they've become better at it, although there's some debate [about this], mostly around the question of whether they are paying too much for this growth over time."

The state of the economy is also having an impact on the rates being paid for insurance, and therefore the commission brokers receive for the business they place with insurers.

JLT also blamed alternative sources of reinsurance capital for driving down reinsurance rates, particularly in the US.

Aon has fought against the difficulties of chasing growth by entering into an agreement with insurance giant Berkshire Hathaway. The deal means that 7.5% of all business the broker places through Lloyd's is taken up by Berkshire Hathaway. This gives Aon guaranteed capacity from one of the biggest names in the industry, and presumably a sizeable commission to go with it. Willis has confirmed that it is to enter into a similar arrangement later this year.

Many industry players have questioned the ethics of these types of passive underwriting arrangements.

JLT executive director Drummond Brady said: "We view these types of arrangements as an attempt by brokers to commoditise their offering, to shrink the number of insurers they direct premium towards to better dominate them, and then to automate the broking process … This is not in the clients' or the market's long-term interests."

But the benefits they bring to those taking part are not in doubt. There may be pressure for others to follow suit if they do not want to lag behind rivals.

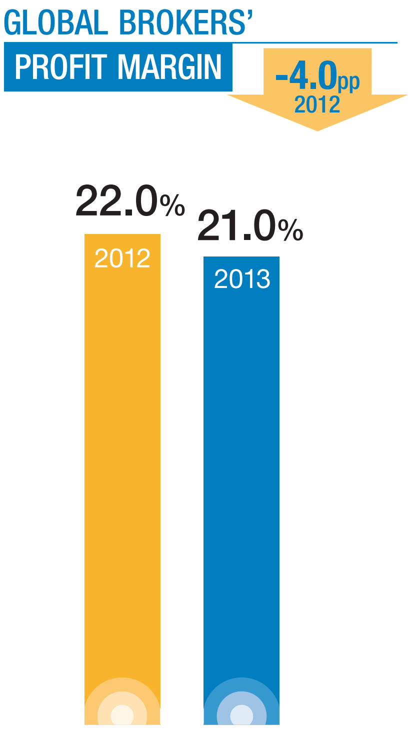
It is not all doom and gloom for the smaller members of the big five, which have grown faster than their larger rivals.

JLT is the smallest broker analysed in this report, but its strategy of acquiring teams rather than companies means it is the only one to have reported organic growth of 6% or more in each of the past five years.

Also, the nature of the economic recovery in the US market is geared towards helping the clients of Arthur J Gallagher and Willis more than the giants that place business with Marsh and Aon, says Keefe, Bruyette & Woods analyst Meyer Shields.

"Their significant focus is on smaller commercial lines where we're seeing a little bit more of a rebound. I think that the external catalyst of the economy provides a bit of a boost to those stocks," he says.

But Newsome thinks the big two will soon be back battling for organic growth as their legacy integration problems begin to fade.



Conclusions

CONCLUSIONS

> 'If companies hold their nerve on pricing, the higher investment returns, coupled with good underwriting profits, should boost overall performance'

Overall
Chief executives and industry commentators have long insisted on the need for greater focus on underwriting profitability, given the meagre investment returns available.

The good news is that almost across the board, the industry has done what it said it would. Most UK general insurers, global groups and Lloyd's insurers alike have boosted operating profit despite, in many cases, precipitous drops in investment income, as rising interest rates have decreased the value of their bond portfolios.

This underwriting profitability will stand companies in good stead for the future. Although rising interest rates have dealt short-term blows to investment returns, they will ultimately bring higher yields. If companies hold their nerve on pricing, the higher investment returns, coupled with good underwriting profits, should boost overall performance.

Brokers have also grown faster than the economies they serve, showing that the efforts to push into new markets and control costs are bearing fruit.

However, there are still plenty of issues to tackle for all the sectors studied.

UK general insurance
Having made a strong start tackling commercial lines underwriting profitability with rate hikes, insurers have to keep on pushing. For example, RSA UK and western Europe chief executive Adrian Brown believes that the industry still needs increases of 10%.

Aviva's £45m commercial motor reserve strengthening underpins the urgency to ensure that pricing is right in this line.

Further progress towards commercial profitability may take the form of rate increases or selective cutbacks in »

MARKET SEGMENTS: UPS AND DOWNS

	COR	OPERATING PROFIT	GWP
UK general insurance	-4.0pp 2012	13.3% 2012	-2.4% 2012
Global insurers	-0.7pp 2012	13.5% 2012	6.0% 2012
Lloyd's insurers	-2.3pp 2012	-0.7% 2012	6.7% 2012

	PROFIT MARGIN	OPERATING PROFIT	ORGANIC GROWTH
Global brokers	-0.4pp 2012	8.9% 2012	-0.2% 2012

CONCLUSIONS

‘The largest broking groups have shown they are capable of growing faster than the economy’

» unprofitable areas. However, both will be difficult as companies need to balance reductions with showing commitment to clients and brokers.

In personal motor, companies will need to keep a watchful eye on claims trends to see if the legal reforms have had the expected effect, and consider adjusting rates accordingly if they have not.

Global groups

Global groups’ rising profits in spite of natural catastrophes and falling investment returns shows they are targeting underwriting profitability.

It also shows they have not been tempted to take more investment risk to offset the poor returns available from their portfolios of invested assets in recent years.

The challenge now will be to ensure that they maintain their pricing discipline as investment returns improve.

The largest groups also need to brace themselves for greater international scrutiny. They are highly familiar with dealing with a variety of regulators around the world, so are unlikely to be fazed by the questions they are asked and the benchmarks they are required to meet. However, they will need to commit additional resources to meet the additional requirements of global systemically important insurers.

Lloyd’s players

Lloyd’s has a strong underwriting record since the introduction of the Franchise Performance Directorate in 2002.

The first half of 2013 did not change this. However, the market is facing an unprecedented new wave of competition from outside. The Aon/ Berkshire Hathaway deal has allowed a company to participate in Lloyd’s business without needing a licence to operate in Lloyd’s.

Although such deals may not be a direct threat to the top players in Lloyd’s, who are unlikely to lose their places on a risk, they could be damaging to the market as a whole. To keep their competitive edge, Lloyd’s companies may want to communicate why they, rather than outsiders, are the ones capable of providing the specialist risk expertise for which Lloyd’s is famous.

Brokers

The largest broking groups have shown they are capable of growing faster than the economy, despite integrating acquisitions, restructuring their operations and, in some cases, fixing underperforming divisions.

The question for them now is whether they can keep this up in the increasingly competitive environment. The smaller brokers in the big five, JLT and Arthur J Gallagher, are growing faster than their larger, slower-moving rivals, either organically in JLT’s case or through acquisition in Gallagher’s.

Also, the bigger players are increasingly butting heads with smaller broking firms. Ambitious brokers Cooper Gay Swett & Crawford and Hyperion, for example, are moving rapidly up the global ranks and making headway in emerging markets.

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