HISCOX

Hiscox Ltd full year results

For the year ended 31 December 2017

"A good result in an historic year for catastrophes"

	2017	2016
Gross premiums written	£2,549.3m	£2,402.6m
Net premiums earned	£1,874.5m	£1,675.0m
Profit before tax	£30.8m	£354.5m
Profit before tax excluding FX	£93.6m	£202.1m
Earnings per share	9.3p	119.8p
Total ordinary dividend per share for year	29.0p	27.5p
Net asset value per share	618.6p	649.9p
Group combined ratio	99.9%	84.2%
Group combined ratio excluding FX	98.8%	90.6%
Return on equity	1.5%	23.0%
Investment return	2.0%	1.9%
Foreign exchange (losses)/gains	£(62.8)m	£152.4m
Reserve releases	£251.5m	£213.0m

Highlights

- Hiscox delivered a profit before tax excluding FX of £93.6 million despite reserving net $225 million for claims in an historic year for natural catastrophes.
- Hiscox Retail now accounts for 56% of the Group's GWP and its profits exceeded £100 million for the second consecutive year. Hiscox USA remains the standout performer with premium growth of 29% in constant currency.
- Hiscox London Market reduced premiums as planned by 20%, and is now set to grow as rates rise following the hurricanes, earthquakes and wildfires in the second half of 2017.
- Hiscox Re & ILS was profitable in a costly year for reinsurers, due to good underwriting on behalf of Hiscox and third-party capital providers. ILS assets under management now at $1.5 billion.

Bronek Masojada, Chief Executive of Hiscox Ltd, commented:

"Our long-held strategy of balance has served us well this year. The strong growth and profits in retail countered the volatility felt in our big-ticket businesses which were impacted by an historic year for natural catatrophes. We have made significant investments in infrastructure and brand both of which will continue. Market pricing has improved and as a consequence we have growth ambitions for every part of our business."

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Notes to editors

About The Hiscox Group

Hiscox is a global specialist insurer, headquartered in Bermuda and listed on the London Stock Exchange (LSE:HSX). Our ambition is to be a respected specialist insurer with a diverse portfolio by product and geography. We believe that building balance between catastrophe-exposed business and less volatile local specialty business gives us opportunities for profitable growth throughout the insurance cycle. It's a long-standing strategy which in 2017 saw the business deliver a profit before tax (excluding foreign exchange) of £93.6 million despite reserving net $225 million for claims in the most costly year ever for natural catastrophes.

The Hiscox Group employs over 2,700 people in 14 countries, and has customers worldwide. Through the retail businesses in the UK, Europe, Asia and the US, we offer a range of specialist insurance for professionals and business customers as well as homeowners. Internationally traded, bigger ticket business and reinsurance is underwritten through Hiscox London Market and Hiscox Re & ILS.

Our values define our business, with a focus on people, quality, courage and excellence in execution. We pride ourselves on being true to our word and our award-winning claims service is testament to that. For more information, visit www.hiscoxgroup.com.

Chairman's statement

Hiscox delivered a profit before tax excluding foreign exchange of £93.6 million (2016: £202.1 million) in the most expensive year for natural catastrophes ever; as hurricanes, earthquakes and wildfires battered insurers' balance sheets. A solid investment return and the balance in our business mix sustained us. Good underwriting and profits from the retail businesses countered the volatility of the big-ticket lines. Our strategy is working.

Our retail businesses had a great year and provided the lion's share of profit at £109.9 million (2016: £158.0 million). Pleasingly, profits from Hiscox Retail have exceeded £100 million for the second consecutive year. Retail is also the current growth engine of the Group at 20.5%, with Hiscox USA the standout performer increasing gross written premiums by 29% in constant currency.

In big-ticket lines, an extended period of benign claims activity and a flood of capacity had diminished margins across the industry and we reduced as planned in Hiscox London Market and Hiscox Re & ILS. However, following the catastrophes in the third quarter, we adjusted course and reworked our business plans to grow as prices rose. On the whole we have achieved good price rises in property, casualty and catastrophe-exposed lines, particularly in loss-affected areas, and it is my opinion that this momentum will continue through 2018.

Our balance sheet remains strong and the options we have mean we are well placed to seize the opportunities that this changing market is bringing.

Financial performance

The result for the year ending 31 December 2017 was a profit before tax excluding foreign exchange of £93.6 million (2016: £202.1 million). Gross written premium increased by 6.1% to £2,549.3 million (2016: £2,402.6 million). The combined ratio was 99.9% (2016: 84.2%). Earnings per share decreased to 9.3p (2016: 119.8p) and the net asset value per share decreased to 618.6p (2016: 649.9p). Return on equity was 1.5% (2016: 23.0%). We made a good investment return of £87.3 million (2016: £74.8 million), before derivatives and fees, which equates to a return of 2.0% (2016: 1.9%) on total assets under management.

I am pleased to announce a final dividend of 19.5p, a step up in the full year ordinary dividend to 29p, which is an increase of 5.5%. The record date for the dividend will be 11 May 2018 and the payment date will be 12 June 2018.

The Board proposes to offer a scrip alternative subject to the terms and conditions of Hiscox Ltd's 2016 Scrip Dividend Scheme. The last date for receipt of scrip elections will be 18 May 2018 and the reference price will be announced on 29 May 2018.

Market

Back in January 2017 we tested the London Market's ability to withstand major catastrophes with an industry-wide 'dry run' exercise, which turned out to be timely. We learnt a number of valuable lessons, and at Hiscox we updated some of our large loss processes, which stood us in good stead for the events of the second half of the year. It is the speed and agility of the London Market to respond to major loss events that makes or breaks its reputation, and regulators are pivotal to that process. We were pleased with the responsiveness of Lloyd's and other regulators.

People

I am also pleased with the progress we have made at Board level in the past three years. In 2017 we saw a number of changes to both the Hiscox Ltd Board and our Executive Committee, and both were boosted by new skills and experience.

Following nine years of service, at which point the UK Corporate Governance Code deems them not independent, Ernst Jansen and Gunnar Stokholm stepped down from the Ltd Board in November. I would like to thank them for their trusted counsel and wisdom which will be sorely missed by the Ltd Board. Our three new Non Executive Directors on the Ltd Board, Michael Goodwin, Thomas Hürlimann and Costas Miranthis, bring impressive insurance industry experience gained across Asia, Europe and Bermuda, which will be valuable to our business.

Our Executive Committee was also strengthened with two new members; Kate Markham, who has moved from our direct to consumer business into Hiscox London Market where she is CEO, and Mike Krefta, who began his career with us in reinsurance operations 15 years ago, and is now CEO of Hiscox Re & ILS. It was especially pleasing to recruit from within for these roles; people build careers here.

It is our people who differentiate us and our focus on building remarkable teams is evident right across the Group. Their enthusiasm, commitment and fearlessness to challenge convention drives us forward and I would like to thank them for their focus and hard work over the year.

Regulatory burden

It's hard not to feel tormented by regulation. On the one hand we were delighted by the response of our regulators to our requests to grow after recent catastrophes. However on the other hand, like many businesses we are working hard to navigate geopolitical issues such as Brexit, US tax reform, General Data Protection Regulation (GDPR) and New York's Cybersecurity regulation. At the same time, insurers are managing the impact of other incoming European regulations such as the Insurance Distribution Directive (IDD). On top of these important and complex customer safeguards, our industry has seen a host of new thematic reviews. I'm all for progress, in fact one of the Hiscox maxims is 'there is always a better way', but implementing these changes in tandem drains resource from the day-to-day endeavours of paying claims, collecting premiums, serving our customers and investing in building our business. I'm sure I am not alone in appealing for some reprieve from the regulatory leapfrog while we deal with so many sizable global issues.

Outlook

The $140 billion of catastrophe losses across the sector led to capital destruction and reserve deficits, and as a result the market is turning. This is not an immediate process; it comes about through each difficult conversation, each new quotation and each renewal. We have been waiting for this, and the good teams we have built and innovative products we have developed mean we are well placed to serve the needs of more customers. Being an underwriter in a changing market brings out the battler in us, and I have been proud of the resolve of our teams.

Our big-ticket businesses have a renewed vigour, and our retail businesses continue to shine. The balanced business we have been building for over 20 years continues to give us options throughout the insurance cycle and there is significant headroom to increase market share across all our retail businesses. We see plenty of opportunity to deliver profitable growth and further value to shareholders.

Robert Childs
26 February 2018

Chief Executive's report

In 2017 the global insurance industry was tested by hurricanes, earthquakes, wildfires and more, and the estimated $140 billion insured loss makes it the most expensive year for natural catastrophes ever. After reserving net $225 million for these events, our profit before tax excluding foreign exchange of £93.6 million (2016: £202.1 million) reflects the robustness of the strategy we have pursued for many years. The steady growth of our retail businesses and their underlying profitability balanced the thunder and lightning of the big-ticket lines.

2017 was another important lesson in the need for flexibility in business, and I have been proud of our resilience. The year turned out to be an historic one for natural catastrophes and it is at times like this that reputations are won or lost. Paying valid claims fast is what our business was built for; if there were no claims, there would be no need for insurance. Our teams around the world have served our customers well.

Looking forward, we have seen rate rises in big-ticket areas, though not as much as we might have liked, but which have allowed us to grow in areas such as flood and property. Our retail businesses will continue on their steady path. Across the business we will invest to modernise our infrastructure and offering for the digital era, continue to build our brand and make sure we adapt to a seemingly never-ending set of regulatory and politically driven changes.

We have a zest for what lies ahead, and see opportunities for profitable growth in each of our business units.

I review each part of our business in turn below.

Hiscox Retail

Hiscox Retail continues to grow in significance and this year generated 56% of the Group's gross written premiums at £1,423.9 million (2016: £1,181.4 million). Comprising of Hiscox UK & Ireland, Hiscox Europe and Hiscox International, it is the single biggest segment in the Group, a strong profit contributor, and differentiates us from our peers. We continue to invest heavily in our brand and our ongoing investment in IT infrastructure in both the UK and USA will support our ambitious growth plans.

Our retail businesses delivered profits of £109.9 million (2016: £158.0 million) and a combined ratio of 94.6% (2016: 88.0%). Growth in the US remains impressive, Hiscox UK & Ireland has done well at the top and bottom line, and Hiscox Europe had its best year ever – despite the distraction of preparing for Brexit.

Small business insurance is now the biggest single product line for the Group, delivering almost £1 billion in gross written premiums, and the profits from Hiscox Retail have exceeded £100 million for the second year in a row.

Hiscox UK & Europe

This division provides commercial insurance for small and medium-sized businesses, typically operating in white-collar industries, and personal lines cover including high-value household, fine art and collectibles, and luxury motor. These products are distributed via brokers, through a growing network of partnerships, and direct to consumers.

Hiscox UK & Ireland

Our most mature retail operation, Hiscox UK & Ireland, increased gross written premiums by 11.6% to £556.3 million (2016: £498.6 million), with every region contributing. The broker channel remains a key driver, with the professional risks and specialty commercial business performing particularly well.

We still have plenty of room for growth in our existing product areas. We have attracted new business with our broadened appetite for larger risks, and have also expanded the range of professions we cover to include milliners and other specialist retailers.

In the high net worth space, we agreed a transfer deal with Aon for its high net worth book of household insurance. In personal lines we also focused on embedding the products we launched in 2016, including our renovations and extensions product and our UK flood product, which have both performed well. We have suffered from an increase in escape of water claims arising from burst pipes, which is a trend affecting the industry. We are working with others to see how we can help policyholders mitigate this risk.

In the direct-to-consumer channel, our investment in IT infrastructure and expanded underwriting appetite for bigger risks are having a positive effect. There is good organic growth in our core direct commercial business, where we are taking on more businesses at the 'medium' end of SME, and in direct home, where we are taking on larger properties. We established a new partnership with Barclays, where we are providing home insurance products to their Premier customers, and are pleased to be the insurance service provider for Plexal, the new technology innovation centre in London's Queen Elizabeth Olympic Park.

The power and distinctiveness of the Hiscox brand is an important driver of our growth. We have seen good improvements in all key brand measures as the long-term benefits of a consistent strategy and ongoing investment continue to pay off. In the UK, we returned to TV with a sponsored ten-part property series on Channel 4, 'Best Laid Plans', to support our renovations and extensions product.

I am pleased to say that the migration of our commercial broker channel business to a new IT platform is complete, with art and private client business scheduled for 2018. The commercial team is already benefiting from improved conversion, pricing and service, and our underwriters now have more time to spend with brokers and work on complex risks. We have also been able to insource our broker channel back-office functions to our shared service centre in Lisbon, which is already delivering benefits in terms of quality and control.

Hiscox Europe

Hiscox Europe had its best year ever in both growth and profitability, delivering gross written premiums of €245.3 million (2016: €218.4 million), up 12.3% in constant currency. All countries contributed to the underwriting performance, with strong new business and retention. Cyber, specialty commercial and management liability products continue to be key drivers of growth and we continue to invest in them.

Germany and Spain performed particularly well. In Germany, a focus on cyber and classic car continues to deliver and the business is achieving impressive 95% retention rates. We also extended our reach with a new sales branch in Frankfurt.

In Spain, we have focused on growing our existing partnerships, through innovation in products and services. We also launched our new cyber product, Cyber Clear, with promising early signs.

Hiscox France returned to growth after a challenging 2016, driven by the professions book and a focus on specialty commercial schemes. New leadership is also having a positive effect. In Benelux, we continue to focus on professionals and specialty commercial business, and to invest in our market-leading cyber offering.

Our mainland Europe business is supported by our shared service centre in Lisbon, where we now have a team of about 230 people. Operations support is mostly integrated with each individual country to ensure as close an alignment as possible, to overcome the tyranny of distance.

Having initiated technology transformation programmes in our retail businesses in the UK and the US, our attention will soon turn to Europe. In 2018 we will begin the planning for this task, with an expectation that this will move to execution in 2019 when the UK programme is largely complete. In the meantime, we are re-launching our broker extranet sites under the rubric 'my Hiscox' with additional products and self-service features to drive sales and service. We have also deployed a state-of-the-art CRM solution across our broker and direct channels, as well as Robotics Process Automation (RPA) to automate back-end processing and even further improve our service levels to brokers and partners.

Hiscox International

This division comprises Hiscox USA, Hiscox Special Risks and DirectAsia. Its revenues grew by 28.8% to £654.3 million (2016: £508.1 million), 28.4% at constant currency.

Hiscox USA

Hiscox USA underwrites small- to mid-market commercial risks through brokers, partnerships and directly to businesses online and over the telephone. The business continues to be a standout performer within the Group, delivering excellent growth of 28.8% in constant currency to $701.6 million (2016: $544.8 million), with all lines contributing. Hiscox USA withstood the impact of the Q3 hurricanes well, testament to the scale and resilience we have built into the business.

Our direct and partnerships division, the fastest-growing segment of Hiscox USA, had another strong year. We expanded our underwriting appetite within partnerships into adjacent small business segments, such as food trucks and insurance agents. Our small business operations continue to go from strength to strength and we now have more than 250,000 policies in force.

Growth in our broker channel business was driven predominantly by professional risks and general liability, where we are seeing continued success in selling it both as a stand-alone product and as additional cover to existing clients. New market participants in cyber have led to increased competition and some downward pressure on pricing, but we are staying relevant through our products and our expertise. We have walked away from unprofitable business in our programmes book, and will remain opportunistic when it comes to new business. Our entertainment business is now established and achieving scale, and our directors and officers' line has benefited from a sharper focus on the most promising industries and geographies.

We remain a small player in the US insurance market, and the opportunity is substantial. Our US team has done extremely well to build a lead in the small business segment, particularly online, and has established strong partnerships. Competition is increasing, but we will be relentless in our investment in the brand, our systems, products and teams.

The IT infrastructure project we are undertaking to replace the existing policy and claims administration system is progressing well, and our direct operations will be the first to benefit from it. Much like the IT projects we have completed in our UK business though, these are multi-year programmes that will create some operational stretch for our teams.

Hiscox Special Risks

This business underwrites special risks including kidnap and ransom, fine art and executive security from offices in Cologne, London, Los Angeles, Miami, Munich, New York, Paris and St Peter Port.

The business delivered gross written premiums of $127.3 million (2016: $128.8 million), a decline of 1.2% in constant currency or a small increase of 3.7% in Sterling terms, which is a good result in intensely competitive trading conditions.

The Security Incident Response product we launched at the start of the year in the UK, and have since rolled out to the US, Spain and Japan, differentiates us and is creating a market where none existed previously. It gives us opportunities with a wider range of clients who are focused on broader security issues beyond kidnap exposure, such as criminal threats, workplace violence, corporate espionage and cyber extortion. It also enables us to leverage additional distribution channels such as directors and officers' brokers, and has been very well received so far. We will look at other opportunities to build on this success in 2018.

The Special Risks underwriting centre we established is delivering material benefits to the business by enabling underwriters to spend more time underwriting complex risks and pursuing new business. The operating model is being refined further with a focus on the US and technological innovation, which we expect will provide further benefits.

DirectAsia

DirectAsia is a direct-to-consumer business in Singapore and Thailand that sells predominantly motor insurance. Hiscox acquired the business in April 2014. Its premiums reduced to £11.4 million (2016: £13.0 million), in line with management expectations, following the sale of our business in Hong Kong in 2016. Our Thai business operates as an agency and therefore is not reflected in these figures.

Despite the extremely competitive environment in Singapore the team is attracting new business thanks to ongoing investment in the brand, improving conversion rates in our contact centres and a more targeted approach to pricing. We also extended our distribution in conjunction with a local aggregator, and established new partnerships with a major vehicle inspection centre and with Shell - both of which are already yielding encouraging results. Product innovations including cover for motorcycle delivery riders and NCD60, a rewards system for customers, have also enhanced our proposition.

In Thailand, where we see significant opportunity, we launched a new TV campaign to raise brand awareness among our target customers. We continue to focus on marketing, including a new social media campaign to leverage the fact that Thais are among the biggest Facebook users in the world on a per capita basis.

The incremental gains we are making in this business are as we expected, and positive indicators of the direct and partnership business we are building in Asia.

Hiscox London Market

In a year severely affected by natural catastrophes, it is no surprise that Hiscox London Market, which has a focus on catastrophe-exposed risks, delivered a loss of £36.2 million (2016: profit of £44.0 million), equal to a combined ratio of 111.6%.

The market conditions facing Hiscox London Market have been deteriorating for some time, so in 2017 we shrank our premium by almost £150 million to £581.7 million (2016: £726.0 million). This was not an across the board retreat, but focused on lines like political risks, healthcare and extended warranty / auto physical damage where our results were marginal. We worked hard to hold market share in our core lines including terrorism, household and commercial property binders, and to progress in our investment lines of cyber, US flood, general liability, product recall and cargo. We believe that this discipline is the key to long-term outperformance.

Our original business plan for 2018 was to continue to shrink, but the accumulation of natural catastrophes caused a change of plan. Our revised plan called for an increase of Syndicate 33's capacity from 2017 levels by £450 million to £1.6 billion. Rate increases to date, whilst good for loss-affected lines like US and Caribbean property and elements of casualty, have not been as strong as we anticipated, so we will expand and expect to see Hiscox London Market return to growth, but not by as much as originally expected. We continue to press for rate rises and the underwriting discipline we exert now will flow though to our bottom line over time.

Looking at each business area in turn:

Property
Our property division includes US and international commercial property, power and mining risks, and US catastrophe-exposed personal and small commercial lines traded in the London Market.

The year started in a soft and softening market for our property team, so we reduced our big-ticket property account whilst maintaining our personal and small commercial lines where rates were under less pressure. The losses of the second half are driving up property pricing, particularly in loss-affected accounts, and we expect to grow materially here in 2018.

A new initiative in 2016 and 2017 was our FloodPlus product which is a commercial market alternative to the government-backed National Flood Insurance Program. Our underwriting resolve and risk selection was tested in Hurricane Harvey which caused extensive flooding in Houston. We paid losses, which is after all the product we sell, but we see opportunities ahead. We created a Lloyd's consortium with other leading players and in 2018 the consortium will seek to grow this award-winning product materially.

Marine and energy
Our marine and energy division includes upstream energy, marine and energy liability, cargo and hull risks.

All lines were impacted by an ever-softening market in the first half of the year. Losses from hurricanes Harvey, Irma and Maria affected our hull and cargo accounts in the second half. To date, rate increases in these lines have not been at the level expected, so we will need to remain disciplined.

Marine liability had a good year, with international performing particularly well and rates increasing slightly. We will look to increase our position in this line as the business renews throughout 2018.

Energy lines continue to experience the knock-on effects of oil price depression, and the impact of more capacity than buyers. We continue to seek out opportunities where the terms are attractive.

Casualty
Our casualty division includes our directors and officers', cyber, professional indemnity and general liability lines.

We have reduced in healthcare and miscellaneous professional indemnity, focusing instead on our investment lines of directors and officers', general liability and cyber, where our market-leading teams and products are having a positive effect. Directors and officers' and general liability are seeing a welcome uptick in pricing, and the cyber market continues to grow substantially as global demand increases.

Specialty
This division includes our aviation, contingency, terrorism, personal accident and product recall business. The space business moved into Hiscox MGA over the course of the year, and we stopped writing political risks business during 2017.

The soft market prevailed, particularly in terrorism and personal accident, and we were selective in these lines. Terrorism remains a profitable class of business and our market-leading position continues to stand us in good stead.

Product recall is still a relatively new line of business and there is some overcapacity, but it remains an attractive specialty area where we can add value with niche expertise. Market losses have helped to curtail rate reductions and we have achieved good growth. We agreed to buy the renewal rights to Liberty's London Market product recall book, and we launched an aviation-focused product that has been endorsed by the Aircraft Builders Council as the product recall policy of choice for its members. In 2018, we will focus on increasing our cross-sell opportunities, particularly in marine and energy.

It was another difficult year for aviation, where rates continued to fall, eroding an already non-existent margin. We significantly reduced our exposure to this line during 2017 and in 2018 will withdraw from aviation hull and liability underwriting.

Alternative risk
Last year I said we would materially reduce our involvement with underwriting agency White Oak in 2017, and we kept to this plan – exiting the extended warranty and auto physical damage business. With the benefit of hindsight our expansion into this area was a mistake as we failed to achieve the margins we expected.

We are now focused on portfolio business, where we match our capacity and experience with the expertise of underwriters in niche lines that complement our core appetite.

Hiscox MGA
Hiscox MGA underwrites and distributes products where customers' requirements for capacity exceed Hiscox's own risk appetite, or where the team's distribution focus allows us to access business in local markets around the world. It operates out of London, Paris and Miami.

We focused on four core lines of business in 2017: yachts and mega yachts, South American-focused property facultative reinsurance, space (which moved into the MGA in 2017) and terrorism. The team is steadily developing the business and we think that this will become a material distribution arm for the Group.

Hiscox Re & ILS

Hiscox Re & ILS comprises the Group's reinsurance businesses across the world and ILS activity through our flagship ILS funds. Our strategy of underwriting on behalf of Hiscox and third-party capital, whether they are insurance companies, other syndicates or capital market investors, is working well.

Gross written premiums for Hiscox Re & ILS grew 4.5% in constant currency to $700.2 million (2016: $670.0 million). Net of cessions to supporting capital partners, premiums reduced to $243.6 million (2016: $306.2 million). The business delivered a profit of $25.5 million (2016: $155.9 million) and a 101.3% combined ratio (2016: 53.0%), a good result in the face of challenging trading conditions. We benefited from our non-catastrophe lines, fees on our management of third-party funds and some releases from catastrophes in prior years.

Hiscox Re expanded its product suite in 2017, with new cyber and flood offerings. FloodXtra, a new product developed using detailed topological and weather analytics, allows us to target the deregulating US flood market. We see real opportunity to partner with US personal lines carriers who wish to enter this market. The product has been in development for some time but Q3 weather events have enabled us to generate good early interest. We will continue to focus on these growing lines of business in 2018.

Growth in US catastrophe reinsurance has been especially pleasing, and helped to offset the closure of our healthcare business and reductions in retro and casualty lines, where rates were under more pressure. Property catastrophe reinsurance makes up approximately 60% of gross written premium for Hiscox Re & ILS. The team's gross underwriting performance was exceptional and as a result we were able to retain our quota share support from insurers and syndicates, and to replace those whose appetite changed.

Hiscox Re ILS, our manager of capital market funds which invest in insurance, had a good year. We were able to attract additional qualified investors and entered 2018 with $1.5 billion of assets under management. The professionalism of the team was recognised when they were awarded ILS Fund Manager of the Year at the Reactions London Market Awards 2017.

Catastrophe reinsurance pricing into the key 1 January renewal season saw average prices increase by 9%. There were clear variations within this, with loss-affected accounts seeing larger increases. The increases were less than we had expected and our aggregate book will grow less than initially planned. It is clear though that rate decreases are few and far between, so we think that 2018 will offer a better risk/reward trade-off than 2017.

Growing in non-catastrophe lines will be a focus for 2018, with opportunities in cyber and casualty. The ILS team will also be working with their insurance colleagues to see how we can utilise our access to both capital market investors and primary insurance to create new products and opportunities.

Claims

2017 will be remembered as one of the most costly years in history for natural catastrophes as a result of hurricanes Harvey, Irma, Maria and Nate, Mexico earthquakes and California wildfires. The total cost of these events to the industry is estimated at in excess of $140 billion, and Hiscox established net reserves of $225 million to cover the expected losses from them. We try to take a prudent view when we create these reserves, but as with many matters in insurance, uncertainties remain. The prudence of our team in reserving prior catastrophes and individual claims was demonstrated with the release of £252 million (2016: £213 million) from prior years. Shocks in insurance are normally negative, so it was pleasing to demonstrate past prudence.

In retail lines, claims activity increased to a more normal level after a very benign 2016. In the UK, in line with others in the industry, we faced a veritable epidemic of escape of water claims. It seems that modern plumbing is not as robust as older methods. Across the world we are investing in retail claims capabilities. We received over 74,000 claims notifications (2016: over 63,000) and paid out £294 million (2016: £248 million). This ongoing increase is a welcome by-product of the success of our retail businesses.

Paying claims well is a core part of our value proposition, so we are pleased that our net promoter scores from those who have had claims remain very strong. In 2018 we are developing a claims 2.0 plan to ensure we can scale our claims and move to more digital processes, without losing the personal touch which is so important to our customers who are going through what is often a traumatic experience.

Marketing

At Hiscox we see marketing as a way of amplifying the reputation we get from dealing with each customer and broker in a fair and reliable way. This amplification is not cheap and in 2017 the Group spent £54 million on marketing and brand-building activity (2016: £42 million). Our initiatives include the 'I'mpossible' brand idea which ran on digital, press, event, radio and even 'in elevator' mediums in the USA. Our US brand awareness peaked at 44% during the year (2016: 38%) and our ambition is to reach the 70% we have in the UK. Our new UK brand idea of 'ever onwards' was also launched in the year. This small commercial-focused marketing drove a double-digit increase in premiums.

We continued to activate a range of sponsorship and partnership activity across the Group, predominantly focused on our core interest areas of art, classic cars and technology. We set the marketing and sponsorship budget for the direct and partnership businesses by reference to the acquisition costs in the broker channel for similar products. This means that as these businesses grow, we expect to increase their marketing budgets as well. There are economies of scale, but we believe that at the moment our long-term interests are served by continuing on this path.

IT

We are continuing on our path of replacing all our core retail systems. In 2017 our UK broker channel moved to the new system and in 2018 we expect the high net worth business to follow suit. The new system is allowing greater automation of the underwriting process, with attendant efficiency gains whose benefit will begin to be seen in 2018. We expect the programme to wind down in 2019 at which time core members of the team will switch focus to Hiscox Europe.

In 2017 Hiscox USA began the preparatory phase of its system replacement, entering phase one in 2018. We now have over 250,000 small commercial customers so the move to a more robust and digital friendly platform is well timed.

As if all of these core systems replacements were not enough, we are also readying Hiscox for the implementation of the General Data Protection Regulation (GDPR), the New York Insurance Department's new cyber regulations, achieving the UK's cyber essentials plus standard across the Group, adapting our systems to Brexit and supporting a finance transformation process. Like all businesses today Hiscox cannot trade and grow profitably without robust modern infrastructure, so we are committed to completing these programmes and other linked initiatives even though, as previously stated, they are increasing our expense ratio by 1% in the short term.

Investments

The main objectives of our investment portfolio, those of providing the liquidity to pay claims and capital to support the underwriting business, have come to the fore this year. Having a conservative approach has ensured that both these aims have been comfortably met. However, whilst we have steered a pretty steady course with the portfolio since the financial crisis, accepting the low returns that have been available in the safer part of the bond markets, we were always prepared to take some risk mostly through an allocation to equities. Following this strategy our investments in 2017, before derivatives and fees, made £87.3 million (2016: £74.8 million) equating to a return of 2.0% (2016: 1.9%). Conventional wisdom always had it that a negative environment for bonds would be positive for equities and vice versa. This correlation held true last year. With our major government bond benchmarks producing negative or very low returns the contribution from fixed income was predictably unexciting. However, a strong year for equities saw our modest allocation to risk assets provide a significant portion of our overall investment performance. This is a good result that exceeded our expectations.

The recovery from the crisis has taken much longer than we expected but it does seem that 2017 may prove to be a turning point and that a return to a more normal level of interest rates has started. Our bond portfolios have been positioned accordingly and whilst those in Sterling and Euros start from very low levels, we are investing our US Dollar cash flow at much higher yields than we have been used to for some time. Portfolios such as ours will be beneficiaries if interest rates move higher in 2018 as we expect. The so-called risk-free returns that we enjoyed pre-crisis are still some way away but at least we are taking steps in the right direction. In the meantime we continue to resist the temptation to take more risk and lower the quality of the portfolio.

Capital and external environment

Hiscox's capital requirement is driven by a mixture of the level needed to provide the required security to our customers and brokers, the expectations of regulators around the world and political decisions in the countries in which we operate. Over the past two years these factors have conspired to drive an atomisation of our capital, resulting in a consequent reduction of diversification and increased capital needs and cost. These trends look likely to continue into 2018.

The first driver of atomisation and increased cost is Brexit. We continue to assume that freedom of services will not last beyond Brexit date, and were pleased that in January Luxembourg's Commissariat aux Assurances approved a licence for Hiscox S.A., our new EU-27 insurance company. We have begun preparations for a Part VII transfer of relevant policies and their associated liabilities to this new entity. We aim to have completed this by December 2018 to provide continuity of cover to our clients across Europe. This adaptation to Brexit will cost Hiscox approximately £12.5 million in one-off cost, and an expected ongoing €2 million per annum. It will also lead to a temporary increase in required capital of approximately £50 million, with only 75% of this moderating over time, due to the loss of diversification in our capital base.

The second driver of atomisation is the USA's recent Base Erosion Anti-Abuse Tax (BEAT). The headline of this new law is tax, but the bigger implication is the difficulty Hiscox, and all other insurers not headquartered in the US, will have in diversifying US risk with UK, European and Asian risks. This leads to higher US capital requirements, and a longer term likely increase in cost to consumers. Hiscox will experience an increased US capital requirement of $75 million as a result of BEAT. In addition Hiscox has written down its deferred tax asset by net $4 million.

The third driver of capital is our collective regulators. The financial crisis of 2008/09 continues to cast a long shadow, so each stress test or model improvement seems to result in a small incremental increase in regulatory capital requirement. There is little incentive for a regulator to say 'we feel you are more than adequately capitalised'.

The final driver is the rating agencies. Hiscox is often referred to as a Lloyd's business, which is a fair reflection of where we came from, but not of the shape of our business today. Rating agencies looked at us in the same category as pure catastrophe writers, not giving credit to the benefits of diversification that our now substantial retail business brings. I am pleased to report that in 2017 S&P had a fresh look at Hiscox and moved us from a high risk category to a medium risk category. I hope that they, and the other rating agencies, feel their judgement is vindicated with Hiscox being profitable in a year of $140 billion of catastrophe losses. This was a great piece of work by our capital team using our new capital model, and results in a lower capital requirement for an unchanged rating.

Most of these influencers on capital levels are not unique to Hiscox as they affect all firms. In the short term the gradual ratcheting up of capital requirements depresses returns, but as economic forces work through it is inevitable that consumers' costs will increase. That may be a price worth paying for ever greater protection of the government and the taxpayer. At the macro level the taxpayer and consumer are the same person, so I hope that higher costs do not lead to lower insurance penetration, thereby causing other problems for the government and taxpayer.

It is testament to the strength and flexibility of our business that Hiscox is capable of paying the losses from the 2017 hurricanes, of providing the incremental capital driven by political decisions, and funding the planned increases in underwriting all from our own resources. In 2018 we will continue to review our capital and funding strategy to ensure we retain significant financial flexibility to react, adapt and take advantage of opportunities that arise from changing conditions.

Change in reporting currency

As previously announced, the functional currency of some of our subsidiaries including Syndicate 33 and the reporting currency of the Group will change to US Dollars effective 1 January 2018. This change will significantly reduce the volatility of the Group's earnings due to foreign exchange movements, in particular due to translation of foreign currency balances. We will report to the market on this new basis when disclosing the Q1 Interim

Management Statement in May 2018, and ahead of our interim results we will publish comparative restated data for our final and interim results of 2017.

Evolution of leadership

It is a common market misconception that the structure and leadership of Hiscox is unchanging. This is not the case. We seek to have a steady evolution of our structure and leadership as we look to marry personal plans with what is needed to achieve our ambitions.

This year our organisation's structure has evolved, some of our pioneers are departing and we have filled their roles and created new roles with a mix of internal talent and judicious external recruitment.

Our retail businesses now account for 56% of our income and, as this year's results have shown, are substantial contributors to our profits and bring welcome resilience to our balance sheet. Reflecting this, and recognising their common challenges of creating a compelling customer experience, driving product innovation, creating scale and leveraging expenses and digitising for the modern age, we appointed Ben Walter, CEO Hiscox USA to the newly created role of CEO Hiscox Global Retail. Ben will relocate to the UK in July and Hiscox UK & Ireland, Hiscox Europe, Hiscox USA and Hiscox Special Risks will report to him. He will work alongside Joanne Musselle, Chief Underwriter of Hiscox UK who was promoted to the newly created role of Chief Underwriter, Hiscox Global Retail in January. Together they will work to drive forward our retail businesses across the world.

The next phase of growth for our US businesses will depend on how we build our presence and brand in the US market, which is why Steve Langan, CEO of Hiscox UK & Europe, and Chief Marketing Officer for the Group will this year move to take up the role of CEO Hiscox USA, whilst retaining his Group marketing role. Our ambition is to build a brand equal in presence to what Hiscox has achieved in the UK, and with Steve's background in consumer marketing and his experience of leading the creation of our UK brand, he is the best person to lead us to achieving this ambition.

We welcomed two new appointments to the Executive Committee, and it was pleasing to recruit from within for these roles. Mike Krefta joined the Executive Committee in September on his promotion to Hiscox Re & ILS CEO, and Kate Markham, UK Head of Direct, followed suit in November on her appointment to the newly created role of Hiscox London Market CEO. Mike and Kate both bring fresh thinking and technical and consumer expertise to the Executive Committee. Jeremy Pinchin returned to the UK from Bermuda, relinquishing his roles as the founding CEO of Hiscox Re & ILS and Group Company Secretary to focus on his roles of Group Claims Director and Executive Committee member. He has also taken on chairmanship of the Hiscox pension scheme and Hiscox Special Risks. During his time in Bermuda Jeremy brought together our London and Bermuda reinsurance teams, drove the creation of our ILS business and established Hiscox Re & ILS as an innovative force in the reinsurance industry.

Some Hiscox pioneers have left the business. After 23 years of service to Hiscox, Steve Camm, Hiscox Special Risks CUO, retired. Steve established our Guernsey operations in 1998, beginning with just one colleague in a basement office, growing it to the centre of our Special Risks operation. He was relentless in his pursuit of a retail approach to our kidnap and ransom underwriting in the face of strong market opposition. We will continue to benefit from his experience as a Non Executive Director to Hiscox Special Risks. Kevin Henry, who has been underwriting kidnap and ransom risks with Hiscox for nine years, has stepped into his shoes.

David Astor has spent 15 years as our Chief Investment Officer and is retiring in March 2018. David's steady nerve during the financial crisis helped us navigate turbulent markets and a low interest rate environment. His measured insight and expertise, dry humour and understatement will be missed. Alex Veys joined Hiscox in December as the new CIO for the Group. Alex brings a wealth of experience in managing large and complex asset management portfolios from 30 years in investment management.

Just as Hiscox grows and evolves, so do our people and our achievements this year are down to their combined efforts. I would like to thank all 2,700 of my colleagues for their endeavours throughout the year. They have delivered in challenging circumstances and their collective desire to go the extra mile is what drives Hiscox forward.

Outlook

2017 was a challenge for Hiscox and the industry. Our balance, in product and geography, has benefited our policyholders and our shareholders. As we look forward this diversity, from direct-to-consumer products, to big-ticket and reinsurance lines as well as insurance-linked strategies, gives us the kind of options that we didn't have even ten years ago.

We have growth ambitions for all our business units, but will remain disciplined if prices are inadequate, as demonstrated by the reductions in Hiscox London Market in 2017. We continue to see great opportunities in retail, and our big-ticket businesses are expected to return to growth as they benefit from the current waves of market dislocation and improvement in the pricing environment. It is now more evident than ever that the balanced business we have been building for the last 20 years continues to give us opportunities throughout the insurance cycle.

The business continues to work on major projects; some we have chosen such as the IT infrastructure upgrades, but others, such as Brexit, GDPR, IDD and new US cyber security regulations are driven by external forces. The aggregation of these projects is placing significant demands on the business but they are all necessary. I hope that 2018 will see these reach a crescendo which will subside in subsequent years.

Our investments in people, products, infrastructure and brand make a difference. We will continue to leverage the opportunities that come with a changing market and to serve more customers.

Bronek Masojada
26 February 2018