Chief executive's statement

Achieving profitable growth while supporting our insureds is key to Beazley maintaining its long term value

Andrew Horton
Chief executive officer

Beazley delivered strong premium growth in 2018, with gross premiums written rising 12% to $2,615.3m (2017: $2,343.8m). Profit before income tax declined by 55% to $76.4m (2017: $168.0m) due to a decline in investment returns. Our combined ratio stood at 98% (2017: 99%) and was affected by severe natural catastrophe claims again in 2018.

In November, we estimated the combined cost of two US hurricanes, Florence and Michael, and two Japanese typhoons, Jebi and Trami, at $105m net of reinsurance and reinstatement premiums. As the year drew to a close, we sustained an additional $40m of claims net of reinsurance for the wildfires that blazed with unprecedented ferocity in northern California. The previous year's exceptionally heavy catastrophe losses had already depleted our catastrophe reserves with the outcome that prior year reserve releases for the group as a whole in 2018 fell to $115.0m (2017: $203.9m).

We are in business to pay claims and the long term value of the company depends on the claims service we provide, which supports strong, enduring relationships with our clients and brokers. When insurers talk of catastrophe claims, they usually mean claims triggered by events such as storms, earthquakes or wildfires. However for our clients any loss may potentially rank as a catastrophe.

Beazley's claims teams worked tirelessly in 2018 to provide the swift and supportive claims service expected by all of our clients.

We have now seen two years of above average claims for short tail property insurance and reinsurance business, following on from five years of very subdued claims activity. The erosion of premium rates we saw between 2012 and 2016 has, to some extent, been reversed. We hope to build on last year's price increases during 2019. In particular, numerous competitors have curtailed their property underwriting following heavy losses and this withdrawal of capacity should make recent price rises more sustainable.

Growth opportunities

Growth in insurance can be opportunistic – driven by firming premium rates – but it can also be strategic, based on an insurer's position in growth markets. Over time, the latter is more important. Beazley is well positioned in a wide array of growth markets. The cyber insurance market, showing double digit annual growth, is perhaps the most widely discussed. Nevertheless demand is also very strong for the specialty liability products we offer to healthcare providers, technology companies, and property developers confronting environmental liability risks.

Our position in markets such as these has underpinned the strong growth of our US operations in recent years, which continued in 2018. We saw locally underwritten US premiums grow 20% during the year to $1,051.2m (2017: $878.2m), nearly 90% of which is written on behalf of the group (the balance is attributable to the external investors supporting Beazley syndicate 623). Our US business has grown at an average rate of 18% for the past five years and we foresee further double digit growth during 2019.

Developing a strong foothold in new markets often takes time. Our US accident and health business is a case in point. In recent years, the soaring cost of health benefits to US companies has generated strong demand for 'supplemental health' offerings to employees that are either partly funded by employers or wholly funded by employees. This has not historically been a target market for Beazley and it has taken time to develop the relationships needed to win a share of this business. Under the leadership of Brian Thompson, our US team began to gain real traction in this market in 2017 and this continued into 2018, when we wrote $20.6m.

Outside the US, we have also been laying the foundations for long term growth. In 2017, our specialty lines division – Beazley's largest – began a concerted effort to capitalise on the growing demand for specialty liability products that we saw developing outside the US, particularly in continental Europe. We saw opportunities in many of the industries that have also fuelled our US growth, such as healthcare and technology, but we also saw significant growth potential in financial institutions business, which we have not historically underwritten in the US.

As described on page 12 and 13 of this report, we have invested heavily in both people and technology to support the growth of our non-US business, hiring 34 underwriters outside the US in 2018. Although we are a UK-based business, Brexit should not present any insurmountable challenges for Beazley. In July 2017 we secured approval from the Central Bank of Ireland for our Dublin based European insurance company, Beazley Insurance dac, to write insurance business. We are accordingly able to underwrite European business for the account of Beazley Insurance dac – which has branches in Germany, France, Spain and the UK – and for the account of our Lloyd's syndicates through the Lloyd's Brussels office.

New strategic initiatives

Change is gathering pace in our industry, fuelled by new technologies and new data sources. In 2018 we launched a series of strategic initiatives to help Beazley adjust to these changes and benefit from them. Our overarching goal is to make the company an even better business partner to our clients and brokers.

A key objective of these initiatives will be to lower, over time, the expense ratios that have proved stubbornly high in our industry. Our value to our clients will dramatically increase if we can pay out less in expenses and more in claims. This in turn will depend on enlisting technology to enhance the productivity of our underwriters and other staff, automating manual processes wherever possible.

Two of our strategic initiatives are tackling this challenge in different ways. Our Beazley Digital initiative focuses on small, relatively simple business, where we see significant scope for automation. Our Faster, Smarter Underwriting initiative is tackling the larger, more complex risks that are the historic mainstay of Beazley's business. We see some opportunities for automation here too, but there is also scope for enlisting new data sources to help us underwrite risks that were previously very hard to price or even deemed uninsurable.

The value we offer to clients depends of course on our underwriting appetite and the claims service that we provide. However it also depends on how easy it is to do business with us. To improve our overall service we need to stand in our clients' shoes and this is the focus of a third strategic initiative we are calling Closer to the Client. In parallel with this, we have been working hard to simplify our policies – a drive epitomised in April 2018 by the launch of a digital version of our WeatherGuard policy that dramatically simplifies weather-related cover for event organisers.

Finally, as a London-based insurer our success is in many respects bound up with the broader success – and particularly the efficiency – of the London insurance market. Last April I was delighted to be invited to chair the London Market Group (LMG), a body that represents all of the market's businesses. At Beazley our London Market strategic initiative was launched during 2018 to ensure that we benefit to the fullest possible extent from the work that the LMG is doing to modernise and promote the London market.

Chief executive's statement *continued*

Executive changes

Succession planning is something we take very seriously at Beazley at all levels in the organisation. Some of our plans are currently being executed: we welcomed four new members to the executive committee in 2018 and a further four will join during 2019. I am delighted that more than half of our recent senior appointments are internal promotions, including all of those to senior underwriting roles.

At the beginning of 2019, Adrian Cox succeeded Neil Maidment as Beazley's chief underwriting officer. Adrian is exceptionally well qualified to assume the role, having run our largest division, specialty lines, since 2008. From the beginning of 2019, we have split this division – which accounted for 56% of our total premiums in 2018 – into two. The new divisions are headed by seasoned Beazley underwriters: one, under the leadership of James Eaton, will continue to be called specialty lines, while the other, under the leadership of Mike Donovan, has been named cyber & executive risk (CyEx).

It is difficult to do justice to the contribution that Neil has made to Beazley. He has overseen the development of one of the best performing underwriting portfolios in the market. He also helped us to shape our business model and brand, and to maintain an open and inclusive culture as the company has grown. We wish him well in all his future endeavours.

In November 2018, Tim Turner succeeded Clive Washbourn as head of Beazley's marine division. Tim joined Beazley in 1998 when the marine division was established and has for several years headed the marine, hull and war risk account within the division. He has represented the marine division on Beazley's underwriting committee since 2016. Clive took the decision to step down for personal reasons. We are however delighted that he has expressed his willingness to continue to offer the team the benefit of his expertise in underwriting and business development.

Mark Bernacki, who joined Beazley in 2005 and has led our property division since 2012, will also be leaving during 2019 and there will be an announcement about his successor as head of property in due course.

Jerry Sullivan, who leads our professions group within specialty lines, is one of the four individuals joining the executive committee during 2019 replacing Mark as the chairman of our US management committee.

Two other key appointments have ensued from the planned retirements of Martin Bride, our finance director, and Dan Jones, who heads our marketing and broker relations functions, in 2019. Martin will be succeeded by Sally Lake in May 2019. Sally has been with Beazley since 2006 in various roles and is the current group actuary. In late 2018, Lou Ann Layton joined us from Marsh as Dan's successor. Prior to joining Beazley Lou Ann held a series of senior positions at Marsh in the US, most recently as head of the south east region.

Investment performance

Beazley's investment returns fell to $41.1m or 0.8% in 2018 (2017: $138.3m, or 2.9%), mainly due to a series of interest rate hikes in the US that only generated a modest return for our fixed income portfolio, which accounted for 81% (2017: 76%) of our total investments at year end. A higher US dollar interest rate does, however, mean that the longer term outlook for these investments is more positive than it has been for a number of years.

Our capital growth investments, accounting for 12% of our portfolio at year end (2017: 15%), suffered from the very adverse market conditions that affected many asset classes, generating a loss of 1% (2017: return of 11%). This performance could have been materially worse had our investment team, led by Stuart Simpson, not prudently reduced our exposure to equities part way through the year.

Beazley maintains a conservative investment strategy which has served us well over the years. Nevertheless with financial assets of more than $5.1bn, it is clear that sharp gyrations in asset values can significantly affect the company's overall performance. In 2018, the 70% decline in our investment return was equivalent in effect to a large catastrophe loss on our underwriting portfolio.

Risk management

Risk management continued to be an invaluable part of our business model and the team, led by Andrew Pryde, undertook a number of special assignments in 2018. In light of the impending Brexit deadline, Beazley implemented a cross business working group to discuss and work through the various possible outcomes ahead of March 2019. At the time of writing, many outcomes still remain on the table but we believe we are well placed to navigate through the uncertainties.

With changes to corporate taxation arising within the US, Beazley also revisited and amended its intragroup reinsurance contracts to ensure that they continued to be as efficient as possible in providing the desired effect on capital allocation and risk management.

The latest chief risk officer report to the board confirmed that the control environment has not identified any significant failings or weaknesses in key processes and that Beazley is operating within risk appetite as at 31 December 2018.

Outlook

Our business confronted some stiff headwinds in 2018, which impacted both our underwriting and investment returns. By contrast, we enter 2019 with some moderate tailwinds: firmer pricing for some lines of business and higher interest rates to underpin our investment returns. However the world remains a very uncertain place, with political risk – the kind that none of us can insure against – threatening global growth through trade wars and protectionism.

In this environment our focus will continue to be on the determinants of growth that we can control, investing in our people, our systems, and in our offices around the world. Emblematic of these investments is our new Birmingham office which opened in February 2018: the first of many new and remodelled offices around the world designed to accommodate the varied workplace needs of our people in the years to come. In 2020, Beazley's London staff will move into similar, futuristic office space at Twentytwo Bishopsgate in the City of London and our New York and Toronto colleagues are already ahead of us in the queue.

It is perhaps fitting that our new Birmingham office houses our robotics team, whose work will free up many of our people's time from repetitive tasks. Our watchword, reflected in the design of our new offices, is flexibility. Beazley has thrived as a specialist insurer by being quicker than competitors to spot opportunities and more decisive in grasping them. The investments we have been making and the strategic initiatives we launched last year are designed to ensure that we can maintain this competitive edge in the years to come.

Andrew Horton
Chief executive