The **co-operative** insurance

2015 Investor Relations Pack



Contents

Section 1: Key Messages

Key Messages

The primary objectives for Co-op Insurance during 2015 were:

a. **Raise Tier 2 subordinated debt**

b. **Sign the Managed Service Agreement with IBM to deliver Transformation**

c. **Deliver the financial plan and balanced scorecard metrics**

d. **Complete Board and Executive appointments and committee structures**

Each primary objective has been delivered. The business is therefore well positioned to progress with the delivery of our strategy, anchored by the Transformation Programme in order to support the Group's vision of "championing a better way of doing business for you and your communities."

"championing a better way of doing business for you and your communities"

Section 2: Financial Results

Financial Results

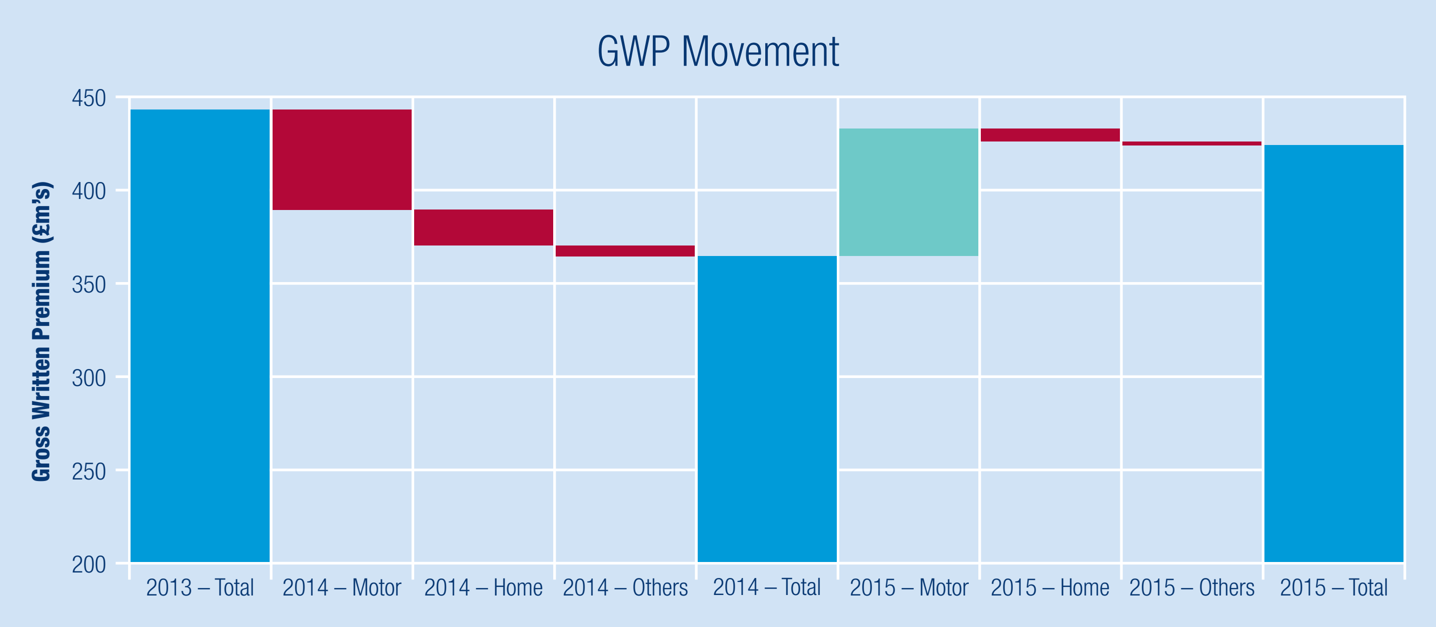
Underlying performance in line with expectations, impacted by severe weather claims and the strengthening of Liability reserves on the legacy book.

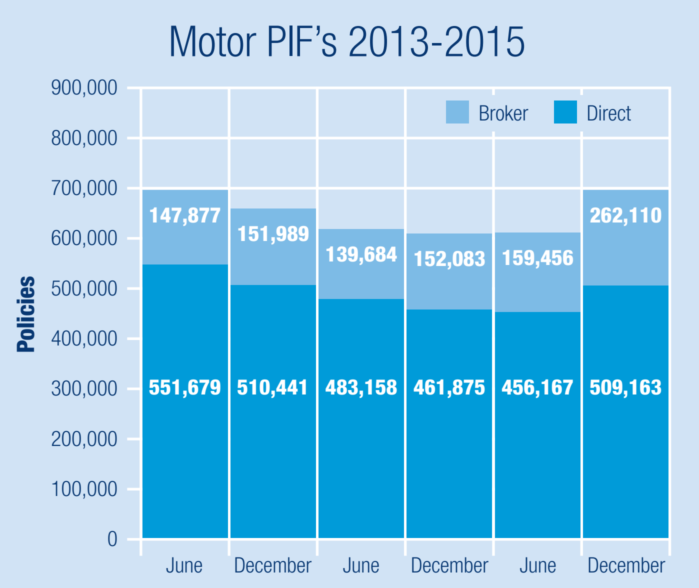
1. Whilst Net Earned Premiums fell by 7%, reflecting the strategic decision in 2014 to withdraw from less profitable business sectors, Gross Written Premium (GWP) increased by £59.1m (16%) to £424.3m. This was mainly as a result of market hardening, and an increase in new business in Motor during Q4 2015.
2. Underwriting Loss of £31.3m, including £5.6m of Employer Liability reserve strengthening, £13.2m of severe weather claims and the release of £10m Unexpired Risk Reserve.
3. Investment Return down from £23.6m to £18.2m, reflecting the yields currently available and a revised Board risk appetite adopted in the year.
4. Operating Loss of £66.1m includes the impact of £47.4m of Transformation spend. 2014 included a £5.7m impairment relating to legacy IT assets.

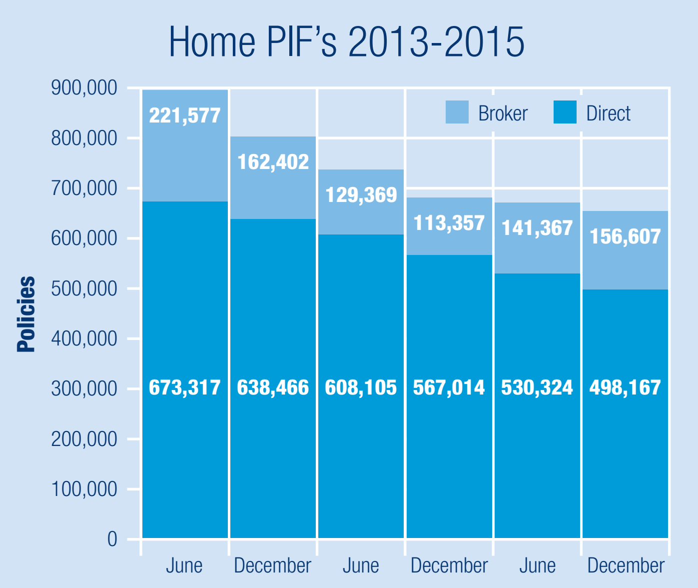
	FY 2015 £m	FY 2014 £m
Gross Written Premiums	424.3	365.2
Net Earned Premiums	345.2	372.6
Underwriting Result	(31.3)	(21.5)
Underwriting Result excluding Exceptions	(22.5)	(12.9)
Investment Return	18.2	23.6
Technical Result before Debt	(13.1)	2.1
Interest on Sub-ordinated Debt	(5.6)	(3.4)
Technical Result after Debt	(18.7)	(0.8)
Significant Items	(47.4)	(5.7)
Operating Result before Tax	(66.1)	(6.8)
Combined Operating Ratio	122.5%	105.4%
UNDERWRITING RESULT BY SEGMENT		
Motor	(28.0)	(34.1)
Home	1.8	21.0
Other	(5.2)	(8.4)

Note: Investment Return includes Investment Income and Profit Realised on Disposals of Investments.

GWP and Policies In Force (PIF) have grown year on year, reflecting our investment in pricing and distribution capabilities.

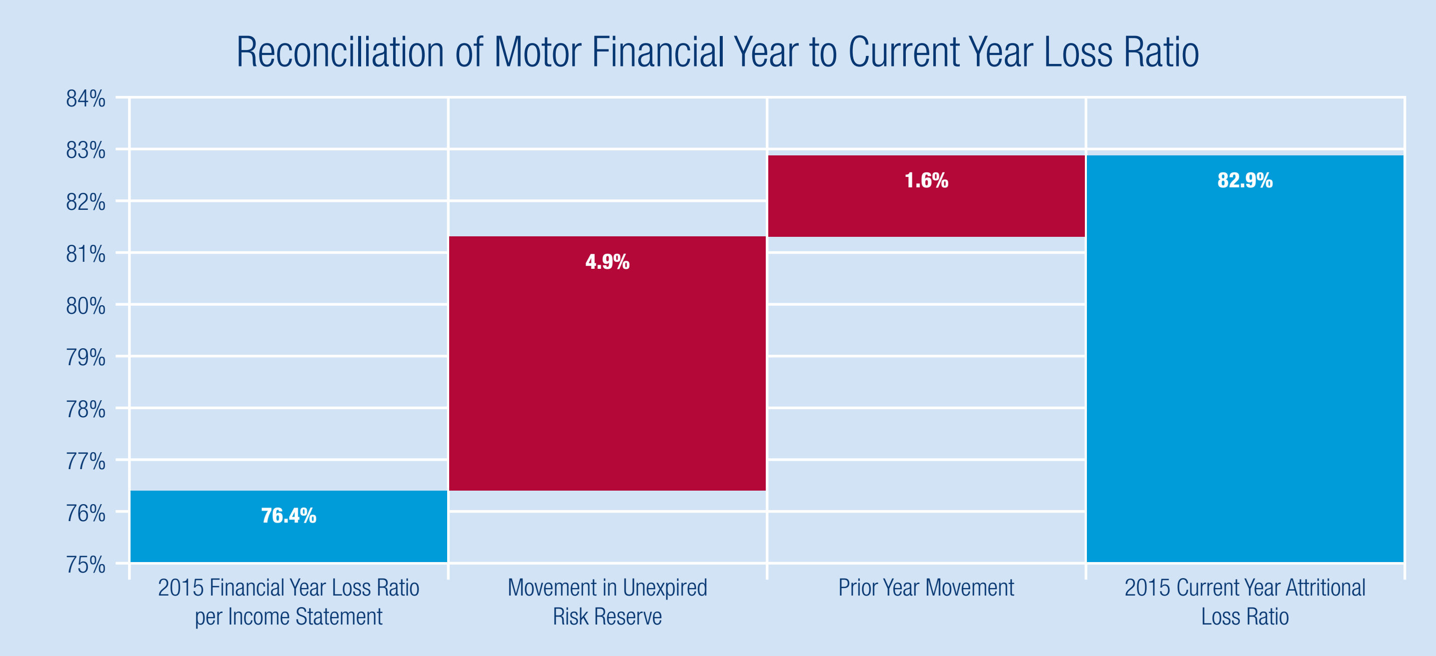






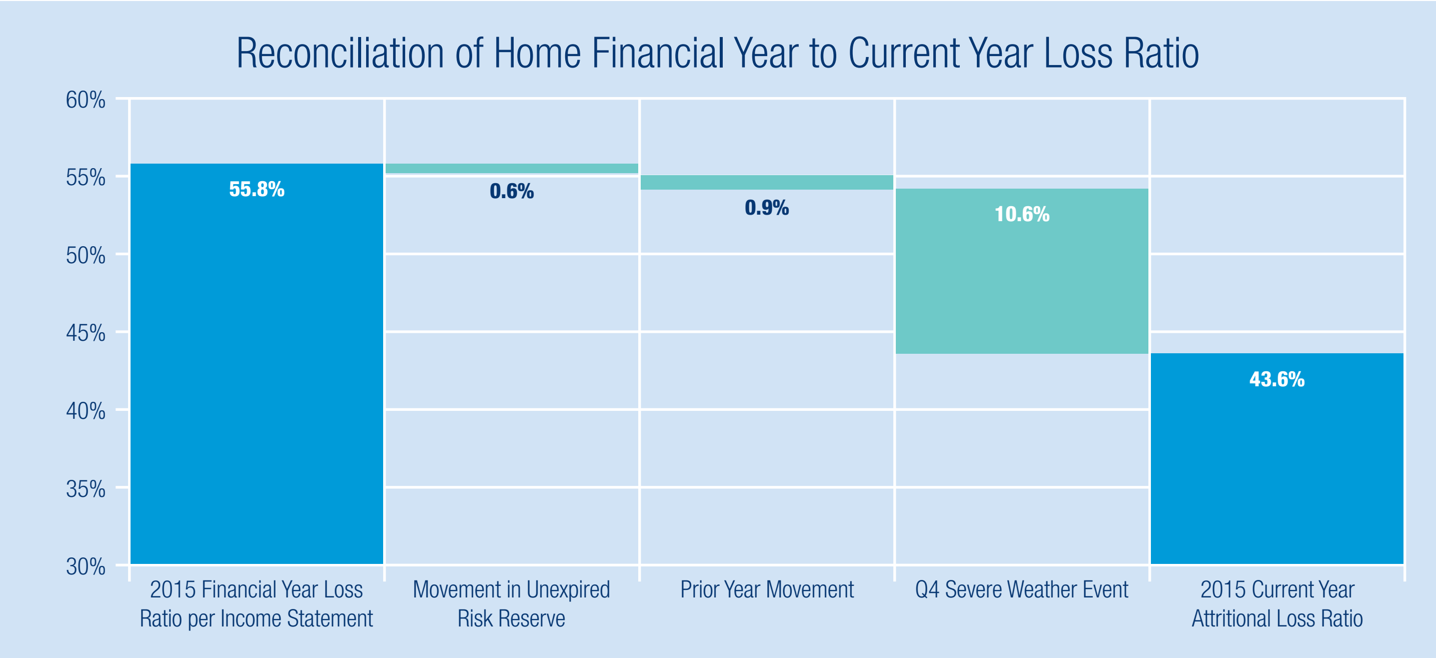
- GWP reduced between 2013 and 2014, reflecting a managed reduction in the size of the book, as we chose to exit less profitable business sectors and those that did not fit our risk appetite.
- The growth in GWP between 2014 and 2015 is largely on the Motor book in H2. New pricing capabilities were implemented in the Aggregator and Broker channels in H2. We have focussed on strengthening pricing capability, including acquiring new sources of data and began to deploy this in H2, initially focussed on the Aggregator and Broker channels. This has increased our competitiveness, leading to volume growth. In addition, Motor market rates hardened, which we responded to, resulting in average premium growth.

Motor performance is improving, reflecting our investments in pricing and distribution capabilities, with Prior Year and Technical Provision Releases providing marginal benefit to the Full Year Result.



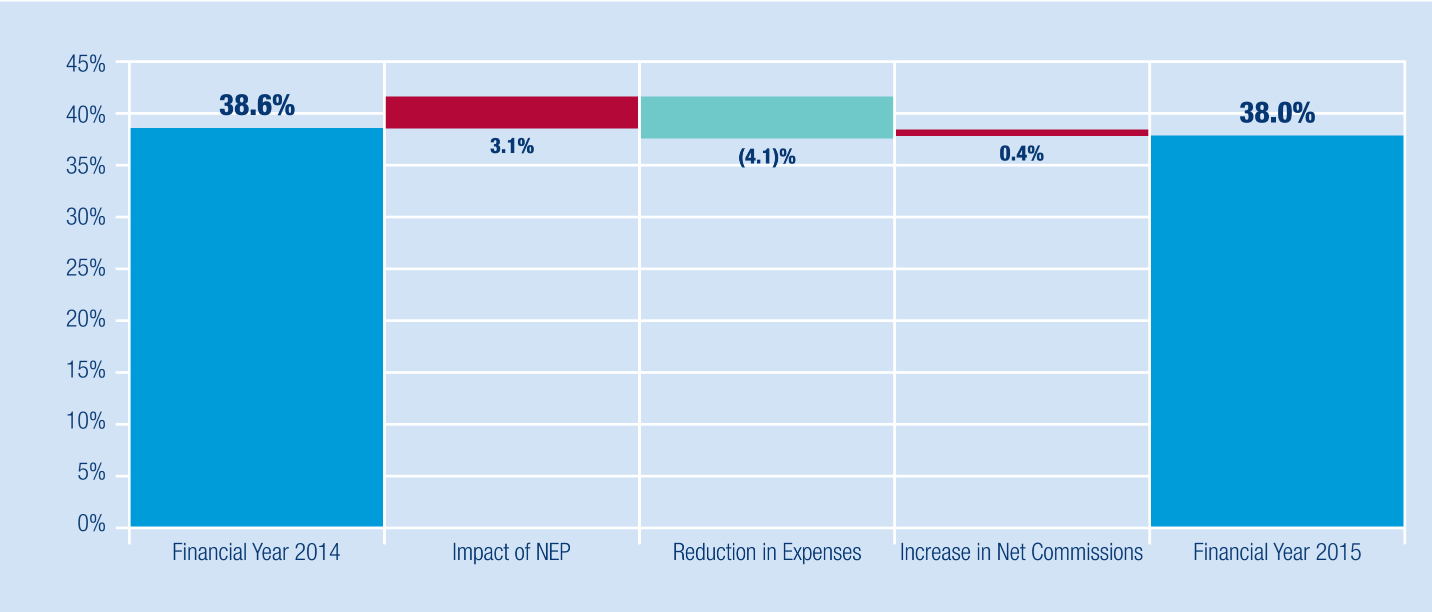
- £10.8m of Unexpired Risk Reserve was released, benefiting the Financial Year Loss Ratio. Since this relates to policies written in prior years, it is excluded from the Current Year Loss Ratio. The net impact of Prior Year Reserve Releases is small, at £3.8m, evidencing a relatively small impact on 2015 Financial Year performance.
- In line with market experience, claims inflation increased in H2 on bent metal claims on our policyholders' and 3rd parties' vehicles. Whilst increases on our policyholders' claim costs were expected due to changes in the vehicle mix being underwritten, there have also been adverse behaviours deployed by 3rd party insurers seeking to maximise subrogated costs. Changes to our operating models are in progress, with the ultimate aim of driving bilateral agreements and thereby mitigating 3rd party claim cost inflation.

The Home book was profitable, despite the impact of severe weather. Investment in pricing capabilities and proposition development will mitigate the managed decline in the legacy portfolio.



- The severe weather in Q4 2015 resulted in an expected net claims cost of £13.2m above seasonal expectations. This assumes a level of reinsurance recovery. There was a small increase in Prior Year reserves, though this impacts the Financial Year Loss Ratio by less than 1%.
- The creation of the Unexpired Risk Reserve of £0.8m is a result of our pre-Transformation expense base and the reduced account size.
- The competitive landscape is characterised by a soft premium environment.

Operating Costs have been reduced. The dual run of the New Operating Model (NOM) and Current Operating Model (COM) environments will lead to temporary cost increases in 2016.



- The focus on cost management was maintained during 2015, with the commission and expense ratio (excluding transformation costs) reducing from 38.6% to 38.0%.
- Management continued to seek cost efficiencies that can be delivered before Transformation. The focus on one-to-one marketing activity and exiting TV advertising improved marketing efficiencies substantially.
- The costs associated with the implementation of the Transformation Programme are charged to the income statement as incurred, except where licenses or hardware have been acquired directly by Co-op Insurance.
- The increase in Net Commissions is driven by the increase in business written via 3rd Party channels, including Aggregators and Brokers.

Investment Portfolio

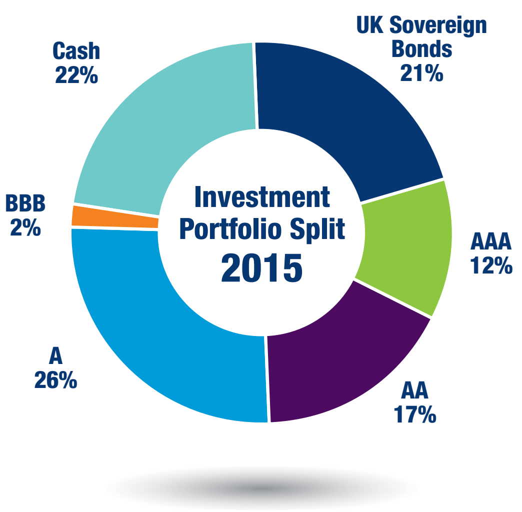
2015 Performance

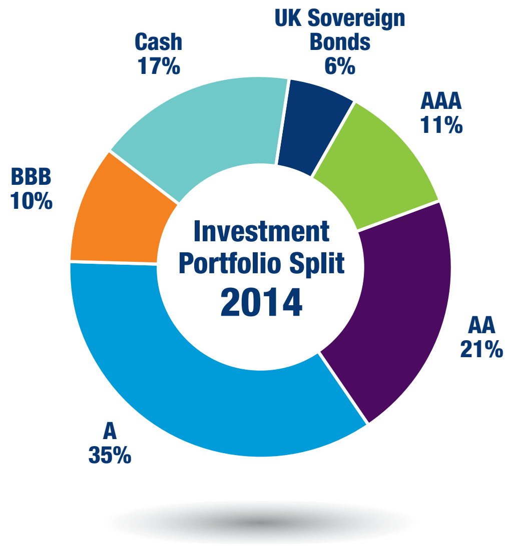
- Overall strengthening of the portfolio.
- UK Sovereign bonds increasing from 8% to 21% of total portfolio.
- Decrease in the level of BBB rated bonds at 10% to 2%.
- Investment income remained at a low level at £15.3m (2014: £20.6m), reflecting the yields currently available in the market. The reduction in 2015 is a reflection of a revised Board Risk Appetite adopted in the year.
- Profit realised on disposals of Investment assets was £2.9m (2014: £3.0m).
- Securities earning a fixed rate of interest totalled £562.6m (2014: £602.9m) with securities earning a variable rate of interest equalling £129.4m (2014: £161.7m).

General

- The portfolio is entirely comprised of UK listed investment grade bonds denominated in sterling.
- All Co-op Insurance proposed investments are screened against the Ethical Policy, and existing investments are reviewed periodically to ensure ongoing compliance in four identified areas: Human Rights, Ecological Impact, International Development and Animal Welfare.

Investment assets by risk rating





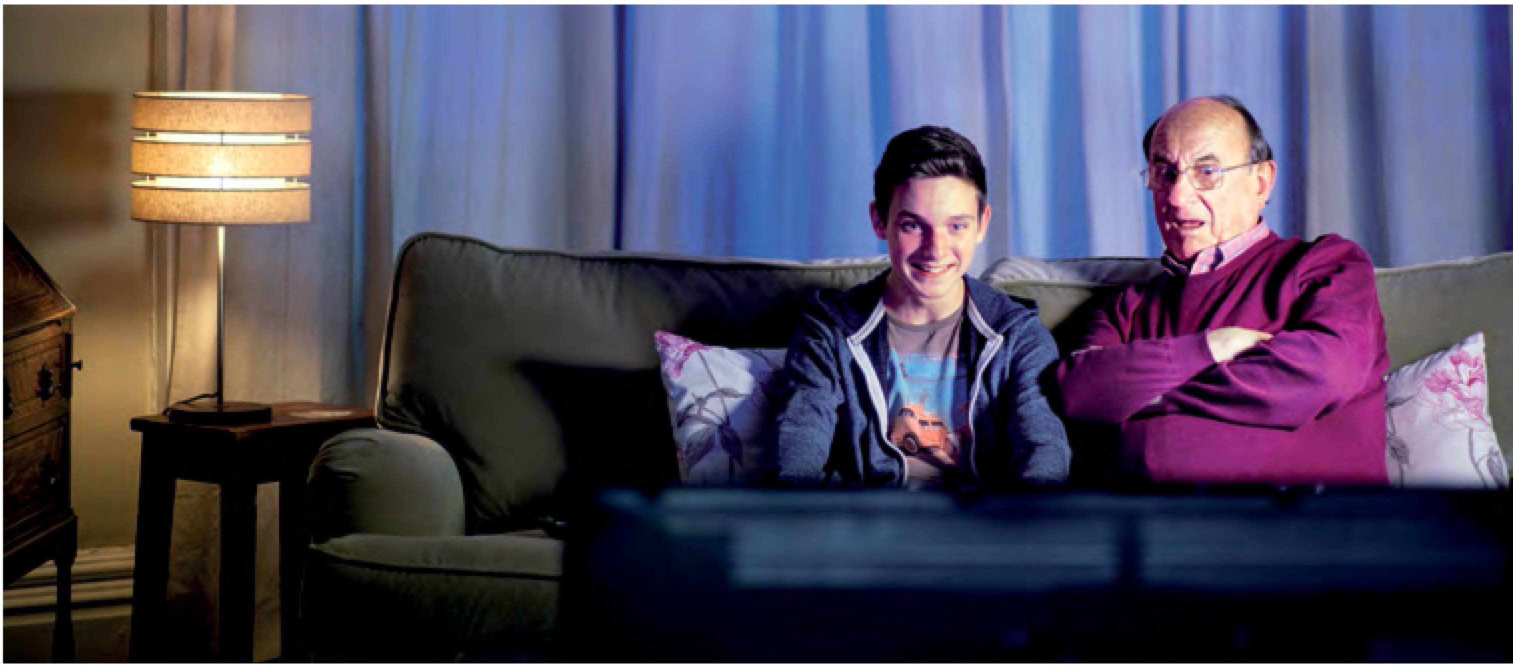
- Cash balances are placed on deposit with approved financial institutions as part of a reverse repo transaction.

The Balance Sheet reflects the growth in the Motor Book in Q4 2015, and the impact on Retained Earnings of our investment in Transformation, off-set by the Subordinated Debt raise.

	YE 2015 £m	YE 2014 £m	Variance £m
Assets			
Tangible & Intangible assets	30.6	22.0	8.6
Reinsurance assets	68.5	71.9	(3.4)
Investments	891.1	920.9	(29.8)
Insurance receivables and other assets	229.4	159.2	70.2
Total assets	**1,219.6**	**1,174.0**	**45.6**
Capital & reserves attributable to equity holders			
Share capital	268.0	268.0	–
Retained earnings	(8.8)	43.0	(51.8)
Other reserves	63.4	70.4	(7.0)
Total equity	**322.6**	**381.4**	**(58.8)**
Liabilities			
Insurance contract liabilities	746.2	737.6	8.6
Borrowed funds	67.7	–	67.7
Reinsurance liabilities	7.4	0.5	6.9
Insurance & other payables	75.7	54.5	21.2
Total liabilities	**897.0**	**792.6**	**104.4**
Total equity & liabilities	**1,219.6**	**1,174.0**	**45.6**

- The success in our main marketing campaign (Great Grocery Giveaway) resulted in us deferring a greater element of the acquisition costs, explaining the £8.6m increase in Intangible Assets.
- The reduction in Investments results from a decrease in debt securities, off-set by an increase in cash. This reflects the changes to the investment mandate in year.
- The growth in Insurance Receivables is a reflection of the increase in GWP in Q4 Motor.
- Borrowed Funds reflects the issue of £70m subordinated debt in year, recorded at amortised cost.
- As a result of an intra Group change in accounting practice, accruals and accounts payable previously accounted for in another Group company (CFSMS) are now fully transferred to Co-op Insurance.

Section 3: Strategy Update



Strategy

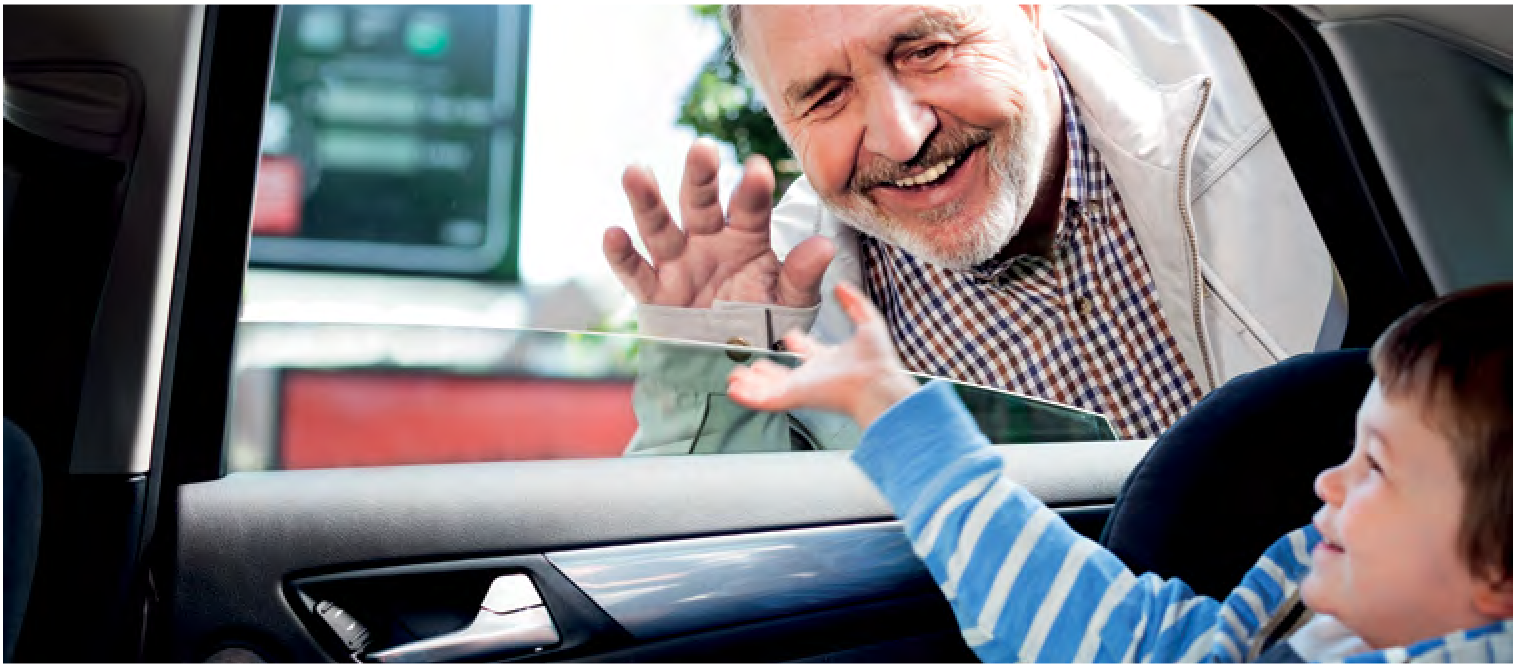
- **The Co-op Group 'Rebuild' Programme progressed throughout 2015. A key element of this programme is 'Transforming General Insurance', which executes the new strategy approved in 2014 and the core focus remains to reduce risk and regulatory capital requirements. The key elements of the strategy to achieve this are:**
  - Focus on existing customers of the Co-op Group;
  - Build strong data and analytical capabilities to utilise and leverage data captured by the Co-op Group for the benefit of our members; and
  - Develop key distribution partnerships.

- **To support the strategy Co-op Insurance intends to leverage three sustainable competitive advantages:**
  - **Brand;** utilising the Co-op brand by building a compelling proposition based around the Group purpose of 'Championing a better way of doing business for you and your communities'. In a market where trust remains an important driver of purchase choice, research has shown that the Co-op brand resonates strongly with consumers in this area.
  - **Unique insight into our members;** Co-op Insurance has unique insight into our members, which allows us to be more engaging, tailor our propositions to be relevant and offer better pricing.
  - **Distribution reach;** active marketing direct to consumers and through other Co-op Group businesses with a focus on members will provide additional opportunities. This will be supported by widening the competitive position and underwriting footprint.

The strategic advantages were validated in our strategic review

Advantage	Validation
Brand	• Trust remains an important component of consumer decision making when purchasing insurance, and the Co-op Insurance brand differentiated in characteristics such as trust, honesty and reliability. • Brand positioning needs to be underpinned by improvement in more rational characteristics, which will be enabled through technology transformation (e.g. quality of service). • 75% of customer enquiries to Co-op insurance not met (due to being uncompetitive or outside of underwriting footprint). Implementation of a panel model, with other underwriters sitting behind the Co-op retail offer, can transform capability to offer competitively priced products to Co-op customers, whilst maintaining a clear Co-op offer.
Unique Insight into our Members	• Validated power of membership data in predicting risk in terms of insight, scalability and sustainability. • Pricing scorecard developed for Motor validating approach to individual member pricing. • Individual member pricing implemented for Motor in 2015. • Marketing strategy re-orientated to focus on 121 engagement with Members, driving response uplift and using value added propositions from across the Group (e.g. Electrical, Food).
Distribution Reach	• Food and other businesses provide a route to improving awareness of Co-op Insurance. Great Grocery Giveaway campaign has validated mutual opportunity for both businesses. • Community is fundamentally aligned with the principle of insurance. There is an opportunity to create disruptive propositions based on the concept of community (e.g. peer to peer insurance) going beyond the traditional value chain (e.g. connecting local businesses in the fulfilment of claims / service needs).

Section 4:
Solvency II and Transformation Execution Update



Solvency II Implementation

- We continued to meet our Regulatory Solvency Requirements as we move to the Solvency II regime.
- The Solvency II regime commenced 1 January 2016. Co-op Insurance is using Standard Formula SCR initially, with the potential to apply for Internal Model Approval in the medium term.
- As at end 2015, Co-op Insurance achieved coverage on a Solvency II basis of 155%.
- The projected solvency levels remain within risk appetite over the life of our planning period, with projected Standard Formula SCR solvency coverage of c. 140% in 2016 and increasing significantly over the following years.

Transformation Programme

- The Transformation Programme aims to deliver a step change in the way Co-op Insurance engages with members and customers, improving experience whilst driving greater efficiency. The Programme to design, configure and implement the new technology solution commenced in 2015. It is planned for all new and renewal business to be written on this technology beginning with home mid-year 2016.
- The new operating model aims to bring expense ratios in line with market levels, provide flexibility to properly utilise the data available from within the Co-operative Group, increase premium and new business volume and enable the planned expansion of distribution partnerships. The key risk to Co-operative Insurance's Transformation Programme is execution risk.

Transformation Programme Progress

- Managed Service Agreement with IBM signed in June 2015 for a ten year Implementation and Run contract.
- Seven months post signing, the Programme has delivered two thirds of the 26 milestones required to deliver to Release 2 (Motor) Go Live.
- We are on track to go live on the core Motor and Home components of our new operating platform in 2016, with ongoing development of new propositions and models to leverage our new capabilities.