Call for Analysts and Investors

Transcript

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Speakers:

CFO Carlos Rodríguez-Ugarte

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Presentation

Beatriz Izard
Head of Investor Relations

Good morning, everybody. My name is Beatriz Izard, I am head of Investor Relations at Linea Directa. We published our 2Q results earlier this morning and I have here with me, our CFO, Carlos Rodriguez Ugarte to present this report.

With this short introduction, over to you Carlos.

Carlos Rodríguez Ugarte
Chief Financial Officer

Thank you Beatriz, and welcome, everybody. I will go straight to page 5.

Linea Directa is today reporting 108.5% combined ratio. We are not where we'd like. Rest assured that we continue to prioritise rate adjustments and we have the resolute strategy at rebuilding technical margin.

On the positive side, our top line grows with determination and prudence. We currently believe we are taking the appropriate measures to achieve both growth and profitability, applying rates at the current level of risk.

On the cost side, expense ratio was excellent, with the continuous control of overheads and continuous optimisation of processes.

Solvency ratio was strong at 186%, benefiting from de-risking of our investment portfolio and improved outlook for Motor margins, as reflected in the best estimate for premiums.

Turning to page 7 on the Spanish Motor market. CPI takes a softer line although the outlook for the year stands at 5% nowadays. Premiums confirm its reversal trend, albeit with a clear lag with cost of claims.

Turning to page 8. I would like to address specific components of cost inflation in the Motor line of business. The sharp increases of the last couple of years both in property damage and personal injury have been unprecedented and exponential. Neither customers nor suppliers were able to absorb or pass on these increases in one go. I would like you to bear in mind this slide throughout this presentation.

Turning to page 9. Home sales fall 6.8%. Rising interest rates continue to put pressure on credit dynamics and we should expect this trend to continue in the following quarters. Nevertheless, Home insurance revenues continue to increase at 5.6%.

As with regards the Spanish Health market, turnover for the industry continues to report significant growth at 7.3% yet the inflow of new customers is slowing in response to the economic cycle.

Turning to page 12. The main message here is that recovery will take time, though we are acting with determination. We stick to plan applying rates according to the level of risk given the current environment.

- Expense ratio was excellent at 19.7% at a consolidated level.
- Still, technical result endures persistent costs inflation. Additionally, the provision for claims includes additional prudence in the quarter.
- Financial result was down 7.9%. Recurring earnings though, are up, on the back of higher reinvestment yields. Excluding realised gains financial result would be up 2.6%.
- Result under IFRS 17&9 did not differ much from IFRS 4. To explain the main differences let's move to the next page.

On the left you have the profit and loss account with IFRS 17 format. The right graph shows the walk from IFRS 4 earnings before tax to IFRS 17&9. Main items are:

- The Home liability for incurred claims, with chain ladder methodology as opposed to the case reserve.
- Equity realised gains not accounted through P&L under IRFS 17 but through other comprehensive income.
- The positive mark-to-market of investment funds through profit and loss.
- And the one-year unwinding of interest discount.

Overall result is pretty much the same

Turning to page 14. Here the message is that we are prioritizing margins over volumes. We see a sliding impact on the retention rates. The Company is focused on rebuilding a technical surplus.

Turning to page 15 we provide some history for the Motor sector in Spain. Back in the 90s and early 2000s, there was inflation coupled with extremely hight frequency. High tolerance to alcohol, the demographic load of generation X and easy access to driving resulted in rocketing high frequencies in the sector. Let's bear in mind the points-based driving licence was not introduced until 2006.

Today the market does not have a frequency problem, frequency has been normalised to pre-pandemic levels.

However, rates have not stopped falling since 2004. With timid corrections, year 2022 ended with the same market average premium as 2015… (just before the Baremo). Injury indemnities rising every year, the sky-high cost of repair and spare parts and normalized frequency; all this results in in tariff insufficiencies that must be corrected by the market as a whole, to adapt them to current costs. There is not a problem of bad risks, it is only of adequacy of premiums to the current context.

Linea Directa displayed worse performance back in the 2000s but corrected well before the sector. Today, we believe the sector's performance will weaken further as there are costs that haven't been yet incurred.

With that, I'll turn to page 16. The Motor segment grew 3.4%. We are growing with determination and prudence; our focus is on rebuilding the technical margin. On the technical front, combined ratio stood at 109.8%.

Cost inflation persists and will continue o exert pressure on margins, although we are seeing early signs of easing inflation. The provision for claims was stepped up in the 2Q to a 95 percentile and will return to the 85 by year-end. For its part, expense ratio was exceptional.

As with regards to Home, premiums reflect certain slowdown in policy growth in response to the economic cycle.

The combined ratio stood at 96%. Loss ratio dropped to 60.5% in the 2Q standalone, as was anticipated in our March results. Atmospheric events added 2.6 percentage points or 1.8 million in the first six months of the year (1.4 percentage points as of June 2022).

Turning to page 18 on Health. Premiums grew 5.1% but accelerated in the quarter to 7.5%. Policy count slowed down due to lower household purchasing power. Loss ratio keeps improving. We continue with a prudent risk selection.

Please let's move now to slide 19, where we breakdown management ratios by line of business:

- Loss ratio is heavily affected by sharp cost inflation and strengthened prudence. Together with rate adjustments, we are further optimising relationships with suppliers and our claims management. Motor and Home also reflect one-off higher frequency as I will explain in the next slide.
- Expense ratio stood at a remarkable 19.7%. The Company does not stop in reviewing processes and improving efficiency.
- Combined ratio was therefore entirely down to the cost of claims in the first half.

Turning to page 20. Consolidated loss ratio reached 88.9%, mainly driven by average costs of claims while we continue with rate adjustments. We were extra prudent in the quarter with our reserving at a 95 percentile, which is expected to return to a normalised 85 at year-end.

We also experienced some increase in frequency explained in the Motor, own damage guarantees. Home, in contrast reversed the 1Q peak and dropped significantly in the 2Q.

As with regards to expenses, we are being extremely strict when it comes to cost control and driving efficiency new measures. Consolidated expense ratio dropped to 19.7%.

Turning to page 22 on financial result. Earnings were down 7.9% explained by less realised gains in the semester. Last year the Company unwound an interest swap of 25 nominal of Italian bonds recording a gain. Also, we recorded 3.2 million of capital gains on equities, taking advantage of a window of opportunity prior to the entry of IFRS 9.

Recurrent financial result is up 2.6% by reinvesting at higher rates.

On slide 23 you can see the overall yield of the portfolio is up to 2.78% excluding net realised gains. We reduced our equity exposure and reinvested in fixed income at 4-5% with short maturities.

Moving on to our solvency position, the Company's capitalisation remains strong at 186%. Eligible own funds remain stable, as the loss for the quarter was more than offset by, first, the best estimate provision for premiums, factoring better margins in the future and to a lower extent, the change in market value of the available-for-sale portfolio.

For its part, SCR decreased by 1.8 million in the quarter mainly explained by lower exposure to equities.

To conclude, we closed the semester with an exceptionally strong balance sheet. We also stick to our strategy to continuously adjust tariffs to risk underwritten. We absolutely have a clear plan to respond to current challenges.

Thank you. I will now hand the call over to Beatriz to begin the Q&A session.

Thank you very much for the presentation, Carlos. First, we'll begin with the questions received from the conference call.

Q&A

Conference call operator

Ladies and gentlemen, we will now begin the Q&A session. If you would like to ask a question, please press star five on your telephone keypad. And if you change your mind, please press star five again. Please ensure that your device is unmuted locally before proceeding with your question. And the first question comes from Max Mishyn from JB Capital. Max Mishyn, now your line is open.

Max Mishyn

Hi, good morning. Thank you for the presentation and taking our questions. I have three. The first one is on the price evolution of motor insurance. What kind of price hikes are you able to introduce to new and existing customers? And then, follow up on this. The decline in the number of policyholders, is it related to higher churn or less aggressive marketing campaigns to attract new customers?

The second one is on the expense ratio. It came in significantly better year on year and quarter on quarter. And is the decrease related to one-offs? If you could provide more colour and what to expect, that would be very useful.

And then the last one is regarding the change in percentile. Could you explain a little bit, in more detail, the reason to change? And does the reduction by year-end suggest we might see a reversal of reserves? Thank you.

Carlos Rodriguez Ugarte

Thank you very much, Max. What I tried to explain on the presentation is that we have been with a strategy of adjusting prices to reach premiums of the portfolio. That has been the case. We began that by the last quarter of last year. We have accelerated that strategy in the first semester of the year. With that, I could give you a couple of numbers. If we compare the first six months of the year with last year, the increase in in average premiums as a whole is in the neighbourhood of 7%, more or less. But it is true that if you take the second quarter isolated, that increase is very close to a double digit. So that is the strategy. I explained in my March presentation that we should be in the neighbourhood of double digit increases in average premiums and that has been the case as of June.

In terms of the number of policyholders that we have lost during this period of time. It's a matter of trying to adjust price to risk premium. I mean we increase average premiums of course not in a mutualised approach, client by client, and those clients with worse risk premiums, we have increased much more average premiums and we have lost some of those clients. So it's not a matter of not being proactive on the marketing approach, because as you live in Spain and you know that we are always on TV, it's a matter of adjusting prices and losing some clients on that ground, which is something that we are not concerned. I mean we like very much to grow our number of clients, but I don't think nowadays it's the name of the game. The name of the game is trying to defend the technical margin, and that probably jeopardises a little bit the volumes of the company.

On the expense ratio. Well, it is true that we keep on improving the expense ratio. It stood at 19.7%. I think it's one of the best in Spain and one of the best in Europe. There is nothing exceptional that we have done on those grounds. I think it's a matter of keeping improving the efficiency of the company, keeping improving our digital approach. I think to give you a number, 87% of our clients are digital. That is a big, big number. Our numbers on digital use by clients keep on increasing and that, you know, has an impact on the expense ratios. And you should expect that to keep on going. I mean we are very much focused on that and we should keep on improving that expense ratio.

And then on the percentile. Well, when you use stochastic methodologies, I mean you need to provide stability to the P&L. I mean it depends very much on how you manage claims, and we have decided to be very prudent on the provision in this year, and that is why we put our percentile on 95.

Looking forward, we will adjust that as the year goes on and we will adjust that to an 85 percentile, which will mean that probably we will see some releases by the end of the year.

Max Mishyn

Thank you very much. Very clear.

Conference call operator

The next question comes from Francisco Riquel from Alantra. Francisco Riquel, now your line is open.

Francisco Riquel

Good morning, Carlos and Bea. Thank you for taking my questions. I would like to start with the slide 15, which is a very interesting insight about the history of the motor insurance cycle in Spain. So I would like to ask… my question is that, in this cycle, you are underperforming at least at the beginning. I would like to understand why. I listened to your explanation before. It seems to me that you mentioned that it's a question of timing, that you are more prudent in terms of recognising losses, and that the sector will still have to show up the further losses in the coming quarters. But I wonder if there has been any structural change in this cycle in terms of risk-taking, frequency, severity that you have relative to the peers. And in this context, if you think that you will emerge stronger after this cycle compared to the peers or not and why?

And then also related to this, if you could please comment on how do you see the churn ratio and the policy count in motor going forward?

And the last question is on solvency. I'm surprised with the increase in the best estimate of setting the reported net loss. So it seems to me that the increased provisioning, that you mentioned is prudent provisioning, and that led to the net losses, you are not considering them for solvency purposes. So if you can please explain why do you think is the reason for the increasing the BEL. You mentioned also higher margins going forward and we still have to go through difficult part of the cycle. And in this context, at the end if you plan any capital action at all? Thank you.

Carlos Rodríguez Ugarte

Thank you, Paco. Nice to talk to you. Well, I think the slide I would try to put there, trying to mirror what happened on the late 90s and what is happening nowadays, I mean it's very clear. I think by that time frequency was very high and combined ratios started to pick up you know which is a similar thing that is happening nowadays in 2023. In our case, we are highly prudent in this year in terms of provisioning. It's not a matter that we have worse risk, which is not the case. Our frequency, although it has increased by 100 basis points as compared to last year, that is not an issue. I mean an increase of 100 basis points is not nothing, but still, frequency is very good as compared to our expectations. And again, it's not that we are reaching to worse risks in the market. Indeed, we are losing customers because we are increasing average premiums. Our idea here, our strategy is that still we need to be very prudent, still inflation is there, although inflation is going down and the underlying inflation which really affects Linea Directa is still on 5-6%, and it's going to be like that by the end of the year probably. So we keep on adjusting our opening provisions that will provide further releases on the future, so that gives you a sense of the prudency that we are putting there. Looking forward on the provision side of the business, I think you should expect on the second-half of the year a much better improvement on the loss ratio in the third quarter and specifically more in the fourth quarter.

In terms of churn rate for clients, of course, rising average premiums at the levels that we are rising. Keep in mind that we have increased average premiums very close to double digits, you know, during the year. We have been increasing average premiums since the last quarter of 2022. It is true that in that case, it was kind of mild, but it has been very strong since January. That, you know, puts a little bit of pressure on the retention of clients. That is the reason why we have lost some clients.

If you were to ask me if we are concerned about that, not nowadays, no. I think nowadays as I explained before, the name of the game is trying to defend the technical margin. I mean we are preparing the company to improve the technical margin and thereby having the opportunity to increase in customers looking forward to 2024. So the churn rate is affected by the increase in average premiums, but still, I think Linea Directa has one of the best churn rates of the market.

And in terms of solvency. Well, solvency I think, it's a good number, 186%. I think one of the main impacts is on the best estimates of provisioning because we have lost clients and that has a positive impact on, a very good positive impact on the solvency ratio. It is true that the increase on the case-by-case provision has increased the best estimates of premiums. But then it is offset by that improvement on the best estimate of provision because we have lost a lot of clients. And also, since it's an estimation of the future, the best estimate also estimates that our claims cost will decrease in the second part of the year.

Beatriz Izard

Exactly, Paco, as Carlos is saying the best estimate liability is composed of two main provisions, right? One is the best estimate for claims and another one for premiums. For claims, these are existing, already incurred claims, and we are accounting for that. If you see in our SCR, it's already taking account of that. But the thing is that the best estimate for premiums accounts for claims that haven't yet been incurred, is a future provision, more than offsets the best estimate for claims. And why? Because this is already taking into account the trend, the outlook, that the margin is going to get better.

Francisco Riquel

OK. Thank you.

Conference call operator

Next question comes from Freya Kong from Bank of America. Freya Kong, now your line is open.

Freya Kong

Hi, Carlos, hi, Beatriz, thanks for taking my questions. Firstly, could you help us understand what the technical margins you are currently writing in the motor business, given the focus on profitability, and what does this mean for the earned through? Do you think we should see a peak in the loss ratio this year or later this year? I think last quarter you said that in Q4 you expected to have a combined ratio below 100%. Is this still the case?

Secondly, looking forward a bit, do you think the market will be able to eventually pass on the high claims inflation to customers such that the market can return to pre-pandemic underwriting margins, like you show in slide 15? How many years do you think this will take, or are you willing to accept a lower margin and grow at those levels going forward?

And last question, could you help quantify the one-offs or any one-offs in the motor and home results in Q2? Any weather-related impacts? Thanks.

Carlos Rodríguez Ugarte

Thank you very much. On the motor insurance business, we don't have one-offs. I mean what we have is specifically in the loss ratio that we have been on an ongoing process of adjusting, you know, our provisioning trying to anticipate further increases on CPI, on inflation. And that is why we keep on adjusting, you know, opening claims both in bodily injury and both in property damage. That, on the short term, medium term, would probably provide some releases for the company. I mean being very prudent nowadays you know will help us to be in a much better position in terms of provisioning by the end of the year.

Do we think we are in a peak in terms of loss ratio in the motor insurance? Yes, my perception is that, and I explained that back in March. I think the first half of the year was going to be very difficult, not only because of the situation of the market but also because we decided to be very prudent, and the second part of the year will be much better. So, I'm still shooting for that, I'm still shooting for a fourth quarter, isolated, a standalone quarter below 100% combined ratio and I think the third quarter will be better than the second quarter and the fourth quarter will be even better than the third quarter. So that I still stick to that number of trying to be below 100%. On the technical margin, we are on 96, something like that on the technical margin. That is what we are working on, still today, the technical margin is not reflecting entirely what we are doing with the average premium. Keep in mind that, I always explain the earned premiums, you know, it takes a while until they take all the impact of the gross written premiums. So still you will see improvements on the second part of the year and we will improve the technical margin of the company. It is true that it's going to take time until we reach a technical margin on double digits like we used to have before, but we are shooting for that, you know? Our expectation is that 2024 will be a year where we will adjust pretty much our combined ratio. It's not going to be on the 92, that's for sure, but probably would be more on the 95s, 94s and that's what we are shooting for. So technical margins would keep on improving as we keep on raising average premiums, and that average premium increase on the gross written premium will transfer to the earned premium.

And I don't remember if you have another question.

Beatriz Izard

Maybe we can comment a little bit on the one on home insurance, yes? Because it's a small account and it has an impact. I mean for example, in the first half of 2023, we had an amount of atmospheric events of 1.8 million and that accounts in the home line of business for 2.6 percentage points in our loss ratio.

Carlos Rodríguez Ugarte

I think the evolution on the home insurance, it's been very much in line on, on what we said on the first quarter. I mean first quarter, we changed some operational procedures, we decided to retract from that on the second quarter, and you see the evolution on the loss ratio, which in the second quarter standalone is in the neighbourhood of 60.5%, which is much better than the first quarter. The combined ratio of the home insurance is on 96%. Keep in mind the market average is close to 98% so we are much better there, and we should expect improvements in the home insurance looking forward.

Freya Kong

OK. Thank you very much.

Conference call operator

Next question comes from Carlos Peixoto from CaixaBank. Carlos Peixoto, now your line is open.

Carlos Peixoto

Hi, good morning, thank you for taking my call. So first, apologies if I might be rerunning some previous questions but I had some difficulties during the call. I was looking at the presentation where you mentioned that you expect provisioning to move from the 95th percentile back to the 85th. My doubt there is does this mean that throughout the second-half, we should see a release of reserves and basically through that means you'll get to the Q4 with a combined ratio below 100 percent and basically how does that translate into that expectations for the combined ratio into the next year? Then second question would actually be related to premium growth, so considering the efforts that you're making on the pricing side but also the churn rate you're experiencing particularly on the motor segments. What type of evolution of gross premiums do you expect to see at year-end, what type of growth I mean. Thank you very much.

Carlos Rodriguez Ugarte

Thank you, Carlos. I had some difficulties in hearing you, but I think I got you. On the percentile, well you should expect, you know, much better improvement on the loss ratio looking forward. If we are in a percentile 95 and we are saying that we would put ourselves on a 85 percentile, you know all things together it will mean that our provisioning will imply some releases by the end of the year. We have to be cautious with that, a statistical methodology applied to provision is a statistical methodology, you know? It takes the history of the company, to calculate the provision. So what we did this first semester is again, given the situation that we are having on the cost side, trying to be prudent, trying to be very cautious and putting ourselves on that percentile, which is probably one of the highest for sure in Spain and in Europe.

Looking forward, we will end the year, our intention is to be in the 85 percentile, which I might say still will be one of the highest percentiles in the market, and that will provide some releases. And in terms of volumes of clients I think you were asking a little bit about the evolution of the churn rate and looking forward on the year. It's not something that we are very much concerned. I mean we love to increase clients, we love to grow, to increase market share. But I think nowadays I mean we should focus on what we need to be focused on, and that is, to defend the technical margin. If that means that we will lose some clients, we will lose them, and we will gather them when the company reaches a combined ratio where the company feels comfortable and feeling comfortable, it will come a time to try to increase in clients. We have lost clients, but we didn't lose, you know, a lot of clients, and what we have lost is the clients we want to lose because they don't want to pay the average premiums that they should pay according to the risk premium.

Conference call operator

Next question comes from Thomas Bateman from Berenberg. Thomas Bateman, now your line is open.

Thomas Bateman

Hi, good morning. Thank you for the presentation. Just going back to the reserving one more time. Could you give us like a nominal euro amount for how much the… you've added or what the difference between 85th and 95th percentile is? And could you give us a split between home and motor? Is it all in motor? Is there any in your other lines of business?

And secondly, just on the motor price increases, so I think you reported 3.4% rise in premiums adjusted for the loss in policy count. We're about 5% up year on year in terms of pricing, but you're talking about double-digit increases. Could you help bridge the gap between those price increases that you talk about and the actual increase that we see in the accounts? Thank you.

Carlos Rodriguez Ugarte

Well, thank you very much, Tom. There is no percentile on the home insurance. Home insurance is taken case-by-case, okay? We don't, we don't have an approved methodology on that. So the provisioning on the home insurance is case-by-case. And it's difficult to give you a number on the percentile 85, 95. It's an important amount, but I don't have a number to say whether it's 10 million or 5 million, something like that. But jumping from 85 to 95 percentile really puts an important amount of provisioning that we would probably be releasing on the second half, but it's very difficult to give you a number on what will be the impact. Keep in mind that the evolution, we will need to see how is the evolution of the claims side of the business in the second half of the year. The statistical methodology is very much in line with the case-by-case provisioning. So we'll see how the case-by-case provision performs and then releases will be higher or lower depending on the case-by-case. My expectation is that being on a percentile 95, it provides a lot of prudency to the company and that prudency will be somewhat released on the second-half. But the amount depends very much on the case-by-case and the evolution of new claims and old claims as well.

And the second question. Well, the second question is on the increase on average premium. If you take a look at the year-on-year, our average premium on the new businesses is in the neighbourhood of 7.5% increase and on the renewals it's in the neighbourhood of 7.6%. If you take isolated second quarter. Second quarter versus second quarter, that number both in the new business, it's above 10% and in the portfolio, it's also above 10%. I think it's 10.4% or something like that. So that gives you an idea of how we keep on increasing average premiums as the year goes on.

Conference call operator

Next question comes from Patrick Lee from Santander. Patrick Lee, now your line is open.

Patrick Lee

Hi, good morning. Thanks for the presentation and for taking my question, Carlos, Beatriz. I just have a couple of related questions on the combined ratio, etcetera, etcetera.

First thing thanks, it was useful for you to highlight some of the main components on the higher cost of claims. But can you give us some thoughts on how much of this is already in your numbers. And in other words, if there's time lag in terms of what we are seeing today in terms of inflation, in terms of the provisioning rate and injury conversion rate. Is there a time lag between what we are seeing today and the effects on your P&L?

And the second one is on the number of motor policyholders. I checked in the first quarter presentation, it was up 2% at the time, while in the first half it's down 0.8%. So was there another specific step change in risk appetite in the second quarter where you became even more ready to lose clients and will this trend of selectively losing clients continue into the coming quarters?

And I guess finally combining these two questions, and relating to your target combined ratio of 100% by fourth quarter standalone, if I look at your combined ratio today of 110%, how do we actually plot the path to breakeven? Because again if I combine, you know, the fact that you are more selective on clients and still high inflation. Do you get to this breakeven by a higher top-line growth in the next few quarters or are you expecting a meaningful fall in the cost of claims sequentially? Thanks.

Carlos Rodriguez Ugarte

Thank you very much, Patrick. Starting from the last question, I think it's a combination of both. I think you should expect better improvement on the earned premium for the company. I think we posted in the neighbourhood of four points & something in this quarter and still yet to come better numbers from the second half of the year as the increase in average premiums which now is only impacting only the gross written premiums, will be reflected on the earned premium. Keep in mind that by September it would probably be almost one year since we started to increase average premiums. So you will see that positive evolution on the earned premiums by the end of the year.

And then on the cost of claims, we should expect some improvements as well. Keep in mind that the churn rate that we are having, that we are losing clients, that will also have an impact on the frequency. We are probably losing the clients with the worst risk premium, which means they are the clients with the highest claim costs. Those clients are somewhat leaving the company and that will have an impact in the medium term on the cost of claims. When a client leaves the company, we have a negative impact because normally what they do is they fix entirely the car. That is why our property damage cost has increased quite a bit in this second quarter because clients leaving the company, they decide to fix the car before leaving the company and that will not happen in the second-half of the year for those clients and frequency will improve.

In terms of and in terms of churn. Well, if we look at the quarter on a monthly basis, I think April was not a very good month in terms of our churn rate, but we have seen improvement of that on May and June and we are seeing positive evolution in July. That means that the market as a whole is also on the trend of rising average premiums. And clients, when they look around for better prices, they are not finding those better prices. Of course, many companies are not being as aggressive as Linea Directa in increasing average premiums, but the market as a whole I think is increasing average premiums. So I think we are seeing a better evolution of the churn rate for the company in the last couple of months and I expect that to happen looking forward throughout the year.

Again, it's something that we are occupied, but it's not something that we are very much worried about. Again, I think nowadays it's much better to improve our technical margin than to focus that much on retaining clients. We are adjusting average premiums to risk premiums and if clients don't accept those average premiums, you know we'd rather lose those clients.

And the third question, on the target of 100% combined ratio. Well, the entire year is not going to be below 100%, that's for sure, you know? But again, I think you should expect a positive evolution of the combined ratio in the third quarter and a positive evolution on the fourth quarter. That will leave us the possibility on a standalone picture of a combined ratio in the fourth quarter below that 100%, should be in the neighbourhood of 98%, something like that. Not much lower than that.

And again, it's a combination of the two things. It's a combination of improving our earned premiums, it's a combination of keeping improving our expense ratio and I think the evolution of the claim cost is going to be milder, with all the actions that we are taking nowadays, on the second-half of the year.

Conference call operator

Next question comes from Fernando Gil de Santivañes from Bestinver Securities. Fernando Gil de Santivañes, now your line is open.

Fernando Gil de Santivañes

Thank you very much. Thank you for taking my questions. Just a quick one and follow-up regarding price increases and number of clients. I wonder if you could give us a sensitivity of how much clients you lose per 100 basis points increase in price, because I've seen the motor number of customers is down and home insurance customers is down QoQ. And I wonder how the price and number of customers is working now, I'm trying to do a guess looking forward. Thank you very much.

Carlos Rodriguez Ugarte

Thank you, Fernando. We don't have that number. We could look at that, but I don't have this strategy of calculating and increasing in X percent of average premium, how many clients are we going to lose. It's very difficult, when you increase average premiums to clients, of course you have negotiations with clients, put through campaigns and all that. So it's very difficult to give you a number of the impact of an increase of 1% average premiums, on how many clients are we going to lose. As I tried to explain before, my perception is that on the last couple of months, the rate of losing clients because of increases in average premiums has slowed down and that means that the market again is also in that path of increasing average premiums. And in the home insurance we are increasing also average premiums. We have been doing that for the last, even before increasing average premiums on the motor insurance business. And of course, it has an impact also on the retention. But we don't have a number, especially because we don't mutualise prices, so we go client by client. So it depends very much on the client profiling, whether we lose a client or not. Of course, what we do when we start to increase average premiums, we don't increase average premiums through the whole client base. We start with the worst clients in terms of risk premium then we go to the next step, then we go to the next step, you know? And that's how we do it. Are we losing clients with the worst risks? Yes, I think most of the clients that are leaving the company are clients that have the worst risk for the company and that will have a positive impact on the claims side of the business looking forward.

Beatriz Izard

Hola Fernando, reinforcing Carlos' message, I mean this elasticity is moving, is not fixed. If the last quarter we experienced increases in churn that means of course that the clients are able to find a better price elsewhere at a loss for the company, by the way. If now we are seeing that this elasticity is squeezing, it's getting down, that means that the market as well is coming with us in this change of cycle which is very, very much needed.

Carlos Rodriguez Ugarte

But to go back to my presentation, it's important to understand that the clear strategy of the company is trying to defend margin on top of volumes, and that's something that we will keep on doing this year. Again, we need to prepare the company to go back to combined ratios at levels that we feel comfortable. Of course, you can imagine that with levels of 108%, we are not comfortable on those grounds. We need to adjust our combined ratio. And let me be clear, it will come a time where the opportunity to go back to growth will come and what we need is to be prepared for that. I think the market still will suffer in terms of combined ratio. I think we are still, in a difficult situation and looking forward, I'm talking about 2024-2025, the company will be much, much better prepared to gain market share.

Fernando Gil de Santivañes

OK. Thank you very much, Carlos.

Conference call operator

Next question comes from Max Mishyn from JB Capital. Max Mishyn, now your line is open.

Max Mishyn

Yeah, hi, thanks. Just one more question on the investment portfolio. You've increased your debt holdings notably in the quarter and I just was wondering if you could guide us on what to expect as a run rate investment income for the rest of the year? Thanks.

Carlos Rodriguez Ugarte

Thank you, Max, again. Yeah, we have increased our exposure to fixed income, especially governments on the second quarter. Reinvesting in levels of 400 basis points, more or less, in governments with a very short duration. Our duration has dropped in the neighbourhood of 40 basis points, and that is because we are taking durations of 2 - 2.5 years. You should expect us, to keep on taking opportunities on the fixed income portfolio. And probably not weighting so much on the equity side of the portfolio. The equity side of the portfolio has an impact on solvency. The equity side of the portfolio has an impact applying IFRS 9. So it is true that we have sold an important position on equities in this second quarter. We will rebuild a little bit our equity portfolio. But again, I mean with interest rates in the numbers that we are seeing, our approach is being on the fixed income more than on the equity side of the business. Our yield for the portfolio is in the neighbourhood of 270 basis points. And our reinvestment yield (this year we have reinvested in the neighbourhood of €110 million of maturities) is in the neighbourhood of 4%.

Max Mishyn

Thank you very much.

Conference call operator

Last question comes from Farquhar Murray from Autonomous. Farquhar Murray, now your line is open.

Farquhar Murray

Cool, thanks. Morning all. I have just two questions, if I may. And apologies, firstly, I just want to come back to the provisioning question. Slide 12 states that the use of the 95th percentile reflects the decision to anticipate subsequent impacts on the provision. Please could you just clarify what those subsequent impacts are specifically within the modelling? And are you saying you anticipate those impacts but then expect them to reverse out?

And then secondly, why are you not seeing peers move as aggressively in terms of repricing as you are? What exactly is holding back the restoration of industry profitability here? Thanks.

Carlos Rodriguez Ugarte

Well, thank you very much for your questions. On the second issue, I cannot comment on competition. I think many of our competitors are on the same route. It is true that Linea Directa is among the two companies with the highest increase in average premiums. My personal opinion is that if you are not in the mood of increasing average premiums, you will have further problems looking forward. I think, again, that the right strategy may be for Linea Directa, but I think for the market, is to increase average premiums on the sector. Inflation is there, inflation has been there for the last two years, and I think that is the right way to move nowadays. If others decide not to increase average premiums, we'll see what happens with the combined ratio. But in our case, we are here to try to make money and that's what we are trying to do. And on the percentile issue, again, you can be prudent or aggressive in the management of the claims that you have. You can be prudent or aggressive on the opening provision of the claims that you have. In the case of Linea Directa, we are having always a very prudent company in terms of provisioning. And in this year, we are even more prudent on the management of the claims, which means that we are increasing our opening provisions, expecting further impacts on the inflation, which will be milder. But again, it will be on 5% probably by the end of the year. And you know, it's just a matter of deciding where you want to be. I would rather, having increased costs on the short term and having some releases on the medium, long term, than otherwise. And that's the strategy of the company.

Farquhar Murray

OK. But just to clarify, why would inflation expectations into the second-half of the year not already be in the reserving expectation. Why are you having to play around with the confidence ratio to do that?

Carlos Rodriguez Ugarte

Well it's not only the inflation. Inflation, looking forward, of course, it's embedded in the percentile because it's always embedded in the percentile. But the provisioning, it is not only on inflation. The provisioning is on how you expect the evolution of the claims, how it's going to impact you, losing portfolio of clients in the property damage claims, all of that is a mixture of that. And again, well it's a matter of being prudent and expect that looking forward those rises will come, you know? But it's a strategy of the company to be very prudent and to put ourselves in a percentile above the percentile that we are used to.

Looking forward, you should expect by year-end to be in an 85% percentile, which is more or less the percentile that we move always, so that will imply that you should expect some releases looking forward.

Farquhar Murray

Alright, many thanks.

Conference call operator

There are no further questions at this time. I will now hand back to Beatriz Izard, Head of Investor Relations. Beatriz, now your line is open.

Beatriz Izard

Thank you. Now we'll continue with the questions received through the webcast.

We have one question coming from Ángela Rabadán Navarrete from Afi. She's saying "Could you please detail the impacts of IFRS 17 on the balance sheet and P&L?

Okay. Ángela, if you go to slide 13, which is where we break down the walk from IFRS 4 to IFRS 17 and 9, the first item that you see is the home liability for incurred claims. What happens in IFRS 4 is that we account with the case reserve. This is a much more prudent methodology than any statistical methodology. Therefore, when we move to IFRS 17, you have this positive impact in the home reserve for an amount of €2.9 million.

The second item you see is the realised gains in equities. If you recall under IAS 39, realised gains on equities are accounted for in the P&L. This is not the case in IFRS 9, so you have a negative impact because these are accounted for directly in other comprehensive income and that's why you have this negative impact of €2.3 million. The third main item is the mark-to-market of investment funds. So again, under IAS 39, this MTM was accounted for in other comprehensive income. Now in IFRS 9, it is accounted in the P&L, in profit and loss. So this semester then mark-to-market of mutual funds posted an increase of €1.3 million.

And lastly, the fourth main impact is the one year unwinding of interests rate discounts mainly on the motor line of business. So these are the four main impacts but they are not really significant.

Carlos Rodriguez Ugarte

That's important to know that giving a non-life insurance company with short-term contracts with our clients, Linea Directa is applying the simplified model on IFRS 17. I think looking forward you shouldn't expect major changes between IFRS 4 and IFRS 17. All the decisions we have made in applying IFRS 17 and IFRS 9, they were all towards providing stability to the P&L and taking all the movements to the balance sheet. But again, I think for this semester, the impact has been positive in a little bit more of half a million euros. But I don't expect major changes on the comparison looking forward. We are a non-life insurance company, which I think the impact is much milder for these types of companies.

Beatriz Izard

I think we have no further questions. So thank you very much to all of you. As always, Investor Relations is around for any follow-up.

Thank you very much, Carlos. And this concludes our meeting.

Carlos Rodriguez Ugarte

Thank you and you all have a good summer. Thank you.