S1 2020 Earnings Call

Company Participants

- Inder Singh, Group Chief Financial Officer
- Patrick Regan, Group Chief Executive Officer

Other Participants

- Andrei Stadnik, Analyst
- Andrew Buncombe, Analyst
- Ashley Dalziell, Analyst
- Brett Le Mesurier, Analyst
- Matt Dunger, Analyst
- Nigel Pittaway, Analyst
- Siddharth Parameswaran, Analyst

Presentation

Patrick Regan {BIO 15131018 <GO>}

Good morning everybody and welcome to our Half-Year Results Presentation. Our first priority in responding to the COVID-19 pandemic was to ensure that all of our people were safe and healthy. And secondly, ensuring that all of our people could successfully work from home and continue to serve our customers. And overall, this worked remarkably well.

Literally, overnight we transitioned almost all of QBE's entire workforce to work-from-home across all of our hundreds of global locations, including our shared service centers in the Philippines, which were previously thought to have little work-from-home capability. Much of that transition is a testament to our operations teams, our IT teams, our human resources teams and our leadership teams across the globe, but also reflects the investments we've made in technology and collaboration tools over the last few years. That's given us technologies such as Microsoft Teams, virtual desktop infrastructure, VDI, and the cloud, along with increased network capacity and resilience. And that made our work shift to working remotely very quick, and while not easy, relatively straightforward.

Productivity has remained exceptionally high across the business. We've maintained customer service levels and net promoter scores at pre-COVID-19 levels, and in some areas, even we've improved. We've also worked really hard to provide our people with the support that they need. We've shipped necessary equipment to the homes, screens, chairs, laptops et cetera. We've also really ramped up communications from an already high level, but now including a variety of things like virtual turn holds, matching hammer sessions, videos, what we call Pat chats, which are messages from me, lunch and learns, educational sessions, et cetera, et cetera.

We've also focused on the health and well-being of our people, providing support, help lines, canceling well-being poll surveys and even making the office space available for those people who didn't feel comfortable or safe working from home. Personally, I think it will be some considerable time before we're all back or even substantially back in the office, if it is the case, then QBE is very well equipped to work from home for an extended period of time.

At the same time, we've tried to provide support and assistance for our customers and obviously this has been a tremendously difficult time for many businesses, particularly SMEs. There are a number of areas where QBE has provided direct customer support, often going above and beyond what other insurance companies are doing. I won't go through every single example across the Group, but I'll highlight instead a few from here in Australia.

For SME customers, we've been providing both six month premium payment deferrals and guaranteed renewals at expiring premium rate, so zero cost increases, temporarily freezing rates on SME, commercial motor and accident and health policies and that contributed to the apparent slowdown in the rate momentum in Australia Pacific during the recent half.

We're also the only insurance company in Australia to proactively provide discounts on personal motor policies to all of our customers. There was very clear evidence of reduced motor claims frequency, particularly in the early period of lockdown, and we helped proactively returning this benefit to all of our personal motor customers was the right thing to do.

Once we'd worked through our immediate priorities, looking after people, looking after our customers and protecting the Group's balance sheet, as management team, we've turned our attention to what we thought might mean to Group's medium-term strategy. Firstly, I should say all of the work that we've been doing on the cell review work and Brilliant Basics program over the last two years, has positioned just really well as we enter a period of clearly improving insurance market conditions.

What other insurers are only just now trying to reposition and re-underwrite their portfolios, we've already done that. Having simplified reposition the business, we're now able to focus on getting rate increases and growing organically. And there were increasing opportunities for profitable growth right across the business, notwithstanding this environment. COVID-19 has also presented an opportunity to rethink our business model and accelerate our digital transformation. I'll talk a little bit more about that later and then, much more about that when we get to year end.

From a performance perspective, we also had a lot happening in the first six months, with significant ongoing uncertainty not only in terms of the pandemic, but also how global and indeed regional economies might recover, I'm pleased we successfully implemented our capital plan early on in the crisis. At 30 June, our capital position is very strong. Regulatory capital is right at the top end of our range and that is even after recognizing the vast majority of what we think will be the ultimate cost of COVID-19. Including the recent renegotiation of terms on some of our sub debt, gearing is right in the middle of 25% to 35% to target range. We also have AUD1.5 billion of cash at the center. We have a low risk asset portfolio and significantly enhanced reinsurance protection as we head into the US hurricane season.

All of that positions us to weather almost any scenario that kind of fall from here, but also take advantage of any organic growth opportunities as they arise. And the pricing environment certainly continues to accelerate with second quarter rate increases averaging more than 10% across the Group, bringing the average for the first half up to nearly 9%. Alongside that positive premium rate environment, we're also seeing significant growth opportunities with organic GWP growth of 10% in the first half, probably the highest level organic growth QBE has seen in 20 years.

Obviously, the first-half combined ratio was heavily impacted by the combined impacts of COVID-19, excess cats, particularly the Australian bushfires as well as the strengthening of prior year claims in North America. As you'll see in a slide later, our underlying first-half combined ratio of 93.7%, gives me real encouragement with respect to the Group's future earnings power. It's also been good to see the strong rebound in our investment returns during the second quarter. Our high-quality fixed income book performed well reversing nearly all of the unrealized mark-to-markets losses flagged at the end of the first quarter. We've also seen significantly fewer credit downgrades in our portfolio relative to the broader market.

Just a couple of points on Slide 5. Obviously, you'll have seen the COVID-19 charges booked had -- during the half, had an impact on our combined ratio of six points. Notwithstanding that, our PCA remains very strong at 1.8 times, which also includes a significant allowance for future COVID-19 claims that we recognized in premium liabilities at the first half.

Our attritional claims ratio took another step down to now be in the 45s, with cell reviews and Brilliant Basics driving further improvements in our underwriting profiles and given the rate increases we're seeing, I'm confident of achieving further improvements in our attritional claims ratio, notwithstanding some of the ongoing loss trends around the world. Worth noting that since we started our program, we've now taken nearly nine points off the Group's attritional loss ratio.

And notwithstanding the first-half loss, the Board declared a AUD0.04 interim dividend recognizing their confidence in both the strength and stability of QBE as well as the promising outlook underpinned by the improving pricing landscape.

And just on that, it's interesting to see the pricing in most markets around the world accelerates as the recent quarter progressed, and in some markets, significantly so. The prospects of lower for longer interest rates, almost zero, increasing climate-related weather events, some continuation of heightened casualty loss trends and indeed losses directly arising from COVID-19, have led insurers with almost no alternative but to materially increase pricing. During the past half, this was particularly evident in the London Market and the UK and in North America. Our average rate increase of over 10% in the second quarter is the highest Group-wide rate increase QBE has seen since the aftermath of 9/11. In International, rate increases accelerated to 14% in the second quarter including particularly strong increases in the London Market and the UK business. Global reinsurance markets have finally started to see some parts increases, which started with the Japanese win renewals in April and develop further with the Florida win renewals in June. We expect QBE Re will enjoy improved pricing momentum going forward. There was also significant price momentum in North America, where we saw strong double-digit rate increases in property programs, accident and health, professional lines and aviation.

Notwithstanding the significant bushfire claims at the start of the year and expectations of ongoing levels of elevated climate-related cats, rate increases in Australia slowed down slightly during the second quarter, albeit this was largely due to our decision to temporarily freeze those rate increases for SME, commercial motor and A&H renewals. Similarly, it was pleasing to see retention improved across the Group.

Looking forward, I certainly expect the pricing environment to remain supportive for the rest of 2020, and at this point, well into 2021. The (inaudible) conditions I mentioned earlier will continue and a number of very large global insurers including Lloyd's Market more broadly will need a significant period of rate increases in order to return to a more acceptable level of underwriting profitability.

In February briefing, I said that in addition to driving further margin improvement, we would start to look to target a modest amount of growth in 2020. We clearly faced a much more challenges set of circumstances during the first half than we envisaged, but it's been great to see organic growth of 10%, supported by rate increases, improved retention and strong new business growth. While most of the growth was driven by rates, we achieved top line growth of rate plus nearly 2%. There has been good growth opportunities emerging across most of our portfolios.

Notable areas in North America included where we have our strongest franchisees and profitability, accident and health, property programs and crop. Our London Market business grew 24% in the first half, supported by strong rates, improved retention and much more high-quality new business opportunities across multiple portfolios. And growth in commercial lines in Australia Pacific was offset by CTP market reform and some reduced workers' comp premium due to reduced payrolls.

Cell reviews and Brilliant Basics remain integral to our program of work here and our long-term improvements in the attritional claims ratio. It was pleasing to report continued improvement across all three divisions during the first half. In North America, that was despite the impact on NEP of purchasing additional reinsurance, we saw an improvement of nearly 2% with attritional -- most notably improving in accident and health and professional lines.

In international, while rate earning though was the biggest contributor, we've also seen the benefit of greatly improved underwriting exposure profiles in property, commercial motor and financial lines. In Australia Pacific, we've seen the continuation of very strong story there with the underlying claims improvement over an extended period of time.

The first half saw a further 3.5 points improvement in the attritional claims ratio, bringing the cumulative reduction since we started the program to now 13%. Once again, that was broad-based improvement, with significant reductions in engineering, commercial property and aviation. And the obvious part of our story in Aus Pac has been a significant improvement in the attritional claims ratio. But as you will see, we've also seen a very large reduction in the large risk claims ratio at the same time.

There's also been an improvement in the Group's large individual claims frequency as well, but that's been somewhat obscured by our change in reinsurance arrangements at the end of 2018. We see the trend here quite clearly. The improvement in the first half was underpinned by International and Australia Pacific, and if you look at the bottom there, we've unpacked a bit of detail on the improvements in Australia Pacific over the last three years.

The chart shows Australia Pacific's total reported large risk claims over the last four half-year periods, particularly notable is the improvement of a very significant reduction in the cost of commercial property types. You will remember, we've talked in the past about how we've improved the risk profile of our commercial property book there exiting high hazard risks such as abattoirs, mines, a large portfolio of pubs and clubs. And this has led to a very significant reduction in large risk claims and the ratio of large risk claims to premium has more than halved in the Aus Pac business.

Couple of other examples of Brilliant Basics at work. Firstly, on our North American programs business wherein we've got property programs that specifically cover wind and quake exposure. The key here is to manage the aggregate cat exposure best measured by what we call as PML, probable maximum loss, against the revenue pool that you're writing and the rate that you're getting for that risk. Of the last 12 months, for that book of business, we've increased rates by 17%, growing GWP by 23%, while at the same time, by focusing renewals and new business in the right geographic areas, actually reduced our PML by 6%.

The net result of Basics was strong combined ratio, improved rate adequacy by 8% while also reducing cat volatility and capital intensity. On our (inaudible) commercial motor book, a few years ago, we had a combined ratio for this book running well over 100% due to both the high attritional claims ratio and excessive large claims frequency. For that book in addition to a greater than 14% rate increases in the first half, we've also worked really hard to change our target exposures in the book, writing more of the lower frequency business like school contracts, charity minibuses, local authorities, community transport, and a little bit less of the higher frequency businesses like national bus services, taxis and non-conventional transport. We've also implemented a series of high quality data analytics and portfolio monitoring tools. Taken altogether, that's resulted in a significant impact, a significantly reduced attritional claims ratio, much lower large claim frequencies, half of that, and an improved combined ratio, now down to 87%.

Let me finish up by talking a little bit about the COVID-19 impacts. Obviously we pre-announced the expected impacts of COVID-19 a couple of weeks ago. We will give you a little bit more detail today. Just as a reminder, the first-half results includes AUD335 million underwriting impact and that split is as follows. An explicit risk margin charge of AUD115 million, reserves for UK business interruption claims of AUD70 million, net of reinsurance, and net cost of AUD80 million for all of the claims and that spans multiple classes including reinsurance, workers' comp, casualty including D&O and accident and health, and that's primarily in international and North America, and premium refund advance and associated expenses totaling AUD70 million including private motor refunds in Australia.

As you can see from the chart, most of the prospective claims are expected to merge in LMI and trade credits, and I'll show you some supporting scenario analysis for this in a moment. Before I do, I wanted to point out a couple of points here. When you take our first-half cat experience and the amount that goes to our cat aggregates, you can see there is now only AUD20 million of downside risk to our second-half cat allowance, particularly first-half cat allowance or catastrophe aggregate adding our planned second half cat allowance or catastrophe aggregate were only $20 million away from our attachment point. This also means there's only $20 million of downside risk to any further business interruption claims arising anywhere in the world. For prudence, we even added in that AUD20 million into our ultimate AUD600 million COVID estimate.

Just a little bit more on business interruption itself. First of all, look, I think it's worth reminding that the fundamental premise of Insurance is to ensure diversified pools of risks such that an insurer can afford to cover a bunch of risks on the basis they can all give rise to a claim at the same time, the whole concept of diversification. Best true whatever form of insurance product, you're talking about. It's clearly impossible to indemnify events where all the policies payout simultaneously, and this is one of the main reasons why insurance companies are so insistent that nearly all business interruption policies and policy wordings don't and never intended to cover business interruption caused by pandemics.

In North America, you will have seen from industry-wide reporting the policy wordings clear, they require physical damage and certainly in our case, all policies also have clear virus exclusions. And international policy wordings are a little bit more varied and indeed, we have a small number of wordings in the UK and Europe where we think we should and will pay business interruption claims. We reserve for the cost of these claims in our first half reserve of AUD70 million.

You'll no doubt be aware of the FCA test case in the UK, and while we are awaiting the outcome of that case, it'd be inappropriate for me to comment any further, other than to reiterate that our exposure to UK business interruption claims is limited to that AUD70 million that we've already booked as a result of our property cat reinsurance.

Given Australia's most noting that as a result of the APA's stress tests back down following the SARS pandemic back in the 2000s, all domestic insurers included specific pandemic virus exclusions in all of their policies. These virus exclusions specifically and exclude SARS with noting that the medical name for COVID-19 is SARS Cov-2, and while there is some tactical debate that policy references to the Quarantine Act as amended versus the Biosecurity Act, both acts specifically and categorically exclude COVID-19 and we remain highly confident our policies never intended to nor do cover pandemic.

Again though, worth reiterating any business interruption claims arising from COVID-19 here in Australia or anywhere else, are covered by QBE's reinsurance protection program. Just on the program, the reinsurance program, whether it's on main cat vertical tower or our cat aggregates or the cat top and drop treaty, they were all purchased on an all payrolls basis. What does that mean? It means all payrolls are covered, unless there is something specifically excluded and there is no pandemic exclusion in our reinsurance treaties. That's different from other cheaper named payrolls reinsurance that other companies may buy which only covers those payrolls which are specifically named. The classes of business covered by QBE's cat treaties include property material damage and business interruption, which means you don't need property damage to trigger the cover, and business interruption is covered in its own right. So business interruption claims covered by COVID -- caused by COVID-19 are absolutely covered by our cats reinsurance program.

When we announced our capital time back in April, we showed you a couple of scenarios for LMI and trade credits. Since then, reflecting a combination of the government stimulus packages as well as in the case of trade credit, some of the government backstops in Europe, the more extreme downsides of those scenarios now appear a little less likely. Indeed, at the present time, we're not actually seeing additional claims activity in either LMI or trade credit albeit we still envisage claims to emerge over time.

On LMI, our AUD600 million ultimate cost of COVID-19 estimate included AUD150 million of incremental LMI claims emerging over a three-year period. And that broadly correlates with worsening of unemployment to around 12% and then average cumulative house price decline of around 20%. We think this is appropriately cautious scenario for the time-being, while the outlook for both the virus and the Australian economy remains uncertain. It's again worth noting, these LMI scenarios are mooted by significant loan-to-value buffers embedded in almost all of our underwriting years and also by the fact that we are in LMI premium over nine years, which means that nearly AUD400 million of unearned premium to offset claims.

Similarly on trade credit, we've seen little if any adverse claims activity so far. Since April, there has been a number of favorable developments in our portfolio. We further reduced policy limits, which are now down 30% since the beginning of the year, with higher limit reductions for our higher risk industries. Government stimuluses in most major economies have kept money flowing, particularly in the SME sector. And a number of the governments in Europe have announced backstops to trade credit insurance including the UK, France, Germany and the Netherlands. The combined impact of these developments just reduced our forecast incremental trade credit claims to around AUD150 million.

With that, thank you. I will hand over to Inder to walk you through the first-half results in a little bit more detail.

Inder Singh {BIO 20594382 <GO>}

Thank you, Pat. Good morning all. Clearly our headline performance has been impacted by the extraordinary events associated with COVID-19. However, I'm pleased with both the operational resilience of our business and the further improvement in the quality of our underlying earnings. Pat has taken you through some of the detail of COVID-19 impacts, so I'll focus my remarks on the result excluding these impacts.

I'll start off with the Group P&L. Gross written premium was up an impressive 10% on a constant currency basis and excluding disposals completed in 2019. The combined operating ratio deteriorated by 2.2 points to 97.4%. This is due to heightened catastrophe claims in Australia as well as prior-year development in North America. On a current accident year basis and with catastrophe claims held to our plan allowance, the combined operating ratio improved by more than 3 points. And I'll take you through this in more detail on the next slide.

We recorded an investment loss of around AUD90 million, driven by the extraordinary market volatility we've seen over the course of the first half. Importantly, the AUD350 million unrealized mark-to-market loss we reported in our credit book in Q1 almost entirely reversed in Q2 as market conditions stabilized and we saw a flight to quality. Our cash loss after-tax for the half was AUD682 million, reflecting the impact of COVID-19 across both the underwriting and investment accounts.

Our financial position remains very strong with the PCA multiple at the top end of our target range at 1.8 times and pro forma gearing reduced substantially to the midpoint of our target range at 30%. We've declared an interim dividend of AUD0.04 a share. This reflects our confidence in the Group's financial position, the improving quality of our underlying earnings and a better premium pricing environment.

I'll now briefly walk you through the key components of our reported combined ratio. As you can see in the first two bars on the top chart, our current accident year combined ratio improved by more than 3 points to 93.7%. Key drivers of this as illustrated on the bottom chart were a 2.2 point improvement in our attritional claims ratio, a 70-basis point improvement in our cost of large risk claims and a more normal start to the year in our North American crop insurance business. These are all important sustainable improvements in earnings quality and reflect a real step-up in our earnings power going forward.

Walking from left to right on the remainder of the top chart, we have set out some of the non-recurring items that have impacted our reported combined ratio. On the right hand side of the chart here, you can see the impact of risk margin strengthening. This is in addition to the risk margin included in the COVID-19 impacts. In aggregate, the probability of adequacy of our claims reserves has increased to 91.2%, this is well above the midpoint of our range of 90% and also above our historical norms.

Our estimated ultimate cost of COVID-19 is approximately AUD600 million of which AUD335 million or 6 points as shown on the chart is booked in our first half underwriting result.

I'll now turn to divisional performance in a bit more detail. Starting off with North America. Gross written premium of AUD3.1 billion was up 14% adjusting for the sale of our underperforming personal lines business. The current accident year combined ratio improved by around 1.5 points to 97.1%. Within this, the attritional loss ratio, excluding crop, improved by 1.6 points. In addition, our crop business has experienced more favorable planting and growing conditions this year after a very difficult 2019. The year-to-date financial performance of crop is in line with our long-term average and this has contributed around 1.7 points to the year-on-year improvement in the North America combined ratio. The cost of large risk claims increased by around 2 points to more prudently reflect inflation risk, albeit year-to-date, we've seen a decrease in the frequency of reported large losses. We've strengthened prior year reserves in North America, primarily in excess and surplus lines and in multiline reinsurance, both these books are now closed to new business. In line with industry experience, we've also seen some losses creep on Hurricane Irma from 2017.

In terms of reserve adequacy, we've taken decisive action on underperforming portfolios. We are booking more prudent loss picks to reflect inflation risk in relevant portfolios and we're using better data and insight in our reserving processes through improved pricing and monitoring tools. These actions along with the first-half reserve strengthening increase our confidence in the adequacy of our reserves in North America. Separately, I am really pleased with the progress we've made on our operational efficiency program in North America over the last 18 months. With the sale of personal lines, we now have a more focused business with a simple operating model and are continuing to rationalize our regional footprint and technology infrastructure. We're on track to deliver around AUD40 million in underlying savings in North America by the end of this year.

Turning now to international. Gross written premium of AUD3.1 billion was up around 12% on a constant currency basis and excluding the impact of asset sales in Asia. This was driven by strong premium rate increases in both our London Market business up around 15% and our UK regional business up around 14% and good new business growth in areas like natural resources and in property and liability classes in Continental Europe.

As you can see from the chart, our current accident year combined ratio improved by an impressive 5 points from 97.7% to 92.5%. Within this, the attritional claims ratio improved by 1.7 points, the cost of large risk claims improved by over 4 points from around 15% to around 11%. This reflects the benefit of strong de-risking and portfolio management actions we've taken over the last few years across financial lines, international liability, large account property and commercial motor.

The expense ratio also improved by 80 basis points. Our cost-out initiatives are continuing to improve the efficiency of our operating platform both in Europe and in Asia and we're also starting to benefit from economies of scale as market conditions improve.

And finally, our home market of Australia Pacific, gross written premium of AUD1.8 billion was up around 4% on a constant currency basis and excluding CTP. The current accident year combined ratio was a very strong 90.2%, down more than 4 points relative to the prior period. The attritional claims ratio excluding LMI improved by a further 3.5 points which takes the total improvement to around 13 points since we first instituted cell reviews and Brilliant Basics in Australia Pacific in the second half of 2016. The large loss ratio was around 80 basis points lower continuing the significant reduction in large loss frequency that Pat referred to earlier.

Expense ratio improved by around half a point supported by disciplined cost management and efficiency initiatives. On LMI, the extraordinary measures from the government and the Reserve Bank continue to support credit quality for the time-being. However, we remain cautious about the near-term outlook and have strengthened our LMI reserves to reflect potential claims that may emerge from current home loan repayment deferrals. In addition, we've taken a AUD50 million charge against regulatory capital through premium liabilities to reflect the likely further deterioration in credit conditions over the next 12 months to 18 months.

Turning now to the operational efficiency program we announced at the end of 2018. You'll recall that we're targeting around AUD200 million of gross savings, AUD130 million of net savings and expense ratio of less than 14% by 2021. We're now at the halfway point of that program, and I'm pleased to say that the delivery of our cost-out initiatives is running ahead of our original timetable. We've executed clinically against all the key initiatives set out in our original program of work. We have simplified our organizational structure and the operating models in each of our divisions, we've made meaningful progress in rationalizing and modernizing our technology state, we sold our inefficient personal lines business in North America, we realized process efficiencies across our businesses in Australia, in Asia and in our shared services center in the Philippines and we've ensued a strong expense discipline in managing and reducing our third-party consulting costs as well as travel and other discretionary costs.

Excluding COVID-19-related expenses and the elevated risk and regulatory costs which we highlighted at the end of last year, our reported expenses for the first half were AUD776 million. Our reported number does include some one-off savings, for example, a lower than normal level of spend on our change portfolio, I would say that our first half exit run rate is closer to around AUD825 million with an expense ratio of around 14.4% when adjusting for these non-recurring items and the additional reinsurance buy-downs we've executed as part of our comprehensive capital plan.

Turning now to investment returns, we've also seen extraordinary levels of volatility in financial markets over the last few months. Against this backdrop, we took decisive action to derisk our portfolio and exited high yield debt, emerging market debt and listed equities, but the risk of market dislocation remains heightened as the crisis continues to unfold over the coming months. We held excess asset duration through Q1, which not only insulated our P&L but generated AUD100 million in excess risk free rate gains following the substantial cuts to global cash rates.

We continue to maintain a very high quality and resilient investment grade credit book. Around 85% of our fixed income is rated A minus or better. We've had fewer rating downgrades at 10% versus 12% across the broader market and our BBB portfolio, we've got fewer holdings on negative outlook or negative watch compared to the market, we have no fallen angels and none of our credit is trading distressed. As I mentioned earlier, we reported around a AUD350 million unrealized mark-to-market loss at the end of Q1 and this is almost fully reversed in Q2.

As you are aware, the outlook for investment returns has been reset lower over the last few months and our fixed income running yield is now around 70 basis points. Whilst we're not providing guidance at this stage, we expect our portfolio, when related to a normalized investment strategy, to deliver a return of around 1.75% over the medium term.

I'll conclude with some remarks on our balance sheet and capital position. During April and May, we executed a comprehensive capital plan that included a series of initiatives to strengthen our balance sheet, both to withstand the potential extreme scenarios of additional COVID-19 impacts and to give us the flexibility to grow organically as we start to emerge from the crisis. The execution of this plan included raising equity and Tier 1 capital, purchasing additional reinsurance and derisking our investment portfolio.

As a result of these actions, our APRA PCA multiple at 1.8 times is at the top end of our target range. This is despite a material allowance for up to AUD600 million in ultimate COVID-19 impacts with the vast majority of these estimated losses either incurred in the first half underwriting result, accounted for in risk margin or reflected as a deduction from capital through premium liabilities. Our S&P capital position remains strong and meaningfully above AA minimum capital levels. our pro forma debt to equity ratio at 30.2% is now at the midpoint of our target range of 25% to 35%. This marked improvement in our gearing is a result of our sustained effort to manage down our borrowings over the last two years and also reflects the reclassification of our AUD400 million Tier 1 hybrid instrument at our borrowings into equity following the change of the non-viability trigger in that instrument on 16th of July. Whilst we're pleased with the strength of our balance sheet, we are continuing to maintain a rigorous focus on capital and risk management in this uncertain environment, and we're using dynamic forward-looking stress and scenario analysis to inform all our decision making.

With that, I'll now hand back to Pat to talk through our priorities going forward.

Patrick Regan {BIO 15131018 <GO>}

Great, thank you, Inder. Our priorities for the rest of the year are clear. Cell reviews and Brilliant Basics program are aligned well. We still do cell reviews, we still do them quarterly, they still have the same impact and we're still driving improvements in how we do underwriting pricing claims from the Brilliant Basics program.

As I mentioned earlier, going forward, we expect to see further improvement in both our attritional claims ratio and our large claims frequency. We also remain super focused on making sure that all of our people around the world feeling looked after and feeling connected to QBE. Also, that they have the tools that they need to help service our customers and work closely with our broker partners.

It's probably going to be some local and regional variations, and in time, we hope to see at least a modest increase in the number of people back working in our offices. However, our current assumption is the majority of our people will continue to work remotely for the foreseeable future. Working remotely hasn't held us back in the first six months of 2020 and I don't think it will do in the future either. We've been putting an increased focus on our customer of QBE program and I think you could start to see the benefits of that in our organic growth numbers.

The fact that we no longer focused on re-underwriting our portfolios, the fact that our broker partners see us as having a stable and clear underwriting appetite and the ongoing work from the customer QBE program has provided a base for organic growth. Albeit with the caveat, there remains substantial uncertainty in the general business environment going forward. For the last two or three years, we've been quietly working our way in modernizing our technology aspects, retiring old applications, automating processes, and develop some quite cool front-end digital tools. And this has helped us materially improve our expense ratio and that should continue to be the case going forward.

This program hasn't been about big policy admin conversions, but more about how we build better digital tools, remove manual processes and how we become the smartest and best users of data in commercial lines insurance. There's lots more that we can do in this space and we're looking for ways to accelerate this program as we speak. As part of this, we will soon start a program of work and reduce the moves, the majority of our technology estate to the clients. I look forward to updating you more on all of this with the release of our results at year end. Thank you. And Inder and I are now happy to take any questions you've got.

Questions And Answers

Operator

Thank you. (Operator Instructions) The first question today comes from Nigel Pittaway from Citi. Please go ahead.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Good morning, everyone. Just a couple of questions. First of all, on the investments, you obviously said that the target return when you get the growth assets back to 15%, what do you think you would need to see before your investments like that?

A - Patrick Regan {BIO 15131018 <GO>}

Gosh. I think we'll know when we see it, Nigel. It's -- there's still a tremendous amount of uncertainty in the world, and it doesn't feel like we're about to reset our asset allocations right now. So obviously there's tremendous amount of uncertainty with the progression of the pandemic in all of our major markets including Australia, there is obviously -- there is economic uncertainty that's associated with that, how the world response as the government stimulus packages start to unwind, and obviously there's political uncertainty as well. So look, I think at the moment, don't assume we do that anytime soon and probably at this stage I would say not in the second half.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Secondly then, with the -- with just the initiatives you've taken in Australia to suspend premium increases, I mean, why is it that that's an appropriate action in Australia where you're sort of still putting through significant rate increases elsewhere in the world? Is it just mix of business or is it marketing or why are you taking that approach in Australia, which seems to be in such contrast to what's going on everywhere else?

A - Patrick Regan {BIO 15131018 <GO>}

So a couple of things. I said in my remarks I was only really showing the examples in Australia, there equally would be examples of payment deferrals, of zero increases in other markets in the world. In fact, actual premium reductions in lines like workers' comp in the US. So it's not that there had been an absence of examples elsewhere, I think a couple of other things, so we got more SMEs in our book of business, generally in the economy here and more in our book of business, so that they've obviously been disproportionately impacted. And thirdly, that the insurance market conditions have changed more markedly in the Northern Hemisphere with rate momentum just accelerating notwithstanding the measures we're taking, rate momentum has just accelerated much more broadly in the Northern Hemisphere than it has here. So we are taking measures, it's just those are the things offset it.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Okay. And then maybe just finally, I mean obviously with reinsurance pricing sort of having put on a spurt in the first half of the year, you do right obviously reinsurance and salary Insurance. I mean, are you going to sort of expand that business now that the rate environment is more conducive?

A - Patrick Regan {BIO 15131018 <GO>}

Selectively. So Richard and the team have really kept a very tight watch on the reinsurance business over the last few years and we've renewed on a number of occasions kind of opportunities for growth and concluded on each of those occasions right conditions didn't justify it, that's changing now. So, there are definitely opportunities for us to selectively write a little more business these are areas where Continental Europe hasn't moved as much yet so far, so probably not there, but other parts of the world where there is better right conditions. So we're not going to go gangbusters, but there will be at some more opportunities to write more reinsurance business, yes.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Thank you.

A - Patrick Regan {BIO 15131018 <GO>}

Thanks, Nigel.

Operator

The next question comes from Matt Dunger from Bank of America. Please go ahead.

Q - Matt Dunger {BIO 16939207 <GO>}

Thank you very much, gentlemen. Just wondering if I could ask a question on crop, there has been some improvement in soy and corn yields, your combined ratio is below 80%. You've previously talked to 92% as a long-term target. Has this changed at all given your high old quota share reinsurance arrangement, your expectations longer term and how are you seeing this book at the moment?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah. Thanks, Matt. So there's a few things at play with crop. So we showed I think before the long-term average -- 10-year average crop is still around that 90% to 92%. Obviously, last year it was a year that was a much higher combined ratio than that. This year it looks much better year. There's actually been a little bit hell activity recently in the last couple of weeks in the Midwest. But you may remember we bought protection against sales. So that's sort of proven to be kind of a timely projection for us. So broadly now, we booked 90% at the half year. We'll have years where that's it's last year was worse than that and a good year, it will be better than that given the actions.

Q - Matt Dunger {BIO 16939207 <GO>}

All right, thank you very much. And if I could just ask on the price increases you're putting through in property, accident and health, you talked to in North America. What's the risk of further adverse development in these books, given what you are seeing on social claims inflation?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah. Maybe Inder talked a bit about that in the script, so I'll ask him to pick that up.

A - Inder Singh {BIO 20594382 <GO>}

Yes, thank you. Look, I think in terms of the prior year that we saw come through in the last half, it's really come through from a couple of specific areas, the excess and surplus lines and assumed Re multiline insurance, both businesses, we've sort of talked a bit about earlier. And we've now closed to new business. Look, there is a bit of social inflation around. We've been very careful and selective about where we writing business in these areas where we are growing, particularly accident and health, we've got really good data science, we're getting plenty of rate and that's far in excess of claims inflation, similarly in program property cat, we've got a good handle on claims inflation in that and obviously got decent allowances in place for cat activity. So we're trying to avoid areas in which there is some elevated claims inflation and we're very conscious of kind of how that's developed in the last half.

Q - Matt Dunger {BIO 16939207 <GO>}

Thank you very much.

A - Patrick Regan {BIO 15131018 <GO>}

Thank you.

Operator

Thank you. The next question comes from Andrew Buncombe from Macquarie. Please go ahead.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Thank you. Hi guys, and congratulations on the results in obviously a very difficult period. Just a couple of quick questions from me please. The first one, do you have any derivatives hedging corn prices at the moment? Thanks.

A - Patrick Regan {BIO 15131018 <GO>}

Yeah. Inder, we took out protection at the start of the year on corn.

A - Inder Singh {BIO 20594382 <GO>}

Yeah, very similar to what we do every year, Andrew, nothing different. What we've seen so far in terms of crop prices from the base price, corn is down around 17%. So we're starting to get into the territory where we've got some value in the hedging. Having said that, the yields looking a lot more promising. So ultimately, we are providing a revenue guarantee and so as long as there is sort of -- they're moving in sync. So higher yields, lower prices, that's broadly neutral for us, but we've got the normal hedging in place to cover where we see a disconnect between pricing and yields.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Excellent. Just in the next one from me, you mentioned the decision in Australia to roll pricing in terms and conditions at June, if you can just give us a bit of color on what your thinking is about potentially extending that program on a selective basis as these troubles roll on? Thanks.

A - Patrick Regan {BIO 15131018 <GO>}

Yeah, it's a really interesting question for us. I think we're minded to probably continue for a little bit of time. I think obviously a lot of businesses still working through difficult sets of circumstances and whether that be the premium payment deferrals and or kind of renewing zero increases, it just feels like it kind of a good thing to do. So it's something we'll keep kind of continually under watch, but obviously we're very sympathetic to the ongoing economic challenges out there.

Q - Andrew Buncombe {BIO 19921333 <GO>}

The other question that I had was just, if you can give us some actually, there has been some commentary out of the UK that Lloyd's may require syndicates to hold more capital next year, do you have an idea of the quantum of this potential change to your book? Thanks.

A - Patrick Regan {BIO 15131018 <GO>}

Look, Andrew, I'll let Inder jump in, they've changed a lot of things, they've changed the proportion of the capital you can hold by LOCs over the last couple of years, they have changed which banks you can use for those LOCs recently and we are up to date on all of those changes.

A - Inder Singh {BIO 20594382 <GO>}

Yeah, look, we've been evolving the way we fund that business over the last two years to three years, we brought down the kind of implicit gearing in that business. We've also tweaked the syndicative banks. So look, we feel good about some of the changes they are making, they're obviously under a bit of pressure from rating agencies et cetera, but we feel that that business is funded really well. We've got a good banking syndicate supporting it in a good structure that's modern and kind of reflective of some of the changes that Lloyd's is trying to make.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Excellent. Thank you.

A - Inder Singh {BIO 20594382 <GO>}

Thank you.

Operator

Thank you. The next question comes from Andrei Stadnik from Morgan Stanley. Please go ahead.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Good morning. I wanted to ask a couple of questions in terms of your outlook and appetite for writing business going forward. Just broadly at a Group level, given the much higher pricing you've seen in US and International, has the appetite changed in any specific lines of business because previously you were more cautious on some of the liability lines and event cancellation. Do you see more lines becoming attractive at these rates?

A - Patrick Regan {BIO 15131018 <GO>}

To an extent, Andrei, it's a good question. So life's easier when rates are going up and that's a startling revelation, I know, so it's easier to get the right rate that you need, it's easier to get 100% rate adequacy. So generally, what we're really focused on doing is obviously trying to provide good customer service so we see a large number of opportunities, and then rates business where we've got a good franchise ourselves, good underwriting capability, and we can write business at rate adequacy. And that's, we did that pretty well in the first half I feel where we've grown, it's where we've got a strong franchise, strong underwriting and we're writing new business at strong rate adequacy. And that's really what we're focused on doing, and actually with a better rate environment that that's true in more areas to your point, because rates are stronger, more new business opportunities are coming through at full rate adequacy than that was true in the past. You still need to be careful, though, there are still loss trends. So we showed an example of property cat, you have to be really careful how much property cat you're writing and where so you don't accumulate too much cat exposures, cat aggregates.

Financial lines' rates are dramatically better, but financial lines' loss trends are much heightened as well. So we're probably still cautious about writing a lot more financial lines albeit we think our exposures -- our underwriting exposures are much better and the rate adequacy is better, we probably would be cautious about significantly growing in financial lines still.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Thank you. And the other question really in terms of, in Australia, the LMI business, what is your appetite in terms of writing new LMI business at the moment? Have you been able to reprice and or the types and some of the term on your LMI book?

A - Inder Singh {BIO 20594382 <GO>}

Yeah, look, I mean I think as you've heard from us half on half of last few years, we've been relatively cautious in terms of the outlook for the LMI business. So we've been very selective year-on-year. I think if you look at for the full year we'll end up flat versus last year, we picked up a little bit of business out of National Australia Bank. But we've been sort of trying to be proactive on where we see opportunities to tweak our risk appetite, where there is need to do so, so for example, we recently put an embargo on new business and/or further drawdowns in sectors that are more people employed in sectors that are more exposed to the pandemic, so such as retail and leisure et cetera.

So look, I think we remain cautious, we're being measured in terms of trying to where we grow that business, we haven't got a huge appetite to grow that. So we're managing it the best we can, given the environment.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Thank you.

A - Patrick Regan {BIO 15131018 <GO>}

Thanks.

Operator

The next question comes from Ashley Dalziell from Goldman Sachs. Please go ahead.

A - Inder Singh {BIO 20594382 <GO>}

Hi Ashley.

Q - Ashley Dalziell {BIO 17763474 <GO>}

Thanks, good morning, guys. I was just hoping you might be able to unpack sort of 10% underlying GWP growth, you got in the first half or middle, in terms of rolling up forward. I mean obviously very confident on the pricing side of the equation, but there has been pretty limited evidence, I guess, during the half and also pretty limited in your commentary any sign of I guess more demand or headwind as a result of the tougher macro, are you sort of expecting that to become a bit more of a noticeable headwinds as we go through the year?

A - Patrick Regan {BIO 15131018 <GO>}

Yes, you've obviously noticed, Ashley, as we went through the commentary that we gave probably a little bit more positive forward color on our price, attritional, large and not much commentary on GWP full because it's just difficult to tell. I think you could say on the component parts, I think you could say that I feel rate momentum will continue that for all the reasons that we covered, general business activity is really tough to call though I think for any of us, we're still in the period of time where in all the major markets including Australia, government stimulus is keeping a lot of businesses going, and when that comes to an end, that bound to have an impact. So I think we're still -- I mean I think for the second half, that probably the impact will be somewhat muted, I think government stimuluses will largely keep going all the second half of this year and rates should keep going. Next year is much harder to call at the moment. I would imagine, there will be some impact from lower business activity, people still have to buy insurance sort of interesting that and you can see this in the major broker results that people have to buy Insurance, and if anything, people are valuing insurance and (inaudible) valuing tail risk more than they used to. But there just will be lower business activity at some point, and I've got I think that will have some impact in 2021.

Q - Ashley Dalziell {BIO 17763474 <GO>}

Okay, very clear. Thanks. And just a second comment on reinsurance, you spoke about stronger pricing obviously supporting QBE Re. But I guess the flip side of that argument is we have an upcoming renewal, you already shared about half the programs already placed for next year, but would appreciate any sort of evolved thoughts on how that renewal might play out, particularly in the context of the business interruption losses?

A - Patrick Regan {BIO 15131018 <GO>}

Yes, look, I'll be helpful and unhelpful on that, Ash. I think I would imagine the renewal prices will be higher. I'm sure it's super helpful for you. What we're going to try and do is renew the program broadly the same shape. So -- but clearly the market conditions are very different from a year ago. So we might have to alter a little bit some of the attachment points et cetera and there'll be a trade-off between our underlying growth that we've got opportunities to grow, how that plays through to our exposures, how that plays through into the reinsurance program, what's available in price. So difficult to give too many more specifics other than to say, if you assume the structure of the program is similar or very similar, clearly it's going to bit for the renewal clearly be at a higher price with a double-digit increase I would imagine.

Q - Ashley Dalziell {BIO 17763474 <GO>}

Okay, thank you for that. Just a final question, I guess on capital management or capital allocation, really, in terms of the thought process around re-rating the investment portfolio. I'm just wondering how are you grading the return on incremental capital from that some of the potential growth opportunities in the market at the moment?

A - Inder Singh {BIO 20594382 <GO>}

Yeah, good question, Ash, I think it's fair to say, look, in the near term, we remain cautious more broadly in terms of allocating and re-rating as Pat mentioned earlier, but when you think about the medium-term kind of financial framework we set up for the company we would say about 15% allocation growth assets makes sense at the right time. But clearly, probably more in the near term and that just kind of depends how that the second half and the first half of next year pans out, there are more opportunities to potentially grow some exposure in the right areas, but we've got enough capital that we don't have to make absolute trade-offs, Ash. So as you think about where the top end of our capital range having absorbed a lot of the COVID-19 losses, let's see how the next half evolves in terms of do we have better sight of that from the second half and then where we see opportunities to grow organically, that will probably take precedent over re-rating and investments, but ultimately we want to -- we can do both.

Q - Ashley Dalziell {BIO 17763474 <GO>}

Fantastic. Thanks guys.

A - Inder Singh {BIO 20594382 <GO>}

Thank you.

Operator

The next question comes from Siddharth Parameswaran from JP Morgan. Please go ahead.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Good morning, gentlemen. A couple of questions, if I can. One is just on the price increase landscape that we're seeing around the world, and Pat, you mentioned that in Australia the rate increases -- you aren't pushing much through at the moment. I was just interested in getting your perspective on how long you think the rate increases in the other markets can continue and whether there is scope to actually increase rates again in Australia, given the very, very tough past six months we saw for capital?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah, look, I'll start with Australia first, there are still sectors where rate increases are going through, so commercial property strata and they need to, for the reasons that kind of pretty, the increase in weather related cat events is fairly obvious, those books still need more rate than they got today, in the short term, this band to be muted by the SME sector and naturally a little bit on things like commercial motor because there is still lower frequency on commercial motor. So I would imagine the nature of that in Australia, there is still some rate increases, because I think coming into this year post the bushfires there was a need for rate in Australia reinsurance costs are going up as well, but it probably will be dampened a little bit by the SME/economic environment. Market conditions continue to strengthen in most of the markets in the world. So clearly, any business right now in London, rates are increasing significantly. Part of that is, I mean if anybody has got any idea when interest rates are going to go up from the virtually zero, that will be out everywhere in the world. I mean that's a big drag on insurers' earnings. So you need to compensate that with underwriting. There is still casualty trends, there are still increased cat-related weather costs around the world, so insurers need to earn more on the underwriting account and that sort of been increasing in strength in London Market, broader UK, certainly North America, even the markets that we're slightly slower, Continental Europe and Asia would start to get some rate, and when I think let's see. But it looks like that will continue for the foreseeable future.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Meaning a year or longer?

A - Patrick Regan {BIO 15131018 <GO>}

Yes, probably, probably.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay, thanks for that color. Just a question on -- on your claims and the reserve increases, we've seen again 2.2%. I mean I'm conscious a lot of it stems from the US, but maybe if you could just make a broader comment as to what you're seeing in terms of claims inflation on long tail in markets like Australia? We have seen some comments from others that there might be some inflation there. And also, just some comments about Europe as well, if you can. And then if there are any changes to how you are reserving on the latest accident year?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah. So look, I think some exposures are different from ours with those of others. On long tail lines, whichever long tail lines you pick up, we are not seeing deterioration of reserving or even current year performance. Our long tail performance or pretty much all of our long tail books in Australia has been good. And that's something we watch very closely. I mean other than stating the obvious, we've all stated before that CTP will produce lower reserve releases going forward for obvious reasons, probably zero, but lower.

Elsewhere in the world, look, I mean social inflation still kind of active. You have to be very careful, with the claims development on the financial lines in the first six months was pretty benign. We think we've got on top of that in previous periods. But there is still lot generally in the market of activity on financial lines and social inflation has not gone away in this period. That is still alive and well on broader casualty trends. But we're very focused on that.

We have strengthened our current accident year picks to pick up really to make sure, I mean, by which we do our rate adequacy calculations. We've strengthened for reinsurance costs, loss trends along the lines we just referred to and actually for that matter, in terms of rate adequacy, lower investment returns as well, so the actuaries around the world are factoring that in.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay, great. Okay. And just final question from me, just on your large and cat claims. Obviously there, you think you're above your expectations in the last half obviously driven by Australia actually in -- but given that we have seen, I suppose elevated activity for a little while, could you give us your thoughts on what you actually think your large loss allowance should be as a percentage of net earned premium given the structure of your program?

A - Patrick Regan {BIO 15131018 <GO>}

Yeah, fair question. So I think your -- two components, the large loss non-cat, I think we've got good trends and frequency and we actually expect that to trend down over time. I think on the cat-related large losses, I think it's a fair point and we'll look at that as we put together thoughts for next year and just walk, you could easily imagine that we'll have a slightly higher cat allowance for the next year versus this year.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

So, overall the combined effect of the two?

A - Patrick Regan {BIO 15131018 <GO>}

Probably not a huge difference. I would imagine they're probably net to close to this year.

A - Inder Singh {BIO 20594382 <GO>}

This year, ultimately, so it will depend also where we end up on reinsurance as well. So we'll have to look at it in the round.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay, great. Okay, thank you.

Operator

The next question comes from Brett Le Mesurier from Shaw and Partners. Please go ahead.

Q - Brett Le Mesurier {BIO 5909278 <GO>}

Hi, thanks very much. You've put together in indication of the results, excluding COVID, but what is the outlook excluding COVID?

A - Patrick Regan {BIO 15131018 <GO>}

Sorry Brett, just specifically on profitability?

Q - Brett Le Mesurier {BIO 5909278 <GO>}

So your business as a whole. So you used to give outlook with the combined operating ratio.

A - Patrick Regan {BIO 15131018 <GO>}

Yes.

Q - Brett Le Mesurier {BIO 5909278 <GO>}

So I understand the great significance of COVID, but you can identify historically what your -- how your performance is ex-COVID presumably you have some expectation of what it is going forward ex-COVID?

A - Patrick Regan {BIO 15131018 <GO>}

Look, it's clearly more difficult to predict the future now than it used to be, so if I just try and pick out the component parts, so on the top line, we've got positive trends obviously on pricing, business activity at some point as I mentioned feels like it's going to have an impact and the rate plus two -- we saw in this past six months, probably I'm surprised that we can get that as we get into 2021 just it feels like business activities are bound to slow down.

In terms of kind of rates versus claims inflation, there clearly is claims inflation activity in terms of cat events, in terms of casualty trends, in terms of general inflation feels a tiny bit lower. Right now, we're getting rates in excess of that. So that's sort of a positive trend for us going forward, I mean, the natural inflation I would say, particularly when you added COVID in this probably higher than normal. But clearly, when we're averaging rate across the Group of 10, we would be carrying rate in excess of claims inflation. So that should have a positive trend going forward.

Q - Brett Le Mesurier {BIO 5909278 <GO>}

Right. So where do you get to see your combined operating ratio ex-COVID?

A - Patrick Regan {BIO 15131018 <GO>}

We wouldn't in any event normally update on that Brett at the half year and certainly in the middle of all this, we will come back to you again at the year-end.

Q - Brett Le Mesurier {BIO 5909278 <GO>}

Okay, thanks.

A - Patrick Regan {BIO 15131018 <GO>}

Thank you.

Operator

Thank you. At this time, I'm showing no further questions from the phones.

A - Patrick Regan {BIO 15131018 <GO>}

Well, great, thank you everybody and we look forward to speaking to you all again soon.

A - Inder Singh {BIO 20594382 <GO>}

Thank you.