Y 2020 Guidance Call

Company Participants

- Inder Singh, Group Chief Financial Officer
- Richard Pryce, Interim Group Chief Executive Officer
- Tony Jackson, Investor Relations
- Unidentified Speaker

Other Participants

- Andrei Stadnik
- Andrew Buncombe
- Kieren Chidgey
- Matthew Dunger
- Siddharth Parameswaran

Presentation

Tony Jackson {BIO 1729093 <GO>}

Good morning, everyone and welcome to QBE's Market Update. We'll (Technical Difficulty) shortly, but before we do, just a quick reminder that this call will be recorded and we can only accept questions from analysts or institutional investors who joined by the web link. To ask a question, please use the raise hand button on your screen, when (Technical Difficulty) ask a question you'd be prompted to turn your microphone on.

I'll now hand over to QBE's Interim Group CEO Richard Pryce.

Richard Pryce {BIO 5184927 <GO>}

Thank you, Tony. Good morning. I would prefer to be speaking with you all for the first time in my capacity as Interim CEO under different circumstances. But unfortunately, as we started finalizing our year-end result, a number of developments weren't as updating the market on our revised full-year '20 profit expectations.

As we state in our ASX release having reported our first-half after-tax adjusted cash loss of $666 million, we now expect to report a full-year adjusted cash loss of around $780 million and the statutory after tax loss of around $1.5 billion. The key factors driving the estimated second half loss are graphically represented on Slide 2 and include while our ultimate net cost of COVID-19 is unchanged to $600 million, we will be recognizing a further amount within the ultimate net loss in the second half, continued adverse catastrophe activity in Q3 and Q4 which almost also impacted our crop business.

Additional prior year deterioration following our year-end reserve reviews, impairment of North American goodwill and related deferred tax assets, legacy IT and real estate writedowns.

Inder will take you through each of these items shortly, before I hand over to him, I wanted to firstly say that I am obviously very disappointed with the headline loss, but I remain confident about the longer term global pricing environment and therefore the outlook for our business.

The underlying trajectory of the business remains favorable. With a full year '20 result expected to show further improvements in the attritional claims ratio and the underlying COR is expected to be broadly similar to that of the first half result notwithstanding a deterioration in the performance of the crop business during the current half.

Turning now to the pricing environment. Slide 3 should be a familiar chart which shows our premium rate and retention trends at group and divisional level. Pricing momentum across the group remains strong with a third quarter year-to-date average rate increase of 9% compared with 5.5% in the prior period in 2019 and 8.7% in the first half of this year. Premium rate momentum is especially strong in North America and international which saw average third quarter rate increases a 10.8% and 13.9% respectively and contributed to an average third quarter group-wide increase of 9.8% in the third quarter.

Premium rate momentum slowed in Australia Pacific during the second and third quarter, reflecting the previously announced COVID-19 related relief measures. Following the lifting of the COVID related restrictions, premium rate increases in the effective classes, business packages, commercial motor and A&H were reinstated effective the 1st of October. And to preempt the inevitable question, preliminary Q4 estimates point to a further increase in premium rate momentum in every division.

In terms of the third quarter year-to-date rate increases, I thought it will be useful to highlight a few areas in each division where rates have been especially strong. Firstly, in North America we've seen particularly strong increases in property programs 18%, specialty programs 13%, professional lines 19%, aviation 17% and finally A&H 10%.

In international, we're seeing particularly strong increases in UK and international markets property at 17%. Financial lines in UK and international markets of 27%, UK motor at 12%, international markets marine 21%, international markets liability 19% and Canada 20%.

Although, Asia still remains a laggard rates have improved of a low base and year-to-date, we're at 7% underpinned by a particularly strong performance in Singapore at 11%.

In Australia, we have seen solid increases in aviation at 12%, commercial property at 12%, household and strata at 8%, professional indemnity at 7% and engineering at 7%. It might be useful at this stage to offer an insight into what I believe is causing this global change in pricing and why I believe it should continue at least through 2021.

The industry is facing a combination of adverse factors that it has not experienced for decades. And that's even before you consider the impact of COVID-19. The lasting financial damage of a protracted and deep soft market is leading to reserve strengthening rather than reserve releases and particularly in financial lines.

Continued heightened catastrophe activity including more midsize losses, claims inflation including the much discussed U.S. Social inflation, the subsequent rise in the cost of reinsurance and last but not, least lower almost non-existent investment yields.

Whilst I don't have a crystal ball, I'm increasingly confident about the outlook for rates, which I expect will continue to increase in most products and most geographies for at least '21 and in some areas into 2022.

I will now handover to Inder to take you through the details provided in the remaining slides.

Inder Singh {BIO 20594382 <GO>}

Thank you, Richard and good morning all. Firstly, I'd echo Richard's sentiments and I am equally disappointed about the headline loss we're expecting to report for the financial year 2020.

However, I do remain confident about how well the business is positioned to capitalize on, what is clearly a favorable insurance pricing landscape. Unfortunately, there will be lot of noise in our full-year result, reflecting the impact of COVID-19, adverse catastrophe experience, prior accident year development and the goodwill impairment, however, the fundamentals of the business remain promising.

I'll turn to slide -- slide on the claims ratio and take you through the underlying performance of the business and the key components of our claims ratio. Our attritional claims ratio continues to improve steadily with the Q3 year-to-date ratio for the 60 basis points better than the first half and more than 2.5 points better than 2019. What is it difficult to be precise at this point, I'm confident we'll see further improvement in the attritional claims ratio in Q4. This continued improvement reflects the benefits of the premium rate increases and the performance disciplines we've instituted QBE including cell reviews and Brilliant Basics.

The positive trend in large individual risk claims continued in Q3, reflecting ongoing benefits from improved risk selection and portfolio mix. This is especially being the case in international which is arguably more of a large individual risk business than our attritional business. The large loss ratio by its very nature can be volatile from one quarter to the next and we expect to print a slightly higher ratio as we close out the year, allowing for our normal IBNR booking process at year end.

Turning to cat experience, 2020 has been a particularly active year for catastrophes. You may recall the devastating bushfires plus the East Coast hail and storm activity in Australia early in the year is contributed to a net cost of cat in the first half of $308 million, which was around $60 million higher than our first half allowance of $250 million. Cat experience has remain elevated during the second half with wildfires in California and the most active Atlantic hurricane season on record with 30 named tropical cyclones this year.

Assuming December cat experiences in line with plan, we now expect the full-year net cat cost to be around $680 million or a $130 million above our annual allowance of $550 million. We are now well into our cat aggregate reinsurance program, which offers us $500 million of protection above the attachment point of $545 million.

Just for clarity, there are two main reasons why our cat cost of $680 million is higher than the cat aggregate attachment point of $545 million. Firstly, our retention is $5 million per event and there has been a very significant number of natural cats as well as multiple business interruption events. First we retained the cumulative cost of all events between $2.5 million and $5 million.

I'll make a couple of comments on our crop business. Despite favorable growing conditions and an encouraging recovery in corn and soy prices, our crop business was also impacted by adverse weather during the second half. A large and unusual devastated corn yields in Iowa and the California wildfires caused material fire and smoke damage to grapes in the Napa Valley.

In addition we've had some late reported preventive planting claims in North and South Dakota. As a result, our crop business now expected to report a combined operating ratio of around 99% on $900 million of earned premium compared with the first half result of around 90% and our Q3 year-to-date result of around 93%.

I'll now make some remarks on prior accident year development. You would have read in our ASX release that following completion of year-end reserving reviews, we're now expecting to recognize around $240 million of adverse prior accident year development in the second half. This includes around $30 million deterioration in short tail lines reflecting further industry-wide loss creep on a number of cats, including hurricanes Irma and Dorian as well as Typhoons Hagibis and Faxai.

We also experienced $40 million of adverse development in our general aviation portfolio in North America where we had an unusual single large claim. The remaining $170 million strengthening of long tail reserves includes a substantial charge in North America, primarily to reflect social inflation trends together with around $40 million strengthening of discontinued E&S reserves and development across financial lines and inwards reinsurance.

Social inflation is a complex and difficult to fully capture in reserving. We have reviewed our reserves in the context of emerging social inflation trends both in our portfolio and the wider industry to ensure that we've incorporated an appropriate and prudent provision for the systemic risk.

Turning now to the impact of COVID-19. Firstly, we remain confident that the $600 million estimate for the ultimate net cost of COVID-19 remains sufficient. However, there is still lingering uncertainty particularly around the potential for recessionary related claims as we move into 2021. We recognized $335 million of COVID-19 related costs during the first half of 2020 and expect to recognize the further $135 million during the current half bringing the total full-year cost to $470 million. We expect to recognize the remaining $130 million of our allowance in 2021.

We incurred around a $100 million net claims in the second half, primarily across the trade credit, LMI, casualty lines and business interruption, plus we incurred a modest amount of additional expenses primarily relating to commercial motor premium refunds in the UK. On business interruption, as we said at the time of the FCA test case court ruling here in Australia, the net cost of Australian BI exposure is expected to be limited to $5 million per occurrence. And as a result, it contributed a minor amount to our net COVID-19 cost in the current half.

On LMI, the downturn in the Australian economy and the residential property market is now expected to be less severe than originally envisaged. However, we will recognize a preemptive LMI charge of around $35 million at year-end to reflect an expected increase in delinquencies over the next 12 to 24 months as mortgage holidays come to an end and as we reach inevitable fiscal cliffs. While the key macro drivers of unemployment and house prices are proving resilient, it is too early call or declare victory on LMI risk.

Turning to trade credit and as is the case with LMI, the economic backdrop in Australia has been more resilient than originally expected. And the trade credit government backstops implemented in Europe have been helpful. While we incurred nearly $40 million of net claims during the second half including a few lumpy individual claims, loss experience has remained manageable.

We are working on the basis that any potential upside in LMI and trade credit versus our original stress scenarios provides a small coverage elsewhere, particularly in liability classes where they will undoubtedly be recession related claims as well as litigation surrounding the management of the pandemic.

On that point during the current half, we have recognized nearly $30 million of additional net casualty claims associated with likely litigation stemming from the management of the COVID-19 outbreak. Finally the $115 million of risk margin pertaining to COVID-19 claims, uncertainty is unchanged from 30 June.

Turning to investment returns and capital. We recorded a net investment return of 0.2% for Q3 year-to-date. This is a significant turnaround from the investment loss in first half and reflects the quality of our fixed income book, which has seen a strong recovery in credit spreads and has more than retraced the significant spread widening experienced in the first half. Well, we're yet to close out the year and year-end valuations can obviously move around, we expect full year net investment income to be around $140 million.

We are currently projecting around $27.4 billion in investment assets at year-end and these remain conservatively positioned with around 93% in fixed income at an asset duration around 2.1 years, which is broadly economically matched with the duration of our claims liabilities. Based on the running yield of our fixed income portfolio and current asset allocation, our forward-looking investment return is currently around 1% allowing for a typical 7.5% average return on growth assets.

While a 15% allocation to growth assets remains a medium term aspiration, we're unlikely to mature re-change our asset allocation in the near term, in part because of lingering economic uncertainty, but also because the pricing landscape currently offers scope to replace lost investment income with even stronger underwriting profits.

On the balance sheet, our PCA multiple is expected to be above the midpoint about 1.6x to 1.8x target range on PCA at 31 December and allowing for a pre-funded Tier 2 refinance, pro forma gearing is expected to be around 33% and within our target range of 25% to 35%.

Our gearing ratio is up from 30% at 30 June, reflecting the goodwill and DTA impairment. Our balance sheet remains strong and we will maintain a rigorous focus on capital allocation and risk management as we move forward into 2021.

A couple of quick comments about our upcoming January 1 reinsurance renewal. Given the year that the primary insurance industry has just experienced with high cat frequency and complexities associated with COVID-19, the reinsurance renewal season is running behind schedule. While we have finalized a number of the group's cat and per risk treatise on terms that are at or within the parameters of our 2021 plan, we are yet to finalize more complex elements of the program such as the top RAP and aggregate treaty.

Given the frequency of cat losses in 2020 aggregate treaties are proven to be challenging to place for primary insurers at or near expiring terms. While we expect to enjoy tailwinds across many aspects of the business in 2021, the obvious near term headwind is an increase in cat allowance associated with the likely higher aggregate attachment point. Components of the reinsurance renewal particularly the RAP and to a lesser degree the aggregate not only hold potential margin implications, but also impact our PCA multiple as we turn into 2021.

We expect to complete the placement of the group's cat reinsurance program over the next few weeks, and will update the market on the final outcome with the release of our FY '20 result in February.

With that I'll hand back to Richard. Sorry, Richard you're on mute there.

Richard Pryce {BIO 5184927 <GO>}

Sorry. That was muted. Thank you, Inder. Just in closing, let me say, I'm not envisaging any change in the group's strategic agenda for 2021. However, I think we can generate a better return from our cell review process during 2021, by being more intensely focused on the poor performing cells and more action orientated. In addition, we're going to accelerate the rollout of our pricing tools and particularly our global property pricing mechanism.

Our agenda will be strongly aligned to financial performance and project execution. And my focus is ensuring that the group does not get distracted, so across the globe we can't take full advantage of the best pricing environment in well over a decade while locking in margin expansion and generating quality growth in the right locations.

With that I'll open the call up to Q&A.

Questions And Answers

Operator

(Question And Answer)

A - Inder Singh {BIO 20594382 <GO>}

First question please, Kieren.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Hi, Richard, Hi, Inder. I've got a couple of questions, maybe just starting on U.S. reserves. We've clearly seen this as a recurring issue over a number of years. Can you just talk in a bit more detail to what specifically has changed here in terms of strengthening inflation allowances, given clear ongoing issues around social inflation pressures?

A - Richard Pryce {BIO 5184927 <GO>}

Inder, do you want to take that?

A - Inder Singh {BIO 20594382 <GO>}

Yes, sure. Kieren, if I just breakdown the sort of second half elements of the development for you, so $30 million of the strengthening relates to prior year cat events. So that's an unusual level of development. And what we've done this year obviously, we've had a lot of cat activity this year. We've picked our cat estimates as conservatively as we can, and obviously, we've got the protection of the aggregate because we're into the aggregate. So that's $30 million of kind of prior year relating to cat.

There's another $40 million relating to excess and surplus lines, this is a business we've put into runoff. So we have shut down this business and we're going to manage the claims in a runoff in a sense and make sure we're extracting value from that, but that's a discontinued business.

We've had $40 million as we referenced in our announcement of a single large claim in aviation, again a very unusual event. There's been -- then there's kind of a broader $100 million we've taken what I'd call to reflect what we currently see as social inflation trends, so we try to project what we think those social inflation trends look like for the next couple of years and make sure we're reflecting that in our prior accident year reserve estimates the best we can. And so, within that $100 million, is a reflection of the social inflation, and some additional strengthening around some of the severity lines and small amounts into management lines, et cetera.

And then, in addition, we've got $40 million what I would say is to do with financial lines. This is our business in international where we've seen some development in the really older years, '13, '14, '15, et cetera. We've re-underwritten that business, as we've gone through '17, '18, '19, and maybe Richard can make a comment on that. But the re-underwritten business and the rate adequacy on those more recent years is holding up very well. So those are probably the five elements around strengthening and a bit more color on that, Kieren.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks. Inder, just to pick up from one point, the $100 million around the social inflation top up in the U.S., I know there's probably a variety of classes sort of underlying that, but are you able to give us a sort of a broad overarching feeling sort of what the percentage change in inflation assumption would be there?

A - Inder Singh {BIO 20594382 <GO>}

Yes. Look, we try to reflect meaningful levels of additional inflation. I guess, Kieren, if you look at the classes that are most affected in the U.S., you've got big company, public market, business which we underweight on. We've repositioned that book with limit sizes that are meaningfully lower in the last few years and we focus that book on private D&O. So yes, we've got a bit of inflation we've assumed in that, but it's substantially lower than that the market is assuming in terms of the mix of the exposure of -- relative exposure of the market has to the bigger end of turn on D&O.

The other element is really around commercial auto and again from some of the de-risking we've done over the last few years, we've got more limited exposure to commercial auto; in fact, we don't actually do any standalone commercial auto.

So where we're picking inflation higher is really in the packaged products where we have some exposure to commercial auto in those classes, those are the main areas of impact. We've done a lot of industry benchmarking. We are picking what we feel is a very reasonable range in the context of those industry benchmarks. We're trying to be prudent where possible. We, just like everybody in the market doesn't want to continue to see a repeat of our strengthening prior reserves. So, we're taking that mindset in setting the reserves.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay, thanks. And just a second question on the reinsurance and cap budgets for the dynamic that you flagged into next year. Obviously, you said the aggregate still isn't done, so appreciate it might be difficult to be precise at this stage. But can you get some numbers to the extent that you counter at this point around how we should be thinking about that aggregate increase in cat budgets into next year?

A - Inder Singh {BIO 20594382 <GO>}

Richard, happy to take that. So, look, we -- whilst -- we're not done, we're well progressed, Kieren, on the discussions with the market on that. As I said, we're assuming in our plans for next year that the cat allowance goes up a bit. I think you can read into the fact that where we've ended this -- end of this year gives you some level of guide into next year, albeit this has been an elevated year of cat. But the reality is, when you look back at last three or four or five years, now the industry is seeing an elevated level of cat. We've got to be pragmatic about that, we've got to make sure allowances reflect the reality around that and we're also going to make sure we're going out and getting the right price for that.

So, we're very much taking a realistic approach to this into our planning for next year. And I would say, we're fairly well progressed with the reinsurance renewal and we expect it to land within the parameters of our 2021 plan, as we stand today.

A - Richard Pryce {BIO 5184927 <GO>}

I was talking -- if I can add, I was talking to the team earlier and unlocking those last bits, particularly the top wrap on aggregate is very difficult, because of the exposure and losses we're likely to put into those. But at the moment, from what I could see from today, we're going to come in pretty close to what we expected I think on structure and price, so on the overall programs, we might pay a bit more on some and a bit less on others. But we will have a higher attachment as Inder says, which I think is only realistic in view of the environment and buying these programs is very difficult now. So I think if we get this done, I think we'll be in a good position.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thank you.

A - Richard Pryce {BIO 5184927 <GO>}

Other questions?

Q - Andrew Buncombe {BIO 19921333 <GO>}

Hello, guys. It's Andrew Buncombe here from Macquarie Securities. Just a couple from me, please. There was a comment in the document that the growth is well into the group catastrophe aggregate cover. Could you give us a bit of an idea of how much of that is left at the moment, please, for FY '20?

A - Inder Singh {BIO 20594382 <GO>}

Look, I think the -- we're not at year-end, Andrew, and I think what we've done in making those assumptions is also assumed what we think is a reasonable amount for our cat exposure for the rest of the year. And obviously, we're seeing some storm activity here in Australia, as we speak. Look, there's a reasonable amount of headroom left in that, it's difficult to quote precise numbers, but the other thing you've got to recognize, Andrew, is that the aggregate is at the end of the line in terms of how the reinsurance especially looks.

So we've got the all the kind of Equator share in credits that we've seen from the divisions and 50% of that loss goes externally through the Equator captive. We've also got the cat towers that come into play well before we get to the aggregate. So the headroom in the aggregate, we do have some headroom left, but also we've got the protections kind of sitting before you get to the aggregate as well.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Okay. My next question was just on the progress of the cost out program given there has been some change at the Group CEO level, should we be assuming that that will continue through into FY '21?

A - Richard Pryce {BIO 5184927 <GO>}

I think, Inder, you can update where we are on that?

A - Inder Singh {BIO 20594382 <GO>}

Yeah. Look, I think we're making good progress, Andrew. So I'd say the COVID-19, sort of (Technical Difficulty) opportunity to continue some of that work. We continue to see opportunities even going into 2021 around how we'd better use real estate and optimize that, our ways of working, we're obviously taking some charges as we start to move some of our technology state onto the cloud. So we're feeling good about the trajectory on our expense ratio and very much if not somewhat ahead of our targets, Andrew.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Okay. And then just the final one from me, please. Just some thoughts would be interesting on whether we should expect some further portfolio exits in the next sort of 12 or so months? Or should we assume that everything's going to stay the same until the group CEO appointment is made? Thanks.

A - Richard Pryce {BIO 5184927 <GO>}

I'll take that. Look, I think, we've done a lot over the last few years to reshape the organization, and -- but if we're going to be very focused on the performance agenda, there can always be the odd smaller portfolio that we may make a decision on, but there's nothing of a material level that we would execute on at this moment in time. I just think it's the odd ones as we reshape and then try and improve the performance in the organization. But nothing that's on our agenda at this moment in time.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Excellent. Thank you.

A - Richard Pryce {BIO 5184927 <GO>}

Other questions?

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Hi, there. It's Siddharth Parameswaran from JP Morgan. I had a couple questions, if I can. So one is just on prior year reserves I was wondering, Richard, if you could just give us an idea whether you're actually seeing any adverse trends on claims and inflation, which are leading you to take some of these increases? Because we've heard about external benchmarking before, I'm not aware whether those benchmarks have changed or whether there is something that you're seeing in your portfolio which is leading to more of these increases again in the U.S. I was hoping you could just make some comments about that. And also, inflation trends in other parts of the world, whether there is any consensus we should have on any of these -- I mean anything that we saw in the U.S. perhaps translating into what might happen in other portfolios around the world.

A - Richard Pryce {BIO 5184927 <GO>}

Yes. So if you look at pure claims inflation that we aren't seeing. In the past we've seen FX driven claims inflation in Australia and so in Europe and we are not seeing at the moment. Obviously, we've got to wait and see what happens with Brexit where we think the sterling is probably at the right place. So any of the FX driven inflation you will always see a little bit of medical inflation and a little bit of motor inflation, but that's normally within our assumptions, I wouldn't say that's out of the range.

I think the area there is quite a lot of people and particularly in financial lines it's not so much inflation, it's just the large claims. And a lot of this has come through in one of large claims, in motor vehicle where excess layers have deteriorated. So if you're writing a high excess layer and the claim is deteriorated five or six years later. And I think that's what's really driving the fact that most people are pulling extreme excess capacity, certainly what we've done on excess layers in financial lines because they're not going to tolerate that late year development on large claims.

But generally, the inflation is okay, then we get the whole issue of social inflation and trying to unravel what that is and as Inder spoke about that earlier, that's a mixture of court cases, I think the fact is it's more difficult to go near a court in the U.S. now and maybe in other parts of the world where corporations are more likely to find it difficult to get a fair day. So therefore, you'll see those claims could arguably be a little bit higher, but the general underlying level in our core casualty motor classes is generally under control.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

And just your confidence that around there is in other parts of the world in it sounds like you're not seeing anything anywhere else?

A - Richard Pryce {BIO 5184927 <GO>}

Well, no. We're not seeing anything in Europe. And in fact, you could say, it's the other way at the moment with economically what's happening. Asia is pretty stable. Australia, Inder could talk better about it than me, but it's not what we've seen in the past. So generally, medical inflation is always going to be a little bit higher, but we're very careful around that. But I think generally, it's what we would expect and our claim -- our claims inflation assumption is up a little bit in the planned for next year, but nothing material.

A - Inder Singh {BIO 20594382 <GO>}

Yeah. I think in Australia, the only thing I'd add is we are not going to be seeing the level of releases that we have historically in classes like CTP and some of the liability lines, Sid. So we're not seeing any issues that causes any concern, but the releases we've seen in the last three, four, five years across the industry are clearly reducing as we've shifted to a new scheme here in New South Wales. And so I'd say the releases are probably drawing up.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay. Fair enough. Just a second question from me just around the write down in the U.S. I was just hoping you could give us some idea of what combined ratio you now believe is possible in the division in the long run given I suppose some adverse trends that we've been seeing on crop for a while and also just obviously the adverse trends that we're seeing more broadly in the U.S.? What are you seeing in your assumptions?

A - Inder Singh {BIO 20594382 <GO>}

Yeah. Look, I think, you've got to kind of bear in mind the fact that as we look at financial statements and the carrying value of goodwill, Sid, there is a greater weighting that we need to place on the historical performance of the business. So, I don't think it necessarily reflects a very different view of the go forward, but we've got to balance the -- we would strike the valuation.

Look, we're -- in the context of the write down we're taking, our working assumption at the moment is that the long-term combined ratio assumption for the purposes of striking our accounts of the goodwill valuation is probably around the 98%, 98.5% mark going forward.

I don't think that necessarily means that our view of the long-term combined ratio of the business fundamentally shifts. What we're doing is we just recognizing that we need to place some weight around the historical performance as well, which we have done historically, but clearly when you look at the crop business again, as you referenced, we've had another difficult year in the second half of this year around crop.

So as we look at the last 10 year average of that business that ticks up a little bit. And the other piece I'd say is really around the investment yield whilst it plays both ways in terms of the investment yield and the risk-free rate movement, it's those dynamics that ultimately lead to a review of the carrying value. So I'd say, it's very much been driven by the second half performance and kind of our outlook around the investment yields in particular.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Yeah. Fair enough. And just a follow-up question from me, just on business interruption in Australia would you be able to give us an idea of what an adverse scenario might look like for you if everything was to go wrong? So, what would a gross philosophy -- we've obviously seen one of your peers provide us with that kind of disclosure. Perhaps you could just give us some or at least update us on your thinking around this, around what's an extreme scenario? What would that mean in terms of the potential losses for you?

A - Richard Pryce {BIO 5184927 <GO>}

I'll take it, Inder. Look, we think it's too premature to come to that, we have a very small number of claims and there's a lot of legal discussion and valuation of claims to go through even on the small number. So we're looking at some estimates, but we're not in a position to disclose anything.

I think the difference between us and others is we feel confident about our reinsurance protections as we said before. And the particular ones we've been talking about which were a little bit challenging to get renewed is because some of those will probably be bearing the brunt of some of this in the event that -- our policyholders make successful claims against QBE.

So we feel it's a little bit early, because when you compare it with a situation I've been running in the UK where we have lots of claims notified, we have a legal determination, we're starting to adjust them. This is way too premature to come to a firm view that we can discuss.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay. Thank you.

A - Richard Pryce {BIO 5184927 <GO>}

Other questions?

Q - Andrei Stadnik {BIO 18854292 <GO>}

Good morning. It's Andrei Stadnik from Morgan Stanley. Can you hear me, okay?

A - Richard Pryce {BIO 5184927 <GO>}

Yeah.

A - Inder Singh {BIO 20594382 <GO>}

Yeah.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Fantastic. I wanted to ask my first question around the opportunity to grow what would you -- in which sectors have you seen the most interesting opportunity to grow and perhaps take market share? And are there any constraints on your ability to grow? Whether having enough underwriting stuff on the ground or having enough capital flexibility.

A - Richard Pryce {BIO 5184927 <GO>}

Yes, so when we look at this it's actually about coming through. So, okay, I think that's better, so sorry. We look and something I'm very passionate about is looking at where we grow more than rate. So we're pretty much going to grow everywhere in the organization in '21 because we're getting more rate in virtually every line and every geography.

But where we think we can grow a little bit more, you might say it's slightly ironic, but we think there's more growth in crop and we just recruited a new financial line, same in North America has taken opportunity of -- there aren't many places where there's a hard market, but there's a hard market in financial lines and it's written in a very different way to what it has been with very different rate on lines in capacity deployment.

So we've hired -- recently hired a team from Berkshire Hathaway to accelerate our growth there. So we will get some growth above rate there. I think QBE Re, our reinsurance business will find some growth as well as some clients decide that they need to buy more reinsurance to protect their capital position or volatility and we're seeing some good opportunities in areas there.

And in Australia, I think across the board, I think we will get back to more of a growth agenda as we come out of the post-COVID rate restrictions. So we'll probably see growth in New Zealand, certainly growth in our farms business, which is one of our best business and in private motor. So these are all areas where we will grow more than rate plus the fact I think we'll get some growth in our European business, which we've always been looking. We've got a plan to double our continental European insurance business which is on track. That will grow not as much of our grade as we thought it would have done because of the economic environment, which we are anticipating being a little bit more challenging.

And we also want to look at the teams. We're not necessarily on the lookout immediately for acquisitions, but if there's teams that we can bring in particularly into the London market business, they will help us accelerate growth.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Yes. Thank you. And I think well I have to meet myself so (inaudible) by that. And in terms of the improvement in that attritional claims and then underlying calendar year combined ratio, it feels a little bit muted given that we've seen accelerated improvement in premium rates. So is there anything else can kind of getting on the modest slowdown improvements in the third quarter in terms of the attritional and the calendar year combined?

A - Richard Pryce {BIO 5184927 <GO>}

Well, not all the rate necessarily goes to the attritional, so that will be one reason. And we're getting to a stage in our businesses where our attritionals have come down quite dramatically and it's going to be difficult to carry on bringing those down much further. And there's always offsetting, so that we've just been talking about claims inflation albeit a little bit of an offset of claims inflation in there as well.

So the rate doesn't fall immediately to the bottom line everywhere that quickly, but I think the reason that our attrition has improved so much over the last few years is in large part not just being to our stellar reviews and performance agenda, but it's been to the consistent rate increases that we've got in particular parts of the world.

A - Inder Singh {BIO 20594382 <GO>}

Just Andre, to help you with the math, a year-to-date number. So you wouldn't ordinarily expect one quarter to shift your year-to-date number. So it's not a discrete Q3 number.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Thank you. If I can ask a third final question. It seems like most of the future COVID estimates or most estimates are coming from bit of trade credit and LMI. The feedback from European piece seems to be there were some concerns about they had casualty lines, will respond in a multi-year view to COVID given those claims could take longer to settle. So am I missing anything there or do you have confidence that you are not going to see as much potential COVID impact in casualty lines?

A - Richard Pryce {BIO 5184927 <GO>}

Well, in the UK and Europe so far, we've seen virtually no COVID impact on casualty, so far so good. Now we are going to take a bit of a provision next year expecting there might be some of that in casualty, particularly in workers' comp. EL is in the UK. So far, we haven't seen that much and whilst we put a little bit of a provision going into next year, it doesn't immediately worry us at this stage. Any other questions?

A - Unidentified Speaker

We're showing Matt Dunger has one question.

Q - Matthew Dunger {BIO 20863237 <GO>}

Thank you very much, gentlemen. I just had a follow-up on the premium growth outlook. You had been seeing premium growth above pricing in the U.S. and the UK in the first half. Could I just clarify the comments given you've called out some pockets of potential where you can pick up volumes versus your comments earlier Richard about more attention to some of the poor performing sales. Are you expecting volume growth in 2020 in aggregate?

A - Richard Pryce {BIO 5184927 <GO>}

Yes. We think -- we're seeing -- because we're seeing the compound rate come through as we get going through the year, we're starting to see a little bit of growth what's encouraging is that, QBE is probably growing now for the first time, it has probably for a decade because we don't have the impact of any disposals. And also, we're seeing the positive rate going through and we're getting some growth outside of rate. It's not dramatic, but it's encouraging.

Q - Matthew Dunger {BIO 20863237 <GO>}

Okay, that's great. Thank you very much. And in terms of the improving retention rates that you're noting, does that imply that you're not pushing pricing strongly enough across some of those divisions?

A - Richard Pryce {BIO 5184927 <GO>}

You've been having the same conversation as I do with underwriters. Where is the tipping point on price and that's something we talk about a lot and there will be parts of the organization where we think we can push rate harder because the retention ratio is too high and that's something we constantly look at as a KPI metric around the performance of the business.

But I think we're about right. I think certainly when you look at our Australian franchise and our International franchise, they're strong, well established and have good client relationship. So our retention even in difficult times, putting heavy price increases, our retention is still very high partly because of the long-standing relationships and also partly we can drive solutions that some of our competitors can't.

People often ask about the new markets entering but most of them don't have the distribution or the product or the servicing to compete with us in those areas. They can compete in a retro market in some of the East deteriorated reinsurance, but they can't necessarily compete in the frontend market. So, I think the retention ratios are about right, but it's something we will always look at to make sure that we're not leaving money on the table.

Q - Matthew Dunger {BIO 20863237 <GO>}

Thank you very much.

A - Unidentified Speaker

We just have a follow-up question from Kieren and one from Sid coming through now.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Hi, guys. Thanks. Just two quick follow-up questions. The first just around the reserving philosophy, as we go into a period of higher rates earning through the book and likely margin expansion. Will the approach be to build up sort of additional adequacy in reserves to ensure greater deliverability of results on a go-forward basis, Richard? What will be the approach of the business as we look into next year?

A - Richard Pryce {BIO 5184927 <GO>}

Well, I think -- yes. Look. as I said earlier, one of the things we're seeing is that horrible impact of a protracted and unpleasant soft market, which the whole industry is when you come out of it, you realize how bad it was, and I remember people saying the cycles have gone a few years ago, well, if the cycles are gone, we'd all be gone because we needed a correction in pricing and we're seeing that correction in pricing.

One would like to think, that you could build up a bit more margin if you can keep this pricing going for a couple of years that would be what we would hope to do. That's what all insurance companies do when you have a better pricing environment. We're not there yet, but if we keep that pricing going through '22, then you'd like to think that you can get a little bit more sustainability in the long-term reserving.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. My second question is just a quick one around crop which Inder you mentioned, obviously, this year another above budget year on the combined ratio. What is your sort of normalized outlook? I think over the last few years, it's drifted down from 92, 93, down to 90. Where are you budgeting that business for next year?

A - Richard Pryce {BIO 5184927 <GO>}

It's drifting up. Inder, do you want to take that?

A - Inder Singh {BIO 20594382 <GO>}

Yeah. Look, I think it's fair to say it's drifting up. I think it's sort of linked to the conversation we're having earlier. As we look forward into the plans, refactoring this year into average for the last five years and we looked at where the market share sits, so we feel it's a very strong business and even at a sort of a 92-ish, 93, call it 90, somewhere in that zip code, Kieren, because it doesn't absorb a ton of capital, clearly it has some earnings volatility, but it's a very healthy return on capital business, albeit we do get some earnings volatility comes through the year, and also come through late in the year. So it's kind of our thinking in terms of plan going forward, Kieren.

Q - Kieren Chidgey {BIO 7268946 <GO>}

All right. Thank you.

A - Richard Pryce {BIO 5184927 <GO>}

Any more questions?

A - Inder Singh {BIO 20594382 <GO>}

I think Sid has got one.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Yeah, thank you - thanks. Yeah. Just a couple of questions, if I can. Inder, you're very kind enough to give us your targets for combined ratios in North America. I was wondering if you could give us those for assessment of goodwill in the two other regions as well?

A - Inder Singh {BIO 20594382 <GO>}

Sid, we -- just to come back to my reference earlier, we're obviously giving you this information on a prelim basis, right? I mean, these numbers will need to be finalized and goes through our review processes at the end of the year. So anything I've said around the combined ratios is very much for discussion as we close out the year.

But look, I haven't got those to hand, Sid, and we don't ordinarily put those out. We feel very good about the businesses and the support of the goodwill that we've got for international and Aus Pac.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Yeah. From memory I think you said a target of around 90 or sub 90. Is that still reasonable for those other divisions?

A - Inder Singh {BIO 20594382 <GO>}

I haven't got those to hand, Sid. It's -

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Right.

A - Inder Singh {BIO 20594382 <GO>}

We've also got very significant headroom in those divisions and we look at that as part of closing out full year accounts, it's not a big area of focus for us.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Sure. Okay. That's fair enough. Okay. Richard, you mentioned that you thought that your reinsurance cost would come in around about where you were budgeting for FY '21. But you said that -- but just to be very clear, are you saying that the price will be the same, but you might have a higher attachment point so the net impact would be a drag on combined ratios versus your budget? Is that what I should be taking away?

A - Richard Pryce {BIO 5184927 <GO>}

No. I don't think it's going to be a drag on our budget at the moment. Look, Sid, we're still right in it. As Inder says, the main programs are progressing like the main cat tower and the risk program, and quoted share with Equator, I think overall progressing as we would have expected and as we budgeted. We knew that the TW that the top wrap in aggregate would be difficult. So we budgeted a higher attachment and we budgeted more money, and will we get close to it? Yes, we will. Will we be exactly there? Maybe no, but we might see some savings elsewhere.

So at the moment, there's nothing material on our reinsurance cost or structure next year that I think would lead Inder or I to worry about our plan assumptions at the moment. We're not there yet, but we're getting there, we've made good progress in the last few days.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay. Now that's very clear. Thank you. And just the 45% attritional loss ratio for the year-to-date to the third quarter, I just wanted you to understand, are there any benefits from COVID that are included in that with basically the costs from COVID, basically coming through the large loss? In fact, what I'm saying is, is that a true reflection of what's going on in the business or is there any benefit from lines like motor or home insurance or property, just benefiting from depressed claims activity? How do you calculate that number?

A - Inder Singh {BIO 20594382 <GO>}

We strip them out. So, to the extent there are any benefits, Sid, we're trying to give you the best view because ultimately the COVID costs that we're reporting net of any benefits that were also occurring. But these are not material numbers, but just to give you a clean read, what we're trying to do is just show you all our claims ratios on an ex-COVID basis and that also includes the benefits of COVID.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Yes. Okay. Great. And so just one final question. Just Richard, just your thoughts on how the CEO replacement is going and whether if you could just say on the record whether you have any interest or desire to stay on? You were due to retire at the end of the year? Just --.

A - Richard Pryce {BIO 5184927 <GO>}

Sid, I meant to be retired.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Yeah.

A - Richard Pryce {BIO 5184927 <GO>}

Now let me -- that's a conversation you should have with the Chairman, Mike Wilkins, it's not one to have with me.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Yeah. But you're clear to that you want to retire. Is that right? Or --

A - Richard Pryce {BIO 5184927 <GO>}

Yeah, that's always been my plan. I'm sure they can find someone a lot better than me to do the job. So -- but no, I'm enjoying it and it's loving working with Inder and the guys, it's a challenge. But look, I think conversations around who the next CEO is certainly when you chat with the Board and the Chairman.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay. Thanks. Thanks very much.

A - Richard Pryce {BIO 5184927 <GO>}

Are we done on questions?

A - Unidentified Speaker

Few more follow-ups.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Good morning. Andre here from Morgan Stanley. If I can ask just one more question, just want to -- just ask about further total investment income, because there was a slide in the first half presentation back in August suggesting investment income will head towards 1.75% in our outlook. And it looks like it's actually come in around maybe 1% in this half, coming in around 1% in this half, and that's the outlook going forward.

So, what's changed because on a percentage basis, there's a very substantial difference between 1.75% and 1%? Like what's changed in terms of the thinking and when is a likely timing to push back towards 1.75%.

A - Inder Singh {BIO 20594382 <GO>}

Yeah. Look, I think there's a couple of elements, Andre. So one is the numbers I was quoting are based on current asset allocation and what we're saying is that we've retained the aspiration to allocate to growth assets back up to 15% over time. But what we're suggesting is we're not going to do that right now given those sort of considerations I laid out earlier.

So the big -- the other big difference is obviously how the credit spreads have moved between when we said that versus where we are today. Obviously, we've seen a lot of credit spread tightening in the second half. We've also seen some risk-free rate movements. So it's -- what we're trying to give you is with current market settings and the current portfolio. What do we think the business is running at today?

We weren't trying to give you a refresh of the 1.75 because that was more of a longer-term aspiration. But I think as we as we get into the early part of next year, we will give you a further update and our thinking is evolving on that both in terms of our decisions around the allocation to growth assets and the timeframes for that broadly speaking and also kind of where the dynamic is rather running yield, et cetera at that point in time.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Thank you.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Hi, guys. It's Andrew here from Macquarie again. Just a quick one from me. You've given us some details on how the net catastrophe cost is running against the budget. Can you maybe provide us some comments on how the large risks are running against your FY '20 budget, please?

A - Richard Pryce {BIO 5184927 <GO>}

Inder, you want to cover that since it was one of your slides?

A - Inder Singh {BIO 20594382 <GO>}

Yeah. Look, I mean the large risk trends, Andrew, tend to be bumpy quarter-to-quarter. But I'd say if you look at the end of last year, I think we closed out at 8.2% and as we look at this year, we'll do better than that as we close out the year obviously in Q4.

We will be looking at our provisioning and the IP now that we carry forward, but I'd say if you look back the last couple of years, we feel good about the improvements in the large loss trends will be a -- it does tend to be a bit spiky. So you need to look through a slightly longer timeframe to get a good handle on it.

But we have reset our insurance programs as you remember a couple of years ago from the large risk and aggregate to actually eating more of our own cooking and we feel very good about the way the underwriting performance focus is really translating into better risk selection and as Richard flagged I think there's more for us to do on that going forward. So we see that as an opportunity to continue to improve going forward.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Excellent. Thank you.

Operator

It looks like there's no further questions, Richard.

A - Richard Pryce {BIO 5184927 <GO>}

Any more questions?

Operator

No, no more questions in the queue.

A - Richard Pryce {BIO 5184927 <GO>}

Okay. Well, thank you for joining us today, and we will close the call now. Thank you very much.