Q4 2015 Earnings Call

Company Participants

- John D. Neal
- Patrick Charles Regan
- Tony Jackson

Other Participants

- Brett Le Mesurier
- Daniel P. Toohey
- David Spotswood
- James Coghill
- Kieren Chidgey
- Nigel Pittaway
- Ross N. Curran
- T.S. Lim
- Toby R. Langley

MANAGEMENT DISCUSSION SECTION

Tony Jackson {BIO 1729093 <GO>}

Good morning, ladies and gentlemen, and welcome to QBE's 2015 Annual Results Briefing. The briefing this morning should last for approximately one hour. You'll be hearing a formal presentation from the Group CEO, John Neal, and the Group CFO, Pat Regan. That presentation will last for approximately 25 minutes, which will leave 35 minutes for Q&A given the share price reaction and all the smiling faces in front of me. Hopefully we won't need 35 minutes of Q&A.

But, on that, I'll hand over to the Group CEO, Mr. John Neal. Thank you, John.

John D. Neal {BIO 20988613 <GO>}

Thank you, Tony, and good morning, everyone. Pat Regan, our Group CFO and I are delighted to present our 2015 financial results, a year where QBE has made real progress, executing on its financial targets, continuing to strengthen its balance sheet, and I believe can demonstrate an ability to perform and further improve even in volatile financial markets.

On our 2015 financial results, which is summarized on this slide, these numbers here are adjusted for disposals during the year, which Pat will take you through a little bit later. We provide insurance in many currencies and of course hold the premiums, the assets and the liabilities in the currency in which we underwrite, and then we consolidate our reporting in U.S. dollars.

So in the currencies in which we actually underwrite or on a constant currency basis, we actually grew by 1% and for the first time for a good few years. Underwriting hit the mark and turned in a 94% combined operating ratio, which was at the better end of our target and this in fact is our best result for five years.

Each of our five divisions has produced an underwriting profit. Accordingly, underwriting profit was 34% up at $731 million. Investment markets were incredibly challenging, as I think you all know, in the second half of 2015, but we think our team did an excellent job in really difficult conditions, allowing us to nudge insurance profit up to $1,099 million, and net profit after tax up 9% to $807 million.

A healthy increase in our cash profit, which is up 9% to $893 million, coupled with the strength of our balance sheet and really importantly the confidence we have in executing our short and medium-term plans has seen the board approve a 36% increase in our final dividend of AUD0.30 or AUD0.50 for the year.

First and foremost, and I can't overemphasize at this point, we are and will remain an underwriting business. And so we were delighted to pull all of our divisions into profit, record a solid combined operating ratio, and actually begin a period of managed considered growth.

Our North American business will continue to improve from the 99% combined operating ratio recorded in 2015. Our North American crop portfolio produced a market-leading result and our North American Specialty Lines business actually grew by over 25% for the second year in succession.

Our expenses in North America can and will reduce further over the next three years. We've pulled nearly $400 million out of expenses in three years, whilst at the same time sensibly investing in those areas where we can grow profitably. There is much more we can and we'll do.

We have an exciting global project underway to contain, manage and reduce our claims costs. And importantly, for a third consecutive half or indeed fourth half absent our workers' compensation business in Argentina, we're reporting a release from our prior accident year claims experience.

The quality of our balance sheet is appreciated by our business partners and our customers, and in fact is acknowledged by each of the world's rating agencies and all of our key regulators around the globe.

We have and continue in 2016 to significantly protect the downside risks to our profit and loss account. Our aggregate reinsurance protections have contained the cost of large individual risk claims and catastrophe claims to less than 9% of net earned premium. And indeed, we actually eroded less than 25% of the cover available. This program has been renewed in full and unchanged for 2016.

Similarly, we smartly bought reinsurance to improve the predictability and quality of the North American crop business, and of course to protect the downside risks associated with our Australian lenders' mortgage insurer.

And as I said earlier, our investments team did well to manage a return of 2.2% in a highly volatile bond market. And our decision to diversify into growth assets paid real dividends in adding 50 bps to our returns.

Now, I'd like to hand over to Pat Regan to take you through the 2015 results in greater detail. Pat?

Patrick Charles Regan {BIO 15131018 <GO>}

Thank you, John. Good morning everybody and thanks for joining us here today. I'm going to take you through some of the financial detail of the results, some of the highlights by division, a little bit of update on growth, expense reductions and expense ratios, a bit about our (06:10) cash remittances from the divisions, our investment portfolio performance, and our balance sheet metrics.

Just before I do all of that, very much the same as at the half year, all the numbers that we're going to talk to you today are our adjusted numbers excluding the impact of the disposals we undertook during the year. To the far right-hand column there, the 2015 column is our full reported number, the next column, obviously (06:35), the impact of those disposals, so that includes the $150 million gain on sales of the U.S. and Aussie agencies.

The $60 million loss on sale of the Argentine workers' comp business; you'll remember that's almost all foreign currency translation recycling, and the $130 million loss on the Mortgage & Lender Services business together with associated taxes.

Next column over (07:02) is the actual trading results of the Argentine workers' comp business, which again, you remember, was excluded from our targets for the year and which by the way had a 140% combined ratio for the period that we owned it. And then, finally, our adjusted numbers, which are 94% combined ratio and a 9% insurance margin. It's worth just noting the share scale of the impact of foreign exchange in the year was driven by that strengthening of U.S. dollar.

FX was down by 8% or some $1.3 billion just through – GWP was down $1.3 billion just through FX. And our cash profit was up 9%, but would have been up 21% on a constant currency basis.

Let me run you through a bit of (07:51) color by division; firstly, starting with North America. We're all very pleased to see the first return to underwriting profit since 2011. A combination of portfolio remediation activities, significant cost out, and a better crop result helping us deliver a 99.2% combined ratio. And probably the biggest contributor comes through the stronger crop performance. The crop business delivered – I think was a market-leading 84% combined ratio, benefiting from both a better year for crop insurance and from those actions we took at the start of the year.

We undertook an extensive cost reduction program in North America and reduced controllable expenses by about $80 million in the year. And we did see a slightly higher level of adverse prior development in North America, although this is mostly due to late reported crop and weather claims from 2014 and some adverse trends in the commercial auto book that have been seen across the industry.

On top-line, excluding the impact of the sale of Mortgage & Lender Services, GWP was down 4% in North America, largely due to increased competition in the standard commercial lines and some underwriting actions on a few portfolios.

That said our specialty lines business grew 34% in the year. Our European business was our standout result in the Group for 2015. In an environment that saw rates down 3.2% in that business, we grew 5% top-line on a constant currency basis and delivered an 89% combined ratio.

The claims ratio benefited from some $250 million, a positive prior-year development, a continuation of the recent trends in Europe. And again, this is not by accident. We've built a track record of reserving conservatively there and delivering actual client savings. We've improved our claims analytics, our fraud detection, our fraud prevention and our supply chain management. At all three of our divisions in Europe, the retail division, international markets and reinsurance, all those grew on a constant currency basis and had strong combined ratios.

Australia and New Zealand delivered a solid result despite a year of, obviously, higher natural catastrophe costs. On a constant currency basis, the Australia business grew some 3% with 5% growth coming through the commercial lines book offset by lower volumes in the Lenders' Mortgage Insurance business.

Our cost ratio further improved from 14.7% last year down to 14% this year. And we again saw positive prior-year development in Australia of some $120 million consistent with 2014. Slightly disappointingly, we saw a higher attritional claims ratio as we both grew the CTP book and we saw heightened level of frequency and New South Wales CTP claims has been much discussed across the industry. We are taking (11:04) action on the CTP portfolio and we've recently filed for a significant price increase in New South Wales that will be effective on May 1. Probably also worth noting that the LMI business continues to perform well, all of our lead indicators, the delinquencies, et cetera, continue to be at very stable levels and our claims ratio was significantly sub 20%. And you would, of course, remember we put in place a new reinsurance structure, the new business written (11:29) in

2016 and 2017 that protects against the deterioration in loss ratio for about one in 20 up to one in 250 year event.

Emerging Markets Division, which has got a, I think a terrific footprint of businesses in 27 of the world's emerging market economies, also returned to an underwriting profit in the year from a loss in the previous year. It grew 9% constant currency GWP and 10% NEP. And the portfolio remediation activities we undertook in the Colombian SOAT product which is a compulsory third-party motor product in Colombia, together with a continued improvement in our Argentinean business really drove that improvement in the underwriting result. While we did see growth in Asia slow in the second half of the year, the 93% combined for Asia was a strong result in a competitive market.

Lastly, Equator our in-house captive, whilst we did some adverse prior claims, the overall combined ratio of 89% was pretty much in line with our expectations.

Just picking out a few things I wanted to highlight within the result, so four kind of topics here. Top left-hand side is the impact of our new aggregate treaty. There is just two things. First of all, you can see 8.7% of NEP, the cost of large risking and cat claims is lower than our long-term average.

The second thing is in most years, nine years out of 10 years, you can lock-in that cost at about 9% of NEP thereby reducing or removing a significant source of volatility out of your results (13:12).

Perhaps my kind of (13:16) favorite feature of the results, top right-hand side, that we're beginning to build a track record of reserving stability. This is now the third half year in a row where we've generated claims savings of around 1% plus of NEP admittedly (13:31) most of those from Europe and Australia and we will try and over time broaden out that contribution.

Bottom left-hand side, as I've already mentioned, we returned to underwriting profits in both emerging markets and in North America and the continued improvement of that combined ratios is a significant contributor to continued improvement in the overall Group profitability.

A lastly on growth, if you look at the impacted – FX as I mentioned just already $1.3 billion, if you back out the sale of the Argentine workers' comp business, the rest of our businesses actually grew, albeit only 1%, but it's a start, and that growth is reasonably broad-based. 5% in Europe mainly in the retail business, 3% in ANZ only (14:23), mainly in the commercial business, and of course in emerging markets as well.

I thought it would be just worth spending a few minutes on the expense ratio. First of all, worth saying, we did about a $100 million of additional cost saves in 2015. Overall, costs were down some $180 million; with those cost saves and the benefit of foreign exchange more than offsetting inflation and the reduction in non-underwriting income.

Since 2012, we completed the operational transformation program, saving some $300 million in the process. And as I mentioned, this year, we delivered a significant cost out program in North America.

That said, despite the additional savings in 2015, our expense ratio went up in the year, as we made both a conscious decision to spend more on reinsurance and had lower net earned premium.

And our expense ratio at 16.9% is both higher than it can be and probably should be, but we do have specific plans to reduce that over the next three years that John will talk to in a moment.

One of our most important topics is cash remittances from the divisions to the center. Two things I wanted to show you here. One is where they come from, so the break down by division and second is the strong cash coverage of our external dividend.

So I break it down by division, a few kind of (15:52) features to bring out. First of all, we're less reliant on Australia and New Zealand, albeit they remain a very strong contributor. We have a higher dividend from the emerging markets which was good to see. Perhaps most importantly, we got the dividend out with North America which is a really important milestone on the transformation of that business. And you can really see the benefit of having a substantial internal captive with the substantial dividend contribution from Equator.

Europe Op was obviously very profitable in the year, but as we were preparing for Solvency II and we didn't know until very late in the year whether we were going to get internal model approval, which I'm very happy to report that we did. We didn't take dividend out of Europe.

So total $715 million of dividends in, you can see on the left hand side that coming in there, less the much reduced interest on parent entity borrowings, leaving strong cash coverage of our external dividend and I think kind of evidencing our confidence on our ability to continue to grow the dividend as we go forward.

As you are – for sure (17:04), you're very well aware, 2015 was a challenging environment for investment performance. Global equities were down some 4% or so, global bond markets returned about 0.9%, the second worst year other than 2008 in two decades.

And even though we reported a lower than budgeted investment income of 2.2%, the chart shows all of our major asset classes delivered in excess of the comparable market indices. And these as you can see developed market equities and unlisted property delivered quite a bit in excess of comparable market indices. Overall, growth assets had to return to 5.7% in excess of about 1.8% from fixed income and cash.

Our overall return of 2.2% was enhanced both by those asset class returns and some tactical asset allocation decision we took during the year where we saw what we thought was market mispricing opportunities.

Our fixed income book on the bottom right hand side there remains very conservatively positioned, nine months average duration, 92% of the book A rated or better, which I think if you look at our global peers stands us in very good stead. We have a negligible exposure to the energy sector with no investments that we're concerned about.

Lastly, then for me, a little bit on financial strength. Our much strength in capital position has seen S&P, A.M. Best, and Fitch all reaffirm the group's financial strength ratings and upgrade the outlook from negative to stable. And indeed our rating agency capital has grown at a faster rates even than our regulatory capital.

And our S&P capital is up some 40% over the last two years. So it actually sits very strongly in the AA capital range now, which really means we've got enough capital under almost any scenario. Accordingly, the board has reset our target PCA multiple to be now 1.6 times to 1.8 times instead of the previous 1.7 times to 1.9 times.

Our actual PCA multiple was 1.72 times, despite the pretty strong headwinds from foreign exchange during the year. Actually without that, the PCA multiple would have been some 1.8 times at the end of the year. And again, I think all of this further underpins our confidence and the ability to grow the dividend going forward.

With that, I'll hand back to John.

John D. Neal {BIO 20988613 <GO>}

Thank you, Pat. Our priorities for 2016 are simply to execute positively and really well against the backdrop of challenging pricing globally for insurance and in a world where we expect interest rates to continue to remain low.

So we'll maintain a strong focus on our underwriting discipline and a strict rhythm of cost control will see us take out another $150 million of cost in 2016 which will reduce that expense ratio, Pat was talking about, by 1%. We are very confident that our North American operations will improve further this year and indeed actually continue to grow.

I can't overplay the investment we're making in managing and improving our control of (20:34) claims cost, and whereas Pat referred the improvement in our prior accident year performance seen in 2015 hasn't risen as a result of chance (20:43). We're creating a flow of organic growth across all of our businesses and we will continue to invest in technology and data and analytics to build a solid platform for the near and for the medium-term.

So looking to our targets for 2016, against a backdrop where we are assuming that pricing globally will fall by around 1%, we're showing modest growth on a constant currency basis between 2% and 3%. We can contain and manage the effects of these pricing challenges and we'll execute to a similar level of performance in 2016 as we have in 2015 with a combined operating ratio in the range of 94% to 95% and an insurance profit margin in the range of 8.5% to 10%. These targets importantly assume no prior accident year claims release and obviously no change in risk-free rates.

So it's our intention to hold an Investor Day in Sydney on the 10 of May, to really expand on the themes that would drive improved performance in our business, our plans and our priorities over the next three years.

As it's a unique business with a global brand, a very strong underwriting D&A, a firm focus on our customers and a plan to improve our combined operating ratio, our insurance profit margin and indeed our return on equity. So in May, we will provide an update on the plans for each of our trading divisions, our investment strategy, as well as our key areas of focus through the next three years and through to 2018, and I wanted to give you just a quick flavor on the topics that we'll be covering off.

So we have five areas and only five areas where we believe we have the underwriting capability, the products, the people and the brand to grow. So these are here in our home market in Australia and New Zealand, in our Emerging Markets division, in the important business of Corporate Solutions and Specialty which is dominated by the Northern Hemisphere, for Bancassurance in Australasia and for SME globally.

Our targeted improvement in underwriting expense is by design to take our North American combined operating ratio to 95% or better. We've actually engineered all of our reinsurance programs to expire on one date, that will be the first time for a good number of years and that date is the 1st of January 2017. So this is allowing us to think about reorganizing our purchase, the program design and the strategies where we think we can drive further efficiency and indeed reduction in spend without taking significant further risk.

In addition to the 1% expense saving target I've talked about in 2016, we're working on a further $150 million of savings or indeed a further 1% on the expense ratio that we'll achieve by 2018. Our claims transformation project is already being activated in every division and is initially focused on fraud management, supply chain effectiveness and heightened use of real-time data and analytics with the latter actually managed out of our own dedicated centers in both the Philippines and in India.

So in 2016, we'll consolidate on the progress we made in 2015. Once again, we'll deliver on our promises and we'll execute against our plan whilst at the same time ensuring that the building blocks are in place to drive a meaningful improvement in all of our key performance metrics in the period 2016 to 2018.

So what I want to do now is to hand over to Q&A.

Q&A

Q - Kieren Chidgey {BIO 7268946 <GO>}

Kieren Chidgey, Deutsche Bank. Couple of questions. John, perhaps you can just start with some comments on the commercial rate environment. I know you're talking 1%

globally, we've heard from some of your domestic peers in some a (25:11) week or two about some firmer rate backdrop here in Australia, and so, interested on your thoughts there on sort of how you're seeing markets in Europe and the U.S.?

A - John D. Neal {BIO 20988613 <GO>}

Sure. If I start here I think the others are a little bit more optimistic than I am. We didn't see rates falling at the moment. I think we're in a period where rates are stable, and our belief is that they'll be stable through the balance of this year positioning to move into 2017. So our anticipation is that rates in the commercial sector here in Australia will be flat through 2016.

The one area where I would agree there is chance for rate movement is if a portfolio needs remediation and correction, then you are able to do that, but certainly I wouldn't be overly bullish to say that rates are already beginning to move.

If you look at other markets globally, it very much depends on the account you write in North America. I think everybody reads MarketScout and apparently rates fell by 4% in the fourth quarter. Our rates actually went up by 2% in the fourth quarter. So it could simply be down to mix of business. So again, in the U.S., our working assumption across our portfolio is that rates will be up, but very, very marginally.

Europe is still a challenge. I think I said to a team of people in this room the other day for Richard Pryce and the team in Europe, they've got 350 insurers that compete within 400 meters of their doorstep. So it's a very competitive marketplace, plenty of capital around. So they don't anticipate any move upwards in price and recognizing some of the specialty lines, and indeed the reinsurance business, we're assuming rates will be up by 1% to 2%.

But important to remember in that business and you've seen it in the results today, we've managed our way away (27:02) from attritional loss experience, and it's for that reason I think, they can maintain performance.

So if you add all that up, actually similar markets 2016 to 2015, with rates probably off a little bit 1% overall.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks. Second question just on the reinsurance optimization, you're kind of flagging, you'll update the market on in May, A, can you give us some examples around that, I know you alluded to sort of seeing areas for optimization last result as well that we're talking sort of less need for fact cover (27:35) given your aggregate protection or what sort of areas, and how material could these earnings (27:41) be?

A - John D. Neal {BIO 20988613 <GO>}

We spend a lot of money buying reinsurance. Highlights (27:48) around numbers, I'll go around numbers, we spend roughly $2.5 billion buying reinsurance every year, of which

$0.5 billion is compulsory sessions to the Fed in the U.S., so on that spend, it's $2 billion, which is exactly the same as what it cost us to run the business.

And we've done a good job in consolidating a number of our placements, but we still buy different treaties for our inwards reinsurance business, for our crop insurance business, for lenders' mortgage insurance in Australia, for our marine business, we still buy fag (28:17). So there's an awful lot of independent covers that are purchased where we do not think where as efficient as we could and we should be.

So by taking a holistic look at all of our reinsurance buying, our sense is that we can save and save quite significantly, could be as much as 10% of our spend and that, obviously, doesn't all flow to the bottom line, but certainly save a significant amount of reinsurance spend with the beneficial impact in net earned premium.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Final question from me, just on the investment income, mismatch, perhaps we kept seeing the average duration creeping up in your bond portfolio, just given the reduced expectations now around the higher rates globally, does it make sense to maintain the duration?

A - Patrick Charles Regan {BIO 15131018 <GO>}

Yeah, it's a difficult question. So when I first sat in this chair, I said that we would look to close the gap as interest rates went up. It's a bit harder to say that now with any kind of confidence, isn't it?

So I think what we'll look to do is broaden out our type of credit. So as you go into 2016 versus 2015; 2015, the move into growth assets worked for us. 2016 is a really difficult market. There's a lot of volatility, some of which we've kind of avoided already. But we look at the margin to try and take a little bit more sensible credit versus something more volatile growth assets to do that, the byproduct to that might be a little bit more duration, because you, kind of, almost can't take more credit without (29:49) taking more duration.

And I think by coincidence that also isn't probably the worst thing in the world, because I think just sitting here with that gap for the next three years if rates don't move, it's just going to be a little bit frustrating. What we won't do is, close all of the gap in the short-term. So I don't think we're ready yet to declare that we've completely moved away from that.

Q - James Coghill {BIO 14006200 <GO>}

James Coghill, UBS. John, couple of relatively easy questions on expenses what you've outlined there, since 2012 expense base – operating expenses that is – have fallen by around $200 million, but you flagged $400 million in savings in your commentary. I think Pat referred to $300 million number when he was talking earlier.

So the question is really, could you explain what the additional $150 million in investment is that you flagged? What is the nature of that item? And could you also just run through how you manage the governance around these spending programs so we can be clear that what you've outlined today will eventually drop into the bottom-line and into that expense ratio?

A - John D. Neal {BIO 20988613 <GO>}

Sure. When you got two minutes, if you sort of turn to slide 26 in the deck that you've got in front of you, that actually gives you a flow in dollars of what our expenses were in 2012 and where they ended up in 2015. So the last two columns detail the savings we made on our operational transformation program at $312 million and other savings through restructuring costs, actually particularly here in Australia and in North America of $71 million. So that's where the nearly $400 million actually comes from.

And then, you can see on that chart as well, my earlier comment is that, you got to keep investing in the business to ensure that it's viable and relevant and able to grow in the future. So for example, we spent $111 million in redesigning or redeveloping some of our systems and $86 million to support growth in emerging markets. So there's some net investment taking place as well.

What's really happening in 2016 is a further analysis of where we can better use onshore and offshore service centers, number one. And number two, a second look at procurement and procurement related savings. So we had a good job of doing that first, we're going to watch around and then have a second look at it. And probably thirdly, just a little bit more cost coming out of North America as those programs complete. So that's where the $150 million is coming from in 2016 already in the plans.

I would say culturally, we're very, very different to the way we were three years, four years ago and I can absolutely assure you we've got really strict control over cost, to the point of announcing today, reemphasizing Colin Fagen's responsibilities in the role of COO, which is really designed to ensure we've got the right focus on expense management and claims cost control management.

Q - Daniel P. Toohey {BIO 16751863 <GO>}

Thanks. Daniel Toohey from Morgan Stanley, just a follow-up on that question, that James raised. You seem to be targeting $150 million of cost savings in 2016. On the other hand, you're investing $150 million for growth and transformation. So will we see any sort of underlying benefit from that cost initiative?

A - Patrick Charles Regan {BIO 15131018 <GO>}

Yeah. That's a good question. So if you try and kind of park impact of FX for a second, what we expect to see next year versus this year, sorry, 2016 versus 2015 is broadly flat NEP, which means there's a bit of underlying growth in there, because we've sold the Mortgage & Lender Services business and absolute cost go down, so – which is the net product of $150 million cost saves, the reinvestments and just sale of the Mortgage & Lender Services business, which as you remember was very expense-heavy business.

So sort of flat NEP, costs down given the 1% improvement John referred to earlier. And I think that's quite important to that - you have absolute cost go down for us 2016 versus 2015.

Q - Daniel P. Toohey {BIO 16751863 <GO>}

Okay. And just a question on the investments. I appreciate you seem to have taken opportunity to sort of lengthen the duration, you've also I guess in this half seem to have changed the shift in mix a little bit taking advantage of (34:30) credits spreads, but your guidance implies, I guess, an underlying yield of 2.4%. Just wondering if you can comment where you see the run rate year-to-date relative to that target of 2.4%?

A - John D. Neal {BIO 20988613 <GO>}

That's not hard to comment on, not much. We're - as we looked at our plans for 2016, we had a target yield that essentially was zero down in January. So if you think January, we got essentially nothing, which wasn't actually probably a bad result, getting nothing in January. So we now got 11%, 12%s of what we've originally set out to this order have (35:10) to think about it.

Q - Daniel P. Toohey {BIO 16751863 <GO>}

Okay. Thank you.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Hi. It's a Nigel Pittaway from Citi. Just following up, first of all, on the investment yield. I mean, you were guiding to 2.6% on the November 17 for FY 2015. It turned out to be 2.2%. So, I mean, firstly what changed, I guess. And secondly, therefore how much confidence do you have in that guidance for this year in the lights of that?

A - Patrick Charles Regan {BIO 15131018 <GO>}

Hi. It's a difficult question to answer, isn't it? None of us, I don't think, can be precise on investment yields for a forecast period. I mean, the biggest impact on us in 2015 was credit spreads actually, where most of our money is still invested in fixed income versus growth assets.

I mean, you saw from the chart that we exceeded market comparables, but some of those were less negative than emerging market equity, emerging market debt, and to the extent we've got any money in high yields. Probably the bigger impact was credit spreads didn't come in.

As we saw things - the S&P rally (36:16) we didn't see the same kind of improvements in credit spreads. So we've got - our position for 2016, we spent a lot of time thinking about how we do this. It's a slightly different shapes of the book, I mean, you set (36:26) the margin. I wouldn't overemphasis - overemphasize it, but with, hopefully, the design we have a little bit less volatility, but the volatility we are seeing in the market makes those kind of things difficult to predict precisely.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Okay. Secondly, just on the U.S. adverse development, I think it was about $69 million in the second half. Was that all related to the commercial auto book or whether some sort of roll through the crop stuff from prior year into the second half as well?

A - Patrick Charles Regan {BIO 15131018 <GO>}

Crop and weather was all first half, the biggest chunk was commercial auto, yes. We had a little bit of bits and pieces of other stuff, but the biggest chunk was commercial auto.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Is that mostly short-tail or...?

A - Patrick Charles Regan {BIO 15131018 <GO>}

Well, it's medium-tail, really isn't it?

A - John D. Neal {BIO 20988613 <GO>}

You quoted long-tail here and the Americas quoted (37:15) medium-tail. But I think we've done – if you recall, I think we were slightly ahead of the market with all of the actions that we've taken on our reserves. I think you saw some fairly dramatic changes coming out on the, both the commercial and personal auto books, the big writers. But to (37:36) about half of what you saw in total for the year, almost all the second half was that auto book.

Q - Nigel Pittaway {BIO 3406058 <GO>}

And the fact that that's now re-priced, it's basically kind of dusted probably?

A - John D. Neal {BIO 20988613 <GO>}

Yeah. I think so. I mean, there was a couple of things going on, there was some specific accounts on our book, but also kind of acquire. (37:52) I mean, we saw a number of it – of insurers deal with the same issue of frequency trends there. So we think so, yeah. And I think we go into 2016 in kind of (38:03) more confidence on all elements of that that prior year, weather, crop and the auto book as well.

Q - Nigel Pittaway {BIO 3406058 <GO>}

And then just on reserve releases in Australia and New Zealand, obviously, at least one of your competitors are saying at least in their guidance that there won't be anymore, what's your view on that?

A - John D. Neal {BIO 20988613 <GO>}

We don't comment on future reserve releases. So we, sort of, said in a tiny footnote somewhere that our guidance doesn't include prior developments. What we're (38:30) trying to do, I mean, it's still – hey, we're building a little bit of a track record now and I think we're still not trying to make a comment in the future about either Australia and New Zealand or any of the regions about what might happen in the future.

Q - Nigel Pittaway {BIO 3406058 <GO>}

And then maybe just finally on crop. Obviously, you protected the book this year, but the crop was actually quite low regardless. Are you going to take out the same protection for calendar year 2016, or how are you going to view that?

A - Patrick Charles Regan {BIO 15131018 <GO>}

I think we'd rather be a good underwriter than a lucky underwriter is the simple answer to that question. And there are some bits that really weren't (39:08) in the results. So the more analytical approach we took to crop, paid real dividends, so our analysis by state, by county, by farm, by crop, by field, really helped with the rest of action and was fundamental to the underlying improving in the result.

You could turn around and say all of the reinsurance that we bought, did you need to buy it, because it was such a good year. But we bought same protections again, going out both against hail, quota share reinsurance. And we're in the process of looking at those derivatives against price. So I'd rather say it in front of you and say we overboard our reinsurance a little bit, but delivered the right result or outperformed the other way round (39:48).

Q - Nigel Pittaway {BIO 3406058 <GO>}

Yeah. Thank you.

Q - Ross N. Curran {BIO 15090587 <GO>}

Thanks. It's Ross Curran from CBA. Can I just ask on the reinsurance, you're rolling it over on Jan 1, 2017; does that include the Australian LMI reinsurance? I understand the term reinsurance and LMI is pretty cheap at the moment for Aussie risk. Has that flowed through your thinking? And as you roll over with less than 12 months to run that contract, does that impact the amount of capital, regulatory capital you have in that business or will affect your PCI ratio through the year?

A - John D. Neal {BIO 20988613 <GO>}

Do you want to go on LMI and then I'll...

A - Patrick Charles Regan {BIO 15131018 <GO>}

No is the short answer. We've got a couple of reinsurances in place. The new one – we talked about new business going forward. And then we have an internal quota share into a quota. So actually both of those are in place and no change in the PCI multiple.

Q - Toby R. Langley {BIO 15924432 <GO>}

Hi. It's Toby Langley from Bank of America Merrill Lynch. A question on the crop business, it's a part of the portfolio that (41:04) doesn't really fit with your buyer (41:08) strategy and the other side of the disposal of the number one player in that market. Can you give us some sense as to what's your sentiment towards it now?

A - John D. Neal {BIO 20988613 <GO>}

(41:19) We wrote an agri book outside of crop as well, not as big as (41:30) should we say. So I'm not been unhappy with the crop business at-all. What we wanted to do is just eliminate the volatility that we've seen through that period, 2012, 2014 which we felt very comfortable with don't going into 2015 and feel very comfortable that we've done in 2016.

So as part of the book in North America, very happy with it; not actually looking to acquire or so. So we're happy with what we've got. We're not going to buy into that market. We are happy to grow a bit organically, comfortable that it can perform with a combined operating ratio normally in the low 90s.

Q - Toby R. Langley {BIO 15924432 <GO>}

Okay. And then, maybe a question for Pat on the cash flows. There was a slight different shape this year. I mean, I appreciate the disclosure you've given this time geographically. I'm wondering if you could comment on what the run rate expectations might be and specifically maybe looking at Australia, is there a decent contribution there from lenders and mortgage insurance?

A - Patrick Charles Regan {BIO 15131018 <GO>}

Yeah. So I mean, in total I think they're now to the bottom there that we're expecting we can do more than $700 million again, which again should provide strong cash coverage with external dividend. We're going to straight look like by division, I mean sort of similar. So we'll probably get a little bit more coming through from (42:46). We've been kind of working on that a bit. So that shifts - as I mentioned, free cash shifts a little bit of capital out of Australia into Equator. So there might a little bit of rebalancing of Australia versus Equator there. Obviously, we'd hoped to still get a dividend at North America. It's nice that's kind of back on stream and obviously hope Europe comes to the party in 2016 as well.

Q - Toby R. Langley {BIO 15924432 <GO>}

Just on that U.S. business, what's been the binding constraint that you've satisfied this year? What's the difference?

A - Patrick Charles Regan {BIO 15131018 <GO>}

Well, there's a few things. I mean there's three tasks really. One is your local capital levels and local capital levels are actually quite good. Two is, we need to make a profit fairly, obviously. So making a profit makes a big difference and actually cover alongside that stability of the business. I think actually it's the last one. This property is important as anything is if there was a business that is stable in all aspects, whether that be kind of people, running of the business, understanding of the business, all of those things.

Q - Toby R. Langley {BIO 15924432 <GO>}

Thank you.

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

Thanks. Brett Le Mesurier from APP Securities. Question on the premium liabilities. They seem to have fallen from 2014 to 2015. I noticed that the probability of adequacy for all insurance liabilities fell from about 95% to 92% and the probability of adequacy for outstanding claims was constant. So it implies that premium liabilities fell. Could you comment on how much that fell by?

A - John D. Neal {BIO 20988613 <GO>}

Well, the biggest reduction in premium liabilities was foreign exchange related, yes. I mean, on all of our movements the two biggest contributions were either sale of workers' comp business, a little bit from mortgage and lender services sale, and the movement of FX, the three big contributors.

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

Right. So what was the absolute amount in risk margins for outstanding claims that was $90 million odd. Do you remember what the number was for premium liabilities?

A - John D. Neal {BIO 20988613 <GO>}

No. Off the top of my head, no. I'll check that for you afterwards.

A - Tony Jackson {BIO 1729093 <GO>}

Yeah, you've got that call on the line.

Operator

And your first question from the phone line will come from T S Lim from Bell Potter. Please go ahead.

Q - T.S. Lim {BIO 5644326 <GO>}

Good morning, guys. You had an effective tax rate of 27%. What's the outlook for the effective tax rate going forward?

A - John D. Neal {BIO 20988613 <GO>}

Thank you. If you look at the tax rate, there's a difference between the full stat results and the adjusted results. So there were a few tax effects on the disposals – on the adjusted result, which is really probably more representative of what it will be going forward. The tax rate was just a nudge under 20%. So, obviously, benefited from the profitability in the Equator.

Probably going forward you'd expect that 20% to be a slightly higher, so somewhere between the 20% to 25% kind of range I think feels reasonable, maybe a nudge higher than the 20%, but 27% was really driven, as I say, over the impact of those disposals.

Q - T.S. Lim {BIO 5644326 <GO>}

Okay. Thank you.

A - Tony Jackson {BIO 1729093 <GO>}

We got second call on the line as well.

Operator

Your next question will come from the line of David Spotswood from Shaw & Partners. Please go ahead.

Q - David Spotswood {BIO 17576616 <GO>}

Hi. Just want to make sure I've got this right. On slide eight, you were saying that your adjusted insurance margin was 9%. So that does include the reserved release of 1.1% (46:21). So you're going to underline which you'll not use anymore, it's 7.9%. Does that 7.9% versus your guidance pass 10% (46:28)?

A - John D. Neal {BIO 20988613 <GO>}

No. Your math is right. So we did get an insurance profit margin of 9%. That obviously did include positive prior year development, but it's 9% versus our target of 8.5% to 10%. We didn't make any statement at the start of the year that they would include or exclude any prior development.

Q - David Spotswood {BIO 17576616 <GO>}

Okay. Thanks.

A - Patrick Charles Regan {BIO 15131018 <GO>}

Thanks.

A - John D. Neal {BIO 20988613 <GO>}

Any other questions from the room? I think we exceeded Tony's five minutes, but it was good. Thank you, everyone. Thanks for coming along.