Q4 2012 Earnings Call

Company Participants

- Frank O'Halloran, CEO
- Neil Drabsch, CFO

Other Participants

- Andrew Kearnan, Analyst
- James Coghill, Analyst
- John Heagerty, Analyst
- Kieren Chidgey, Analyst
- Mark Tomlins, Analyst
- Richard Coles, Analyst
- Ross Curran, Analyst
- Ryan Fisher, Analyst
- Siddarth Parameswaran, Analyst

Presentation

Operator

Ladies and gentlemen. welcome to the QBE market update. During this event, all lines will be on mute, with a question and answer session after the presentation.

I'd like now to pass over to QBE's Group Chief Executive Officer, Frank O'Halloran; and Neil Drabsch, Group Chief Financial Officer.

Frank O'Halloran

Thank you. And welcome to this conference call regarding the release that we just made to the market on our 2011 preliminary results and the outlook for 2012.

Obviously, I'm extremely disappointed with the numbers. And the impact of the record level of catastrophes. And the lower risk-free rates. And the blowout in credit spreads that we have seen over the past 12 months and that have affected insurers and reinsurers around the world.

This feels a bit like 2001, which followed a few years of falling premium rates and a major event; that horrible event in September of 2001. I think. And I hope, that during this conference call we can get across to the market and to you that premium rates are moving rapidly upwards. And we've already processed significant premium rate increases over the last three or four months.

So what I'll do now is I'll quickly go through the catastrophes, the risk-free rates, the credit spreads, dividend and capital adequacy; and then talk about the expectations for 2012; talk a little bit about the noise that was in the market yesterday and today on the US regulatory issue. I'll talk a little bit about the US crop and talk a little bit about another article that was recently published on reinsurance. But I'll, first of all, start off with the catastrophes.

As we said in the article, the catastrophes which are large risk and individual risk and catastrophe claims which are net of reinsurance finished up being around 15% of net earned premium versus what we expected when we talked to the market in August of around 13%. Those -- in terms of total cost, the total cost was about $1.2 billion higher than we experienced in 2010.

As everyone knows, it was a record year for catastrophes. Some are saying that it's a year that will not be repeated. Now, I'll talk about the outlook in a few moments. But the one thing we are doing is not assuming that 2011 will not repeat itself in 2012. But I'll talk about that in a few moments.

In the month of December, we were able to finally get in to have a look at what happened around Thailand and begin assessing the claims. I think most of you release that the floodwaters only subsided in early December. So we sent a number of loss adjusters in and were able to get some fairly clear indication of what the business interruption, loss of property, loss of machinery, loss of stock in trade was for that particular event. And it was significant for us because we are a major commercial lines insurer in that marketplace.

In addition to that, we had a number of crop (ale) claims coming from the US. In the case of the US, we don't really get -- claims are not really lodged until early December so we actually had to assess that. We obviously made some allowances through the first five months. But in reality, what happened is that the average claim size of the (bale) claims was some three times higher than previously experienced. And that was due to the nature of the crops involved.

In addition, we saw the Western Australian bushfires. We are a major -- we are the liability insurer for a number of quasi government bodies around Australia and we did receive, right between Christmas and New Year's Day, a liability claim, which obviously we'll defend, for the Western Australian bushfires.

We also saw the Christmas Day storms in Melbourne.

And what this meant of course, this accumulation of these events meant for us that we had to tally all the information up, double check with all our operations around the world. Then obviously we came to the market as soon as we got a reasonable estimate of the cost of these events.

So in reality, those items that I mentioned cost us around about $500 million, with Thailand being the major contributor. And I can talk a bit more about that later.

In respect of the risk-free rates, I think the market has been aware that risk-free rates have fallen. They've fallen from 3.15% at the end of June, or 3.2% at the end of December, to around 2.15% on average at the end of December 2011. The impact of that on us is an unrealized loss and a charge against the underwriting result of around $200 million.

In the case of the investment portfolio, I think everyone's aware that the European debt crisis meant credit spreads blew out on high quality. And cash and fixed interest paper. We saw the brunt of that. So we also felt the impact of the rising credit spreads.

We had no permanent impairments on any one of our cash and fixed interest securities. But we are required to book the unrealized losses or the mark-to-market value of movement to the profit and loss account. And that cost $160 million against our insurance profit for the year. In addition to that, we have about another ($80 million) that goes into shareholders' funds.

So what happened between -- so, in total, the impact of those three items on our insurance profit margin for -- or insurance profit for the whole of 2012 -- 2011 is ($1.6 billion); which is a very, very significant sum indeed.

The question really is are we going to see risk-free rates fall further? I don't know the answer to that. All I do know is that they are at the lowest level ever. Will the credit spreads blow out further? A lot will depend on resolution of the European debt issues. Will the catastrophes be higher in 2012 than in 2011?

We're working on the basis that it may happen. And therefore, we have made significant reductions to our exposures in the certain areas; in addition to substantially increasing prices on property package. And other class of business. And also changing deductibles.

In respect to the dividend, we discussed the dividend at length and we felt that -- in view of the level of catastrophes, the record level of catastrophes that we experienced, we felt it prudent to reduce the dividend to (AUD0.25) a share. That's our estimate at this stage because we still have to complete our financial statements and go through the actuarial and audit review process.

We're obviously not very happy about that. But we think it's prudent that we do so in the interest of maintaining capital adequacy. And I'm sure that most of our shareholders realize that the record level of catastrophes that we've experienced is something that we didn't budget for. And I don't think anybody in the industry budgeted for.

Capital adequacy is still strong; above 1.54 times. We're not going to underwrite the 2011 final dividend underwritten. We will be above 1.5 times APRA's minimum capital requirements at the end of December.

In respect of the outlook for 2012, as I said, it feels a bit like 2001 to us, where we are seeing reinsurers pushing up prices significantly. We are seeing prices for property rates go up significantly. We have led the market in rate rises in non-commercial lines in Australia. I won't go through the detail of the rate movements at the moment. But they are significant.

And as I mentioned earlier, that we are increasing deductibles on commercial lines and personal lines insurances; and we have made the decision to cut back our exposures in some areas.

We were particularly surprised about the level of flood claims that have come through this year, which included Victoria, Queensland, Northern New South Wales. And of course Thailand. And Thailand, as most of you know, is a huge loss for the industry.

So expectations for 2012 are that -- our underlying target I should say for 2012 is for a combined operating ratio of 89%, on the back of what I just mentioned; and an insurance profit margin of 15%. And both of those include an allowance for large risk and catastrophe claims net of reinsurances of 10% of net earned premium. And an expectation of interest rate yields on policyholders' funds of around 3%.

Now just to set a couple of things straight on some articles that have been published in recent times, I'll deal with the US regulatory one, which is foremost in everyone's mind, I think.

The facts are that a group of state attorney generals have been reviewing lender-placed insurance as part of the overall inquiry into mortgage practice for the last two years, or so.

When the Dodd-Frank bill passed in 2010 there were provisions in it specifically relating to lenders' placed practices, with which we were. And are, complying. The plaintiffs bar and consumer advocates have continued to agitate and one of their lines of attack have been to say that the state insurance departments have not been regulating the lenders' placed market.

One of the analysts mentioned this was more likely just a continuation of pre-existing reviews of the industry. And that is the case. The New York department came in late compared to the others. And we have a very cordial relationship with all the regulators.

Finally, I should say on this, our premium rates are approved by the States, the insurance commissions in the States, where we carry out this business. And most importantly, the overall regulatory position that I just mentioned was well understood by us at the time of acquisition. And nothing, nothing has changed since that date.

The second thing is the crop insurance. There's been some recent comments on proposed changes to US crop insurance. The last changes to the crop program by the federal government in the States was made in 2010 and is locked in for the next five years. The current discussions are around the farm bill. And don't really pertain to crop insurance but to unrelated farmer subsidies and catastrophe relief programs.

The only recent change that impacts crop business is that the government re-wrote a corn and soya bean prices, effectively lowering them marginally. But very importantly, that we understand that and we take appropriate action by adjusting other key profit drivers to limit the impact on our profitability. And I should say, just on the whole, to give you an example, we are putting up premium rates, or proposing to put up premium rates, by close to 100%.

The next article which I should mention is that there was a recent article in the UK press re. the cost of our 2012 reinsurance, which was referred to yesterday by one of the analysts. Our market release that we sent today sets out the true and factual position in relation to our 2012 reinsurance arrangements. And I do not propose to comment any further on the article.

So in summary, from QBE's point of view, the whole QBE team is obviously extremely disappointed with the 2011 numbers. Obviously, we understand that there was a massive impact from the catastrophes, the record catastrophes which did not cease; they just continued rolling in as the year progressed, as we found out on Christmas Day.

And we certainly not only disappointed because we pride ourselves in the way we manage our insurance business for our shareholders and how we have regularly outperformed in a highly competitive market. And my gut feeling is that we will outperform in 2011, although we haven't seen the published results of our peers.

I think what I'll do now is just hand over to Neil to just add anything he needs to add. And then open up for questions.

Neil Drabsch {BIO 2093435 <GO>}

Thanks, Frank. I think Frank covered the key points in terms of capital adequacy. While this is a disappointing result, the strength of the balance sheet is such, both at a Group level and entity level. So we're very comfortable with all of our regulatory capital levels. And recent rating agency work and affirmations, the size and the extent of capital adequacy provides us more than sufficient capital for our needs.

This business is producing very strong cash flow, that's despite the losses that we're seeing. And this is a direct result of some of the more recent acquisitions particularly.

We have a -- and on the asset side of the balance sheet, as Frank mentioned, we have not seen permanent diminution in value. The results for the full year (aren't) dramatically affected by the spread movements and market value movements at year end. And of course the requirement to take (up) discount. So the balance sheet is well prepared going into 2012.

Clearly, the lower dividend, while disappointing, is a prudent approach. The Board has taken that view. And that just makes sure that we preserve and we've got the right levels of capital going forward.

I'm happy to take some questions later on if anyone wants any more detail. But I think they're the key points from me, Frank.

Frank O'Halloran

All right, we'll open it for questions.

Questions And Answers

Operator

(Operator Instructions) John Heagerty, Credit Suisse.

Q - John Heagerty {BIO 7044314 <GO>}

Just a couple of questions, at least, I guess. But just really want to know, when you gave your latest guidance on October 25, at a conference you were giving the same risk-free rates, claim around 2.6%. And a gross investment yield of 2.7%. Were those realistic at the time, because rates haven't really fallen that much since then?

A - Frank O'Halloran

John, I spoke at that conference and, as you know, those rates have been moving up and down dramatically. They went down dramatically at the end of September; they came back up in October; they fluctuated through the months. But it has been a downward trend. And we haven't seen -- and the euro position of course seemed to exacerbate that. But that's at a point in time.

I did say at that conference. And I think it was one of the (concluding) final statements, we said that the market should be clearly aware that the result will be affected by the risk-free rates. And of course any market value. And I think there's information in the market to work those numbers out. But that was the key in my closing comments in October.

So I think, John, just to add to that. And I think it's important that we all understand this, that we have a large number of overseas investors who do not understand risk-free rates and do not understand that we are the only country that requires mark-to-market to be taken through the profit and loss account. So in our release we careful mention that because we have so many overseas investors say what in the hell is this all about? And I'm sure you get the questions.

But the reality is that the credit spreads kept on going out and the risk-free rates kept on falling. And I think if there wasn't enough information in the marketplace for investors and analysts to calculate that figure then we apologize. And all we can do is just to make sure there's more information in the marketplace for you to be able to calculate.

Q - John Heagerty {BIO 7044314 <GO>}

Thanks. Just second question, looking forward a little bit, obviously gross investment yield last year 2.1%. But I note you're forecasting 3.0%, at least (stating governments) on 3.0% for next year.

A - Frank O'Halloran

Yes. We believe --, sorry, John.

Q - John Heagerty {BIO 7044314 <GO>}

I think you know where the question is going?

A - Frank O'Halloran

Yes, go on; keep the question going.

Q - John Heagerty {BIO 7044314 <GO>}

It just seems quite high considering where things have ended up. And given the fairly powerless state of the global economy at the moment.

A - Frank O'Halloran

Yes, John, we currently have a running yield on our cash and fixed interest portfolio just over 3.2%. We have pushed that down to 3% because obviously we've got money to reinvest at lower interest rates during the year.

We have not assumed any increase in -- sorry, we have not assumed the credit spreads are going to go out further, or come back in. So if you want to make some assumptions on what's going to happen to credit spreads then you're most welcome to. But we haven't made any assumptions in that regard.

Q - John Heagerty {BIO 7044314 <GO>}

Okay. Thanks very much. And just a last question on the dividend policy. Obviously, I guess it's a question for the Board really. But is the current dividend cut indicative of what we might anticipate going forward?

A - Frank O'Halloran

I think I can answer that by saying that if we meet our underlying targets then obviously the dividend will be adjusted up accordingly for the interim and the final.

Q - John Heagerty {BIO 7044314 <GO>}

So you're targeting a payout ratio?

A - Frank O'Halloran

When we look at this we look at the payout ratio net of dividend (risk) for reinvestment because there's so many of our shareholders that participate in the dividend re-election plan, which, as you know, is more like a bonus share. And we look at how much capital we're retaining.

But it would be wrong of me to pre-empt what the Board has to say about the dividend. But they are -- the dividend will rise if we meet our insurance profit target of 15%, or our underlying insurance profit margin of 15%.

Q - John Heagerty {BIO 7044314 <GO>}

Okay. Thank you.

Operator

James Coghill, UBS.

Q - James Coghill {BIO 14006200 <GO>}

A couple of questions. Just, firstly, again on guidance for '12 on your large loss assumptions. So you said 10%. Now, it's obviously very difficult for us to try and piece together exactly what happened at the end of '11 to evaluate that objectively. But you typically structure it as 9%. You've supposedly taken out additional reinsurance covers to mitigate against a repeat of what's happened in the second half year. And it's 1% higher, notwithstanding all these new comprehensive covers that you've got in place. Can you just explain why that's gone up?

A - Frank O'Halloran

Yes. We struck it at 10% because we have our crop business in the US and so we've included the catastrophes allowances in that 10% for crop. I think it's a very important part of the reinsurance arrangements where we put out to the market. And I'm sure you will either want us to now or later on go through it in more detail the reinsurance.

But one of the things that we did when we bought the $200 million of protection for frequency of catastrophes in Equator Re of captive, this year we made sure that, that reinsurance protection did -- does not inure to the benefit of the Group cat cover. So which is a major plus for us in terms of in 2011 the claims in Equator Re that inured to the Group aggregate cover were a net of reinsurance coverage this year for 2012; they're not.

So we really haven't added anything to our large risks in cat allowance, other than to say that it's 9%, plus we add another 1% for the crop business. So it's actually 10%.

Then you might say, well, why didn't we do that at the beginning of 2011? In our own minds, we did to some degree. But we just felt it more prudent to come out with a 10% figure this year, rather than a 9% figure.

Q - James Coghill {BIO 14006200 <GO>}

Okay. So just another question on your MCR coverage, Frank. Sorry, I think I heard you say coverage was at 1.54 times at the end of the year so I just wanted to clarify if that is what you said, or just above 1.5 times.

A - Frank O'Halloran

I said --

Q - James Coghill {BIO 14006200 <GO>}

Then following on from that, it was at 1.68 or 1.7 times at the end of June. So obviously you've got a shortfall in earnings and the dividend that will come through and erode some of that. But it just -- that's not going to account for such a big move in coverage from 1.7 down to just above 1.5 times so perhaps you can just explain what else has happened to give rise to that shortfall, if it is indeed -- or that decline, if it is indeed down at 1.5 times.

A - Frank O'Halloran

Yes, I'll let Neil cover it. But part of it obviously relates to the risk-free rates dropping from 3.15% down to 2.15%.

A - Neil Drabsch {BIO 2093435 <GO>}

And also, James, at June 30, you may recall at the end of May we'd just completed that ($1.5 billion) sub debt so what we're seeing in the full year now is the full development of the premium pool. Obviously, Balboa's there now for nine months; it was only one quarter before. So the combination of those portfolios now fully earning and the sub debt having its impact across the whole of the (portfolio) for the full year, (just puts it back).

So the half year, 1.7%, or 1.69%, I think, what it was, was at the higher end. So around the I think -- we think it's probably going to be around 1.3% -- 1.53%/1.54% at the moment; that'll be dependent on the final actuarial reviews.

As I said earlier, this is extremely comfortable position. Remember, this is applying the more stricter criteria and given the size of the portfolio's now, the 35% premium growth during the year, that we've got very sufficient capital. All the acquisition work has been done and funded; the funding is in place; and this book is set to now just to develop on it. And as Frank said, we've got premium rate increases coming to help it. But I hope that answers why (apparent different) between June and December.

Q - James Coghill {BIO 14006200 <GO>}

Yes. That's fine. Thank you.

Operator

Andrew, Merrill Lynch.

Q - Andrew Kearnan {BIO 1702520 <GO>}

Two-part question. I'm wondering, given the volatility in profits caused by interest rates falling again, whether the Group should or is in the process of reconsidering its practices, mismatching assets and liabilities?

A - Frank O'Halloran

Is that --

Q - Andrew Kearnan {BIO 1702520 <GO>}

Strategically, whether it might be more sensible to bring that back into line.

A - Frank O'Halloran

I think you are well aware, Andrew, that even APRA have come out and said that matching is not the best position to be. It's somewhere between zero and being matched. And I think you've seen that in the latest -- I'm not too sure whether you've got the latest draft of the proposals from APRA. But that's basically where they've come to. And our position is probably where APRA says the industry should be for the capital charge.

We still believe that in a volatile market, such as ours, such as we're facing now particularly with the European debt, that the short end of the yield curve is a better place to be. That may not necessarily be the case in Australia.

But just to give you an example, the one thing that we've been able to do is, as the European debt crisis has developed, we have been able to move money from what we thought was quality to even better quality much quicker than you would have to be if you were three or five years out in the yield curve.

So there are more things to managing investment portfolio than just looking at matching. There's a whole approach of protecting the capital of the Company when you have things like a European debt crisis come into play. And one of the things we can proudly say, we do not have any exposure to the Irish, Greece, Spain, Portugal issues that have been referred to in recent times. And it's one of the reasons why we can actually say we have no permanent impairment of any one of our cash and fixed interest securities. But I can assure you, if you're longer out in the yield curve, you try to move money and you've got no way.

So it's a balance. It's a balance between a yield, liquidity. And protecting the capital of the Company. And protecting the interests of policyholders. So it's just not as easy as just saying matching is the way to go. And I again repeat, APRA have really come very much somewhere between the middle, zero. And a matching. And that's where we are.

Q - Andrew Kearnan {BIO 1702520 <GO>}

Secondly, just appreciate some insights into the position around risk margins and reserves; whether the PoA has been stable or otherwise in the context of the interest rate movements. And indeed the profit position?

A - Frank O'Halloran

Andrew, there is little doubt that the PoA will be down on where it was at the end of June. And that's primarily driven by a lower risk-free rate applicable to those non-Australian GAAP companies; namely, European and now US operations.

We are currently in the process of getting all the actuarial numbers put together. We feel that we'll be somewhere around 85% or higher. But it's a long way to go before we actually tally up that number. We won't have that number until the end of January.

In many ways, we discussed the whole question of PoA but I think it was more important for us to come out to the market today and say we've actually been hammered by catastrophes in the last month and then tell the market where we stand. But we won't have the answer of PoA until the end of January, Neil.

A - Neil Drabsch {BIO 2093435 <GO>}

No.

Q - Andrew Kearnan {BIO 1702520 <GO>}

I appreciate that it's obviously something which is still going to come. I'm just wondering what the firm's policy will be should the PoA end up at the very lower end of that targeted Group range of 85% to 94%.

A - Frank O'Halloran

It will be -- if it's 85%, we'll leave it at 85%; if it's 86%. Whatever the calculation comes out to be, we'll leave it at that. But we do reckon -- I think the important thing is that on an undiscounted basis our claims reserves are going to be at the same level as they were in terms of degree of adequacy as they were in December 2011. And 2010.

The risk-free rates applicable to our European operations and US operations will move that probability of adequacy up and down. And I think that's well known by the market and hopefully well known by the analysts. But we won't have an answer to that at the end of the year. But we wouldn't have gone out to the market if we didn't think it was going to be around 85%, Andrew, or more.

Q - Andrew Kearnan {BIO 1702520 <GO>}

Appreciate your comments, thank you.

Operator

Kieren, Deutsche Bank.

Q - Kieren Chidgey {BIO 7268946 <GO>}

A couple of questions. Firstly, in regards to the 2011 catastrophe costs, it looks like you're looking at around $2.3 billion. Can you just clarify, that's post the additional aggregate reinsurance recoveries you took out in second half of $150 million?

A - Frank O'Halloran

It's post all reinsurance recoveries that we posted, we received during the year. And the reality is that we haven't finally assessed the number for that second group cover. But we do know that the 15% is the net large risk and cat figure that we'll be publishing in our full-year results.

So it's after all reinsurance recoveries and, as I said earlier, is that $500 million of that $2.3 billion that's come through in the month of December -- or actually late December when we got all the information that we needed to assess the Thailand situation.

The Thailand situation was quite unbelievable because we had people flying over the areas that were totally flooded. We knew we had business interruption. We knew we had all the coverages on these commercial properties. But you couldn't assess. We didn't know how much stock had been taken out and whether they had moved the plant equipment. And so on. And so on.

So that information, I personally got a first report on Thailand from the loss adjusters about just before Christmas. Then we instructed the team to go back and say we wanted a greater percentage of the exposures actually assessed before the end of the year. So the loss adjusters, with our claim staff, worked their backsides off to try and get a full assessment of the extent of the damage.

So it is net of recoveries. And there won't be any more recoveries (during) 2011.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. Can I just follow on from that? Has the reinsurance program responded how you would have expected? I mean the level of net costs here is so significantly above a normalized year and above guidance, just wondering whether or not you're revisiting the structure of the reinsurance program.

I doubt it, given you've placed the cover for 2012. But perhaps you could say how the 2012 program would have responded had it been in place in 2011. What sort of additional protections would we have seen?

A - Frank O'Halloran

It's a very good question. So the first thing I might just cover, Kieren, if you wouldn't mind, is the 2011 program was a change from 2010. And we did mention at the halfway mark it benefited our results by $298 million. Now, we actually haven't calculated the comparison; we will do that for the whole of 2011.

But the most important thing about 2011 coverage is that we didn't have any re-instatement premium protection to pay -- sorry, re-instatement premium to pay on those worldwide covers, although we only had one claim and that was in respect to the February New Zealand earthquake cover.

But the other important thing, if we'd our 2010 covers in place, we would have run out of cover. Then we would have been like some others, going and having to buy additional coverage at a time when prices were just so exorbitant. So in reality, we'll find out that the 2011 program was more beneficial than 2010.

So for 2012 we've renewed that cover that we had in place. But what we have done is we've purchased a separate program for the whole of what we call QBE first, the lenders' placed homeowners' insurance in US. We've combined the (Seoul) sterling portfolio and the Balboa portfolio and we will allow the retention of that to inure to the benefit of our worldwide covers for 2012.

And in reality, it hasn't changed our net retention under those worldwide programs, except for a US windstorm, where our retention on the primary business for US windstorm has dropped from $300 million to $250 million. So that's number one.

Number two is that the way we structured that Equator Re protection, which is $200 million of protection for a second, third. And fourth loss, that reinsurance -- if we hadn't had a reinsurance recovery, it will not inure to the benefit of the new Group aggregate cover.

So what we have in place is the $200 million for Equator, which is effectively against an accumulation of catastrophes. We have $200 million of cover for catastrophes, accumulation of catastrophes above $1 billion for the Group, that's in excess of $5 million per event; we have a deductible $5 million.

Then we have $200 million of risk cover for claims, like exactly the same as last year, where we had $200 million accumulation of risk claims above $5 million. But there's no deductibles. So once a claim gets above $5 million it starts from zero against that cover.

Now, that cover wasn't triggered -- sorry, there were no reinsurance recoveries against the risk cover, aggregate cover in 2011 because we had a pretty good year in terms of risk claims, not so good in terms of cats.

But the changes that we've made. And to give you a couple of examples, I think it's probably worthwhile, is, for example, in New Zealand we have obviously made significant changes to the way we're looking at our exposure to earthquakes, in particular, with Christchurch. Then Christchurch will only provide protection -- we've coded Christchurch into different (colors) and we'll only provide protection I think it's east of Christchurch. And even then we'll only give protection if we assess that the risk.

In the case of Australia, for example, the latest numbers I've seen from homeowners in Queensland, for example, our latest retention of homeowners' policies was 60% in numbers of policies. But in terms of premium, it's 98% retention so you'll get a feel for what's happening there.

In the case of Thailand, we have withdrawn flood coverage.

In case of Melbourne, we've made some changes. So our loss from the Christmas Day storms is less than we anticipated. And less than what we would have previously had.

So we just keep on adjusting our business. So I answered the whole question in a roundabout way. But it might save a few other questions about what's actually happening. But other than that, (inaudible).

Q - Kieren Chidgey {BIO 7268946 <GO>}

I just had a couple of other shorter questions, if you don't mind. Just on the combined ratio, you've said 96.5%. If I back out the cat impact of 15% and the discount rate impact. And assuming your expense ratio is still around 29% to 30%, it does imply an attritional loss ratio above 50%. Is that fair? Have you actually seen an increase in attritional loss ratios?

A - Frank O'Halloran

No. I think it's just going to be very much in line with where we've experienced over the last couple of years.

And one of the things we have not been able to do at this stage and our actuaries have not been able to do is reflect the impact of the increased prices that we got in the second half of the year on the actuarial reserve. So we'll see the flow-on impact of that coming through in 2012. But our attritional claims ratio across the Group is pretty much around that 49.5%/50% mark.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. And finally --

A - Frank O'Halloran

Yes, go on. I'll probably -- we will obviously provide that information. But the attritional claims ratio, you will see, is pretty much in line with the market, plus or minus 0.5%.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. A lot of the commentary here is referring to the profit at an insurance level, just wondering if you could provide some quick comments around the yield on shareholder funds for 2011. And also the tax rate for full year?

A - Frank O'Halloran

Yes, I'll leave that to Neil. We do mention though, Keiren. And I hate to say this because I'm just so disappointed, that our profit after tax is down 40% to 50%. So that gives you a bit of an indication where our profit after tax will be.

But Neil, do you want to comment on the tax rate and the shareholder funds?

A - Neil Drabsch {BIO 2093435 <GO>}

Obviously, the fixed interest and cash yield that you see in policyholders' funds is the same yield in shareholders' funds. Shareholders have got equities. While the equity exposure is much lower, just over $300-odd-million at the moment, it will be affected, probably maybe $25 million/$30 million unrealized loss in that. That'll come through the shareholder; that will drop down that yield, Kieren.

And borrowing costs, I think you've got enough information on that. Obviously, that runs separately.

You should also be aware that, as in the acquisitions that we made in the last year or so, the amortization costs will go up. That's one of the variables just at the moment while we go through our year-end audit and closure. But the previous year I think that was around about $60 million; well, that'll be double that this year, if not a little bit more. And that will be an ongoing number. So that also has an impact on the reported profit.

Income tax has also got some variables in it because of the spread of the business globally. But I think if you -- somewhere around about the 20% mark will be probably where it will sit when we get the year end.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thank you.

Operator

(Operator Instructions) Ryan Fisher, Goldman Sachs.

Q - Ryan Fisher {BIO 3487027 <GO>}

Just a quick question on the capital position. With the MCR just of 1.5 times, Neil, can you perhaps just give some comments on what you think is going to come out of (lagik), as you can see it at the moment? It sounds like you don't think the mismatch is a big problem. But is that likely to have much of an impact? And if so, where would you lower the line in the sand to? And what does that give you for acquisitions in the future?

A - Neil Drabsch {BIO 2093435 <GO>}

Thanks, Ryan. As you know, this is a bit of a moving feast at the moment. But we're not uncomfortable with the (lagik) change; I think that's been fairly well studied in the market generally by most of the insurers and it doesn't have any real impact on us.

There's one positive factor coming out of which I think consistent with the banks where we'll probably see the dividend, that is the future dividend taken out of it. So at a particular closing date that will have a bit of an offset.

So overall, we're not really seeing a lot of movement. And in fact, given our number, when we've -- (we operate) our models on this, overall, I think it's going to be quite minor.

Q - Ryan Fisher {BIO 3487027 <GO>}

Thanks, Neil. And just maybe more broadly to the acquisitions question for you and Frank, a, do you have anything major in the pipeline at the moment? And b, are you easing back over the next six to 12 months? Or are you still going to do whatever comes across?

A - Frank O'Halloran

I think it's important that -- so, Ryan, if we continually get acquisitions put across our plate. And I'm firmly of the view that if we've got a good quality acquisition we should come and talk to our shareholders about it. And we are working on acquisitions all the time, as we've consistently said. And we are working on acquisitions.

We're obviously very conscious about the things you mentioned and -- but I think it would be wrong for us to not come to our shareholders if we felt that there was a good quality acquisition that they would like us to consider. But we are working on a number, as we always do.

Q - Ryan Fisher {BIO 3487027 <GO>}

Thanks. Final thing, hopefully a lot easier question, you had ForEx trading gains in the first half, did those just hold steady in the second half? Or was there any change?

A - Neil Drabsch {BIO 2093435 <GO>}

Yes. It just held steady. So we haven't quite finalized our accounting on this yet. But it will be around probably 1.1%, I'd say, at the moment (of net earned) premium.

Q - Ryan Fisher {BIO 3487027 <GO>}

Great, thank you.

Operator

Richard, RBS.

Q - Richard Coles {BIO 16129434 <GO>}

Just a follow up the question John asked on the running yield. To get the running yield currently around 3.2%, as you're saying, has there been any change in the mix of that portfolio going forward versus what we would understand it to be in the past?

A - Frank O'Halloran

No. No. The running yield is as high as it is. And Neil please add to it if you feel you want to. The running yield is above -- slightly above 3.2% at the moment, mainly driven by the credit spreads because, remember, we are measuring the yield against the market value of the investment portfolio at the end of December.

A - Neil Drabsch {BIO 2093435 <GO>}

So just remember, our strategy that's been over the last year or so is to take advantage of the current illiquidity of the banks, high quality credits to lock in these very light credit spreads. And so the impact of that is -- and also to increase the maturity of that line.

So it does two things. Taking the maturity out, it gives us a bit of a yield pick up. Two, we still remain (inaudible) floating rate note. So we take out of play the interest rate risk, which Frank talked about earlier. And thirdly, the credit spreads, which are there at a balanced date will be the variable.

But if you follow this through, as this market starts to settle down. And when we've bought these securities we've actually locked in very strong yields, on quality paper that will prevail through the year. That's why we're able to say, look, underlying book, we're comfortable with around 3% at this stage.

A - Frank O'Halloran

So I think it's important. But I -- I know the analysts do a good job on this, is that for those on the line is that looking at Australia's interest rates and comparing it to that 3%, you must wonder what's going on. But over 65% of our investments are held in offshore to Australia; most of that is in the UK, Europe. And US where we have to hold those for regulatory capital purpose. But also to match the currency exposure of our liabilities.

Q - Richard Coles {BIO 16129434 <GO>}

Yes. I guess it's just a little confusing how in the back half of the year spreads have been blowing out, yet it hasn't helped the yield more when that's going to be helping you going forward. Obviously, government rates have come down. But there's a big fall in the back half on the yield. So wouldn't the spreads have been helping you then as you're moving into those and offsetting some of the falls in the government rates?

A - Neil Drabsch {BIO 2093435 <GO>}

It's just all in the timing; not enough in the last quarter.

Q - Richard Coles {BIO 16129434 <GO>}

Yes, okay, fair enough. No worries. Thanks very much for that, guys.

Operator

Mark Tomlins, Citi.

Q - Mark Tomlins {BIO 17312751 <GO>}

Two quick questions, if I can. Just regarding the franking of the dividend you're suggesting, I presume that's unfranked given you're probably looking to be fairly close to either break-even or make a small loss second half?

A - Frank O'Halloran

Unfranked, the dividend would have been --

A - Neil Drabsch {BIO 2093435 <GO>}

Yes, sorry, the dividend, our franking rates, because of the low Australian tax paid relevant to the whole, keeps us at the (inaudible). I must admit, I haven't looked at the dividend.

A - Frank O'Halloran

It won't be zero, Neil.

A - Neil Drabsch {BIO 2093435 <GO>}

It certainly won't be zero, that's for sure. It'll be probably 10% to 15% I think at this stage. Could be fractionally higher on the final.

Q - Mark Tomlins {BIO 17312751 <GO>}

Okay. And given your guidance for profit down 40% to 50% on last year and the first half profit you made, it seems to suggest that you're swinging between a loss of around $34 million/$35 million and a profit of heading up into the mid-$90 million. Do you expect to make this profit second half? Or is there a risk that it come out as a small loss?

A - Frank O'Halloran

I think your assumption is not far wrong because what's happened in the second half, we've had an extra just over $1.2 billion of cat claims. And we've got -- had to book something like $200 million on the risk-free rates. And $240 million on the credit spreads. So that's $440 million, plus the catastrophes.

And I think you could quite easily say that it's been a very, very difficult second half of the year for us. In many ways, the matter's outside of our control. At the end of the day, that's the nature of the business we're in.

Q - Mark Tomlins {BIO 17312751 <GO>}

Okay. So we could see a loss second half?

A - Frank O'Halloran

Neil?

A - Neil Drabsch {BIO 2093435 <GO>}

Yes. The 40% to 50% range, clearly, at this stage we've got moving parts that, I'm sure you'll excuse us, we're still three weeks away from closing our books. But it's not going to be too much either side of that.

If we come up with a profit, given that we're talking about a 50% or a 40% movement, you're talking about marginal impact. But you'll have to come to that -- unfortunately, we'll have to come to some conclusion on that at the moment until we close.

Q - Mark Tomlins {BIO 17312751 <GO>}

Okay.

A - Frank O'Halloran

I think it's an interesting question because the last thing -- we talked about the release with our Board this morning and the last thing that we felt -- we would have preferred to stay below -- away from the bottom line because we've got so much work to do on the tax side of it and other areas. But at the end of the day, we thought we should give a range. And that's what we did. 40% to 50% is a fairly wide range. And that's where we feel at the moment we're going to be within.

Q - Mark Tomlins {BIO 17312751 <GO>}

Okay. Thank you.

Operator

James, UBS.

Q - James Coghill {BIO 14006200 <GO>}

Just another quick one on guidance for next year. I appreciate that you're three weeks away from finalizing things, Neil. But are you planned to move away from your typical range? Or if you aren't, is (15%) a mid point? Or is that likely to be an aspirational upper-end of the range number?

A - Neil Drabsch {BIO 2093435 <GO>}

That's our target, James. We're taking a leaf out of our competitors' book in this marketplace, where they actually have a target of underlying profit margin; and that's our target, an underlying profit margin. In reality it's --

Q - James Coghill {BIO 14006200 <GO>}

(As our guidance) will look when we get the result at the end of February.

A - Frank O'Halloran

It'll be an underwriting profit range of around (15%). And a combined operating ratio around 89%.

Q - James Coghill {BIO 14006200 <GO>}

Thank you.

A - Frank O'Halloran

I think we should probably explain, James, to clarify that is that there are so many moving parts to the business that started to occur as a result of the GFC. It just makes it very, very difficult when you have to pick up movement in credit spreads and movements in risk-free rates; and to look at the impact of those on profitability on a daily basis, it's just too hard. So we're looking at targeting an underlying profit margin, which is not too dissimilar to what our competitors have done.

Q - James Coghill {BIO 14006200 <GO>}

Thanks.

Operator

Ross, CBA.

Q - Ross Curran {BIO 15090587 <GO>}

I just want to get a bit more feel for the outlook for the increase in rates. I know you've said that you're pushing rates up 30% across some lines, I'm just wondering what impact that's having on retention rates and whether there's any particular geographies or asset classes that you're getting more success pushing rates up through?

A - Frank O'Halloran

We'll obviously provide a lot more detail at the end of -- in February. But really, basically where we are is that on property lines of business in Australia and New Zealand are going up between 10% and 15%. Homeowners are -- and motor, you know that from talking to the direct underwriters; packages are going up.

In the US, interesting enough. And markets haven't caught up with this. But we're looking at close to 15% rate increases on property. And we're in the market to file for further rate increases.

In the UK, we're actually seeing rate increases on property business for our International business. We're not seeing much rate increase for Mainland Europe. But we are seeing some rate increases for property on UK business.

So in general terms, across the board we're seeing very substantial rate increases on property insurance.

And in the case of retentions, it's not impacting our customer retention in Australia, on the commercial book; it's not impacting our retentions in New Zealand. In actual fact, New Zealand's holding up much better than we anticipated. And primarily because some companies are withdrawing from certain areas of earthquake in New Zealand.

Our retentions in the US, interestingly enough, are actually slightly better than they were.

The only area that's been affected in terms of retentions is in Queensland in homeowners' insurance. And parts of Victoria and Melbourne in terms of homeowners' insurance.

So we've obviously pushed hard on price and deductibles in areas that we got impacted in 2011. But we'll give a lot more detail on (a lot of it). But the good news is that we'll be saying to the market our overall price increases for the Group are going to be much higher than we anticipated.

Q - Ross Curran {BIO 15090587 <GO>}

That's great, thank you.

Operator

Siddarth, JPMorgan.

Q - Siddarth Parameswaran

Just a couple of questions, if I can; one is just on your guidance for next year. The last time we had seen a downturn in the global economy, we did see some recession-linked claims. I was just wondering if in your guidance at all whether your normalized numbers account for that, or is that something we should be separately be deducting, or otherwise?

A - Frank O'Halloran

No. I think we've now had, what, nearly three years of what they called the GFC? I don't know what they call it now. But probably the Europe debt crisis. We have seen some inflation in some areas. But it hasn't been material.

It's probably been more material in motor than anywhere else. And obviously, as you probably appreciate, we're not very big in motor in this marketplace. In the UK, we're very much a commercial lines motor underwriter. And we have seen some inflation. But not much. It's been lower than we anticipated.

Probably, the only area that there's been a fair bit of inflation is in workers' comp in the US. But I think, we're not large in the US in workers' comp. And we are seeing some price increases and we're in states where we want to be in that class of business.

Q - Siddarth Parameswaran

Yes. Sorry, it's more a forward-looking question; if there is a downturn in Europe, just do you have significant exposures in classes such as trade credit in those markets, or workers' comp? And are you taking any mitigation efforts? Or have you taken any mitigation efforts?

A - Frank O'Halloran

The answer to the question is, yes. We don't have any exposure to workers' comp in Mainland Europe. We do have exposure to employers' liability in the UK. And if you've got time down the track, Siddarth, I'll show you how we monitor inflation on that class of business. We analyze it to death and break it down and all its various elements.

So we are monitoring inflation on employers' liability. And that's why we have cut back our exposure to that part of the world.

In the case of -- sorry, what was the other part, Neil?

Q - Siddarth Parameswaran

Trade credit?

A - Frank O'Halloran

Trade credit. We write about a GBP30 million trade credit book in Europe. And it's basically all in the UK; it's none in Mainland Europe.

Q - Siddarth Parameswaran

Right, okay. Okay. Great, thank you.

Operator

Ladies and gentlemen. unfortunately, due to time constraints, we are unable to take further questions. I would like to hand over to Frank for last comments.

A - Frank O'Halloran

Finally, I'd just like to say again that we are extremely disappointed with the number we've given to the marketplace. And obviously that's been reflected in our share price. But I can assure all investors of one thing. And that is the same assurance I gave them at the end of 2001; that we have a fantastic business, which has outperformed against our peers consistently over a number of years. We are absolutely determined to make out the shortfall in profit in 2011 and make it up again. And more. And there is little doubt that this is a surprise to the market, which doesn't please us.

The other thing I would like to add is that, hopefully, by clarifying some of the comments that have been made respecting the US regulatory position and in respect to US crop and other matters, that people will ring us before they jump to conclusions. Because the one thing we face every day of the week. And I'm not being critical of the US. But this is the US and it is one of those areas where people do (play) and it's consumer advocates and others will do anything to put pressure on us as an insurance company. And it not only applies to us. But it applies to banks and other public invested companies, or companies operating in that marketplace.

So please, please be careful when you're reading things that are coming out of the media. If you have any questions, give us a call because we're more than happy to work with you. And if it's a notification required under the (AA6), we will obviously notify the (AA6).

But I really do appreciate your time. We've got Tony Jackson coming on board in 1.5 weeks' time; and obviously the reason why he's coming on board is to be able to spend more time with investors and the analysts, helping them work through our complex and very diverse organization, which is now in 52 countries around the world.

So thank you for your time. And thank you for your patience. And thank you for your questions. And as I said, please do not hesitate to call us if you've got any further queries. So thank you, everybody.

Operator

Thank you very much. Ladies and gentlemen. that ends our teleconference. Please disconnect your lines. Have a great evening, afternoon, or day. Thank you very much.