S1 2021 Earnings Call

Company Participants

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

Other Participants

- Analyst
- Andrei Stadnik
- Andrew Buncombe
- Kieren Chidgey
- Matt Dunger
- Nigel Pittaway
- Siddharth Parameswaran

Presentation

Tony Jackson {BIO 1729093 <GO>}

My name is Tony Jackson and I'm the Head Investor Relations. This morning you'll hear from our interim group CEO, Richard Pryce, who will be presenting from London. And our group CFO, Inder Singh, who is presenting from Sydney. We'll then open up to Q&A. Before I hand over to Richard. (Operator Instructions).

And with that, I'll hand over to Richard.

Richard Pryce {BIO 5184927 <GO>}

Thank you, Tony. Good morning, and thank you for joining us today for QBE's 2021 half-year result presentation. I'll start by discussing the key features of the result, provide more granular detail on the current pricing environment and the implications for premium growth and margin expansion. Before handing over to Inder to talk through the details of the financials. I will then close with our priorities for the second half of the year, before opening up for Q&A.

So if we move to slide 3. I would like to start by saying that the Board and the Group executive are pleased with the improvement that is clearly evident in the first half result. We have made encouraging progress with the performance agenda and momentum is building across the business. Profitability rebounded strongly during the half and underpinned by a material improvement in both underwriting profitability and investment returns, which contributed to an adjusted cash profit ROE of 11.9%. Our combined operating ratio of 93.3% is encouraging and over 10 percentage points better than the prior period, which is heavily impacted by COVID-19 and the significant unfavorable prior year development. It also shows an improvement on the 2020 exit COR of 95% that we reference back in February.

Just briefly on COVID-19. The COVID-19 current (inaudible) impact during the half was modest, only $20 million, which may be impacted A&H and workers compensation attritional claims in North America and the small business interruption impact in Australia. We flagged the likelihood of a further $130 million of COVID-19 related claims in 2021 and while they're still a long way to go before year end. I would be disappointed if we didn't come in below that. Given the only modest first half impact, we haven't excluding COVID-19 claims in our underwriting result. However, it makes sense to continue to exclude the very significant COVID-19 impact form the H1 20 comparable figures.

In 2020, we set aside significant provisions and gross margins for COVID-19 claims and we remain confident that these will prove sufficient. Importantly, we have already received some COVID-19 BI related reinsurance recoveries and currently have no concerns around recoverability.

Now turning back to the broader business. Headline gross written premiums increased 27% on the prior year or 20% on a constant currency basis. The GWP growth reflects a combination of the ongoing strong premium rate environment, targeted growth and improve customer retention across the group. Premium growth also benefited from significant growth in our crop business, which I will touch on later. Given the ongoing positive pricing conditions, result unsurprisingly included a further improvement in the attritional claims ratio, which I will discuss by division in a subsequent slide.

The only disappointing aspect of the result was catastrophe claims, which were above our increased allowance by 1.6% of net earned premium. Texas winter storm Uri was a standout event during the period, which led to near record first quarter losses for the U.S. P&C industry and heavily impacted our North American result, as well as the results of international markets in QBE rate within the international division.

We also saw elevated activity during the half in Australia, including cyclone Seroja, East Coast floods, storm losses and the bush fires. While it is early days, it is pleasing to see a modest amount of positive prior accident year development, including a positive outcome in all our divisions. While the stability of reserves in North America is encouraging, but in a fluid operating environment, particularly with respect to claims inflation, we are keeping an extremely close eye on numerous reserving data points. I'll talk about inflation little more later.

Premium rates increase further in the first half of 2021 with the group achieving an average renewal rate increase of 9.7 % up from 8.7% in the prior period. Pricing remains strong across all regions and in almost every product line. I will discuss this in more detail later. Although, the pricing environment remains attractive, of course, you knew that there are some signs that momentum is moderating, particularly in the international markets here in London, where rate increases have been particularly strong now for nearly four years. While the investment return was impacted by mark-to-mark losses on fixed income securities due to the significant increase in risk-free rates during the period, investment income rebounded strongly to $58 million from the loss of $90 million in the prior period.

Asset allocation remains appropriately conservative giving growth asset valuations and uncertainty around the outlook for global inflation, but also given the opportunities for profitable capital deployment across the group's underwriting businesses. I will leave the balance sheet for Inder to talk about in more detail, but I'm pleased to see that all the balance sheet metrics are moving in the right direction.

Now, if we move to slide 4. Most of the charts on this slide speak for themselves. As already noted, we saw very strong growth during the half with GWP up 27%, to $10.2 billion or up 20% on a constant currency basis. As you will see shortly, our crop business contributed significant growth, but even excluding crop, GWP was up 14% on the same basis.

The trend in premium rate increases is impressive, particularly the step-up in 2020 and then a gain in the recent half and then this compounding effect of rate on rate that is driving the improvement in the attritional claims ratio, so clearly evident in the chart on the bottom left.

Inder will discuss our combined operating ratio in a later slide, but suffice to say that the trends we are seeing are encouraging and we are pleased with the improvement. While it's not apparent from the chart, the 93.3% is the best combined operating ratio the group has reported in almost a decade.

Looking briefly at large individual risk claims. The net cost of large individual risk claims increased to 8.1% of net earned premium from 7.5% in the prior period. Gross is not apparent in the chart, the current accident year result includes substantially more IBNR than in previous periods. And so the underlying trend in risks losses could prove to be more pleasing than it first appears.

Turning now to catastrophe claims. The recent trend in QBE's catastrophe costs is concerning, increasing to 7% in the most recent far to 5.5% in the prior period and well above the group's first half allowance. The rising frequency and severity of catastrophe costs is one of the more difficult issues that the industry is presently grappling with. As I have mentioned before, we continue to view all catastrophe exposure with caution. We still consider the pricing of catastrophe risk to be merely adequate rather than margin enhancing. And as a consequence, we have not increased our catastrophe exposure during the half.

As part of our reinvigorated cell review process, we are reviewing the performance of all our catastrophe exposed portfolios and reassessing the effectiveness of the models we use.

And finally in this slide, prior accident year claims development. Given the reserve strength we took at the end of 2020, particularly in North America as well as adopting more conservative IBNR assumptions for the 2020 accident year and the current accident year, it is pleasing to see the group report a modest amount of positive prior year's development. While all the divisions reported positive prior accident year development, the early signs of reserving stability in North America is encouraging. Noting, of course, that is based only on six months development.

Briefly on claims inflation. In some shorted property lines we are experiencing what at this stage appears to be short term, rather than permanent structural shift in claims inflation associated with supply chain shortages leading to increased labor and material costs. There has been a small impact on the results for some property classes in North America. In long tail classes, we have not seen any material changing claims inflation, including social inflation and our underlying assumptions by division remains sufficient and are largely unchanged from the level we outlined back in February. That said, we are looking closely at trends in claims inflation emerging in new pockets, including liability, Western Australia workers compensation and new South Wales CTP new scheme modern claims in Australia, as well as bodily injury here in the UK. Regardless, we remain vigilant on claim innovation and will not hesitate to further increase our pricing and reserving assumption change should any signs of a sustained acceleration in claims inflation emerge.

Now we move to slide 5. Turning now to pricing momentum in a little more detail. As I said earlier, premium rates continue to strengthen with the group achieving an average annual rate increase of 9.7 % in the half up to 8.7% in the first half of 2020. While we have seen consecutive quarters of stronger rate increases relative to the prior corresponding quarter, namely 8.9% in the first quarter followed by 10.6 in the second, there are some signs that rate momentum is moderating, particularly here in some lines in international markets.

Turning briefly to each region, premium rates in North America remains strong with an average renewal rate increase of 10.2% in the half compared with 9.5% in the prior period. Premium rate adequacy continues to improve and rate increases are comfortably in excess of claims inflation across most portfolios. Noteworthy rate increases by class included 22% in financial lines, 17% in aviation, 16% in property programs and 11% in accident and health. In international, we achieved an average premium renewal rate increase of 10.5% compared with 10.1% in the prior period. This included rate increases of 14% in international markets, 13% in UK, 11% in Continental Europe, 7% in QBE Re and finally 5% in Asia.

Although there are some signs momentum is moderating, particularly in international markets, which contributed to the slightly slower second quarter increases relative to the equivalent prior period. Rate increases remain well above claims inflation and it is encouraging that rate continues to build the portfolios where significant premium rate correction was necessary, such as financial lines and international liability.

Noteworthy rate increases included 32% in UK financial lines, 20% in Canada, 19% in UK property, 18% in European financial lines, 16% in international markets property, 16% in international markets financial lines, and finally 12% in European property. The acceleration of premium rate increases in Continental Europe more broadly is also pleasing as the commencement of an upswing in rates in this portfolio light other territories and support our growth plans in this region.

Australia Pacific achieves an average annual renewal rate increase of 7.7% up from 5.5% in the prior period. As you'll recall, rate increases in the middle quarters of last year were impacted by COVID-19 relief measures. So it's pleasing to see rate increases recover this year, particularly given the catastrophe experience in recent years. Noteworthy rate increases by class included 14% of professional indemnity, 13% in commercial property, 12% in householders, 11% in (inaudible) and finally 10% in engineering.

Before I move on, it's worth highlighting the steady improvement in the group wide customer retention, which reflects the activities included in our customer QBE initiative and reduced remediation activities. In addition to premium rate increases and new business growth, improved retention contributed to the strong growth we achieve during the half. No doubt, you're interested where IC rates trending from here. And as always, my response is, it's very difficult to predict. While there are some signs that momentum is moderating, there are plenty of factors supporting ongoing increases including recently elevated and possibly accelerating catastrophe experience, negligible interest rates, the likely short-term claims inflation in short-tail lines, I mentioned earlier. And frankly, the needs of the industry to build reserving prudence to manage the potential that are more sustained increase in claims inflation. In summary, I believe rates in most products and geographies need to continue to increase to offset the factors I just mentioned above.

If we now turn to slide 6, gross written premium. As I mentioned earlier, gross written premium increase 20% on a constant currency basis reflecting the strong pricing environment, targeted new business growth and improved customer retention. Our crop business in North America experience 48% top line growth during the half, reflecting significantly higher commodity prices and ongoing targeted organic growth associated with our market-leading service proposition.

For those of you interested in further details, we've included a slide on crop business in the appendices, which is slide 24. Excluding crop, gross written premium increases by 14% on a constant currency basis with the growth of 17% in North America, 11% in international and 18% in Australia Pacific. This translates into growth of around 7% in excessive premium rates. Despite the strong headline growth, we've retained our underwriting disciplines targeting new business that is appropriately priced from within our risk appetite. Our priority remains optimizing risk-adjusted return on capital.

Turning now to each of our division in a little more detail. Excluding crop, North America achieved GWP growth of 17%, underpinned by strong growth in specialty programs, commercial property, A&H, middle market P&C and financial lines. Growth in the middle market is central to our strategy of building additional scale, while at the same time enhancing portfolio balance, particularly reducing our exposure to mono catastrophe explodes lines.

Following our investment in market-leading talent, financial lines portfolio grew 14.2% in the current period. To be prudent, we have supported this growth with a 50% quota share on the current accident year. International achieved growth of 11% on a constant currency basis, underpinned by growth of 25% in Continental Europe business, and 15% in QBE Re, driven by specialty and casualty lines. We have seen less than optimal growth in international markets in Asia, which will -- we will focus on these areas in the second part.

Australia Pacific achieved premium growth of 18% on a constant currency basis, underpinned by 23% growth in commercial lines. Strong growth is also achieved in LMI, workers compensation, commercial packages, engineering, commercial motor and farm. Through our (inaudible) Group's net earn premium let to grocer intriguing during the half, reflecting a number of factors including, especially strong growth in heavily reinsurance classes like crop and financial lines, as well as earning patterns, including crop and LMI.

While overall reinsurance expense will be subject to business mix trends, the gap between written premium and earned premium should narrow somewhat during the second half. Inder will speak to our reinsurance expenses in a later slide, but with the current pace of top-line growth, our net earned premium trajectory should move closer to gross written premium in the second half.

Now touring to slide seven, the attritional claims ratio. As I said earlier, given the strong pricing conditions, the further 1.8% improvement is the Group's attritional claims ratio to 43.7% is not surprising. North America's attritional claims ratio improved 1%, reflecting rate increases and excessive claims inflation across most lines. This is despite a modest amount of COVID-19 related claims, which impacted A&H and workers compensation and short-term inflationary pressures in short-tail property lines due to higher materials and labor costs.

Internationals attritional claims ratio improved by 3.6% reflecting the compounding effect of especially strong premium rate increases seen over the last 18 months. Somewhat disappointingly, Australia Pacific attritional claims ratio increased slightly during the half. Improvement in most classes was more than offset by higher weather-related claims in householders, strata and the Pacific businesses. Given the strength of the ongoing premium rate increases, and the rate increases, we are still earning through the P&L. It is reasonable to anticipate some further improvement in the group's attritional claims ratio.

I will now hand over to Inder to take you through the financials in more detail.

Inder Singh {BIO 20594382 <GO>}

Thank you, Richard. Good morning, all. As Richard has highlighted first half results, clearly demonstrates a strong recovery in earnings driven by material improvement in both the underwriting possibility and in investment returns. Pleasingly, the overall quality of the result is strong with headline financials now more aligned with the improving unlike trends, we have referenced in recent reporting periods.

I'll now provide a bit more detail on our financial performance starting with the overall group P&L on Slide 9. Gross written premium for the half was $10.2 billion, a 20% increase over the prior period as measured on a constant currency basis. This reflects the benefit of compound rate increases, improved customer retention and good new business volumes. The combined operating ratio improved by around 4 percentage points to 93.3% reflecting further improvement in the attritional claims ratio, a lower expense ratio and a modest release from prior accident year reserves. I'll step you through each of these components in a bit more detail shortly.

Our investment portfolio delivered an annualized return of 40 basis points, excluding the impact of risk-free rates, the underlying annualized fixed income yield was around 50 basis points. Growth assets, delivered a 12% return on an annualized basis. This was well ahead of our long-term assumptions and reflected the supportive market settings for risk assets in the first half.

The statutory profit after tax for the half was $441 million strong rebound from the $712 million loss reported in the prior period. It's worth briefly touching on the impact of risk-free rate movements and net P&L during the half. As slight at the AGM, we modestly shorten, the duration of our fixed income portfolio in Q1. So as risk-free rates moved higher, we generated a net P&L gain of $73 million with the $205 million benefit to the claims line, more than offsetting the $132 million adverse mark -to-market impact on investment assets. The annualized cash ROE for the first half was 11.9%. This number equates to 10.4% excluding the tactical investment gain, I just reference. The board declared an interim dividend of $0.11 share up from $0.04 per share in the prior period. Informing the CEO on the interim payout the board, sought to balance the strength of our earnings recovery, the outlook for organic growth and the higher inherent weather-related uncertainty in our second half performance.

I'll now turn to Slide 10 and step you through some of the key movements in the group's combined operating ratio. As you can see on the chart, our first half combined operating ratio of 93.3% was around 4 percentage points better and the 97.4% reported in the prior period. Walking from left to right, the first block shows the impact of movements in prior accident year reserves. The 2021 half-year result included a modest benefit around 1 percentage point versus an adverse impact of around 2 percentage points in the prior period.

The current accident year combined operating ratio improved by around 1 percentage point in aggregate across the components shown on the chart. The main driver of this improvement was attritional claims ratio, which is around 2 percentage points lower at 43.7%. This reflects the benefit of earned premium rate increases and are now well established underwriting disciplines. The 60 basis point improvement in our expense ratio, reflects the benefit of our nation see -- efficiency initiatives over the last two years, coupled with discipline cost control and operating leverage from the higher premium base. The improvement in the commission ratio primarily reflects a shift in business mix. In particular, the strong growth in our crop business where commissions are reimbursed by the US government and growth in class is protected by quota share insurance such as North America's financial lines and lenders mortgage insurance.

On large individual risk claims, we are seeing a relatively low level of reported claims activity, while we're continuing to hold higher IBNR assumptions to reflect both the inherent volatility in these claims and the high risk of inflation over the medium term. Catastrophe claims were elevated reflecting the winter storm in Texas, floods and storms in the east coast of Australia and cyclone Seroja in Western Australia. We have booked our crop business at our current accident year combined ratio of 95% relative to the 2021 plan of 92% and the prior period comparison of 90%. This reflects both elevated drought risk in the Dakota as well as in Minnesota and the inherent difficulty in accurately forecasting the crop result prior to the harvest in November.

I'll now turn to divisional performance in a bit more detail. I'll start with North America on Slide 11, gross written premium for the half was $3.8 billion, an increase of 31% versus the prior period or 17% excluding crop. Before I talk about the combined operating ratio, I'll just describe what we're showing on the charts on this divisional slides. The left-hand bar show the current accident year combined operating ratios with CAT claims elevated allowance. And then the middle section of the chart shows the impact of actual versus allowance on CAT claims for each half. As well as the movement in prior accident year reserves. We think this provides a good view of the underlying performance of the business of the two comparative parts.

So as you can see here in North America, the current accident year combined operating ratio improved by around 70 basis points to 95.9%. Within this attritional claims ratio improved by around 1 percentage point with the benefit of premium rate increases partly offset by the impact of claims inflation. Short-tail property classes related to both construction materials and labor costs. The large individual risk claims ratio improves 40 basis points, compared with the prior period. We've seen a relatively low level of reported claims, but are continue to booked IBNR assumptions, given the inherent volatility in large individuals' claims. It is worth noting that the continued build out of casualty lines such as financial lines will ultimately shift our business mix slightly towards large individuals' claims and away from attritional claims. Catastrophe claims exceeded our first half allowance by 5.7 percentage points mainly due to the extreme winter weather in Texas as Arctic temperatures and power shut shortages resulted in record insurance claims.

Overall, the Texas winter storm has been estimated as a $10 billion to $15 billion loss event for the insurance industry ranking the first quarter of 2021 as close to the worst first quarter in history and second only to the first quarter of 1994, which included the Northridge earthquake. After this, we undertook last year, prior accident year claims experience was broadly stable and in line with expectations. We remain vigilant around the risks that could challenge the adequacy of our reserving estimates, in particular social inflation and its implications for casualty claim costs remain a focal point for both us and the industry more broadly. We continue to make good progress in improving the operational efficiency of our business in North America, the underwriting expense ratio improved by 3.2 percentage points to 11.6% reflecting the benefit of these efficiency initiatives as well as the improved operating leverage from the much higher premium base.

I'll now turn to our international division on Slide 12. Gross written premium was $3.9 billion was up 11% on a constant currency basis, reflecting the strong premium rate environment and targeted growth particularly in European insurance and in QBE Re. On the left hand side of the chart, you can see that the current accident year combined operating ratio improved by slightly more than 1 percentage point to 91.9%. Within this the attritional claims ratio improved by around 3.5 percentage points, 39.1% reflecting the benefit of compound premium rate increases and reduce claims frequency in motor and liability lines hardly assisted by the government lockdowns. The cost of large individual risk claims increased by around 2.5 percentage points to 13.1% mainly due to higher IBNR assumptions, which enable to get account for more than 70% of the total cost of large individual risk claims incurred during the first half. Prior accident year claims experience was modestly favorable with NAV reserve releases of around 40 million or 1.5% of net earned premium. Several experience in UK motor and UK and European liability lines was partly offset by some further strengthening in legacy financial loans portfolios.

On catastrophe claims, we had benefited from particular benign experience in the prior period and this partly normalized during the first half of 2021 both international markets and QBE Uri or impacted by the Texas winter storm that I referenced earlier. Despite this increase, catastrophe claims were within the international divisions allowance for the first half. The expense ratio improves 50 basis points to 13.4% reflecting operating leverage from the substantially higher premium pool coupled with disciplined expense management.

Moving to our home market of Australia Pacific on Slide 13. Gross written premium was $2.5 billion was up 18% in constant currency terms with premium rate momentum recovering following the expiry of temporary COVID-19 release measures that we put in place last year. Premium growth was broadly based with good momentum in our core SME and mid-market segments of commercial packages, commercial motor, commercial property and workers comp. The current accident year combined operating ratio remains strong at 90.8%, albeit 60 basis points higher than the prior period. Within this attritional claims ratio was around 30 basis points higher with the benefit of premium rate increases more than offset by higher weather related claims and our householder's book, strata book and in the Pacific Islands portfolios.

The cost of large individual risk claims was around 60 basis points, lower than the prior period. But as I referenced earlier, this is an inherently volatile metric and we remain acutely focused on the risk of elevated claims inflation, particularly in the longer tail liability lines. Prior accident claims experience was mostly favorable with net releases around 24 million or 1.2% of earned premium. Adverse development liability lines, workers comp was more than offset by favorable development and short tail classes in CTP and some modest releases in trade credit and LMI. Catastrophe claims remain elevated at around 1.5 percentage points in excess of our allowance would be down from the levels, we've experienced in the prior period, which included the extreme bushfires on the East Coast of Australia. We are seeing higher new business volumes and lenders mortgage insurance driven by historically low interest rates and government incentives. But we remain cautious with respect to the group's net exposure to the Australian housing market and accordingly increased our quota share insurance on this business from 30% last year to 40% for the 2021 underwriting year. LMI credit metrics have remained stable and the combined operating ratio improves to around 49% from 55% in the prior period. This improvement included the benefit of a modest prior reserve release, reflecting the improved economic outlook and the strength of the local residential housing market.

Turning now to our investment portfolio and performance. Our investment portfolio remains conservatively positioned with around 93% invested in high quality fixed income securities and the remaining 7% investment -- invested in growth assets, including unlisted property, infrastructure and private equity. We remain focused on quality and resilience across our portfolio and within our corporate credit book have seen less incidents of downgrade or negative outlook than the broader market and none of our investments have been downgraded to some investment grade. In the middle table, you can see that our core fixed income booked generated an annualized yield of 50 basis points. This excludes the impact of risk-free rate movements and we also saw a 20 basis points benefit from narrower credit spreads. Within growth assets unlisted property and infrastructure portfolios delivered strong cap depreciation, while our private equity portfolio kept pace with listed market strength.

The net annualized investment returns for the half was 40 basis points. In addition, we generated the $73 million net P&L gain from the tactical short duration position that I referenced earlier. As you can see on the chart on the right hand side of the slide, the running yield on the fixed income portfolio is currently around 40 basis points, which is markedly lower than prior periods due to both lower risk-free rates and credit spreads. Given the currently strong outlook for possible organic growth on the underwriting side of the house, we will retain a measured approach in deploying towards our long-term strategic investment portfolio settings of a 15% allocation to growth and risk assets.

Moving now to reinsurance balance sheet and capital management on Slide 15. As you can see on the chart, on the left hand side of the slide reinsurance expense in the half was $1.4 billion, an increase of $400 million relative to the prior period. This increase was driven by three key elements growth in the crop business with higher premium seeded into the U.S., Federal MPCI program. Increase in the level of quota share reinsurance in North American Financial lines, and lenders mortgage insurance, and in trade credit. And as backed in February, the cost of group's for CAT and risk XOL treaties increased by around $40 million. In the middle of the Slide, you can see that the PCA multiple is increased slightly to 1.73 from 1.72 times at the end of last year, and remains above the midpoint of our target range. The positive impact of earnings generated during the half was largely offset by the capital cost of new business strain. We saw meaningful increases in insurance liabilities, premium receivables and deferred reinsurance expense, all of which carry risk charges within the PCA calculation. On capital management, we redeemed $200 million of subordinated Tier 2 notes in the first quarter of this year. This redemption was funded by the Tier 2 subordinated debt issued in August last year. As a result of this redemption gearing improved to 31.1% from 34.8% at the end of 2020. We're now closer to the midpoint of our internal benchmark range of 25% to 35%.

With that, I'll hand back to Richard for his closing remarks.

Richard Pryce {BIO 5184927 <GO>}

Inder. Before we move to Q&A. I'd like to quickly run through our areas of focus for the remainder of the year. Which broadly fall within our strategic priorities of performance, customer, modernization, and talent and culture.

Starting with performance. As I've said before, market conditions remain attractive, and better than we've experienced in more than a decade. So, it's incumbent upon us to capitalize on those conditions to maximize a premium rate that we are achieving. But also to lock in as much growth as we can, while still maintaining underwriting discipline. Well, I'm pleased with the overall rate that we've achieved during the half. There ourselves where we need to push harder. Similarly, I'm pleased with a targeted premium growth we achieved during the half. But there's always room for improvement, international markets in Asia being prudent, examples. In terms of specific lines of business, I'm hopeful that we can continue to see growth in North American retail QBE specialty and casualty lines, Continental Europe and core commercial lines in Australia.

Moving on to modernization -- sorry, before that. Recognizing, there's always more to do to improve performance. the focus for the second half of the year, will remain multifaceted. So reviews portfolio optimization, especially in catastrophe exposed areas and further evolution of our brilliant basics program, including the delivery of our global property pricing project and more development on pricing in financial lines We're also undertaking, a more sophisticated and granular assessment of risk, including reserve, underwriting, catastrophe, credit and operational risk that is expected to improve capital allocation by sale in region. Cost facilitating and more accurate assessment of premium rate adequacy to better inform our decisions on where to grow.

Turning now to the customer. Targeting profitable new business growth and retaining our existing high-quality customers will be key to the future success of QBE. Alongside are committed and talented underwriting and claims teams. The extra ingredient is customer of QBE. Having launch customer QBE in late 2020. Recent activity has been around how to better connect with our customers including quantitative and qualitative research into what is important to our customers, their business mindset, risk management approach, buying behaviors, and what they are looking for in their insurer partner. This will underpin our aspiration to build stronger relationships with all our customers via truly differentiated proposition. We intend to further embed the use of sales metrics to provide better visibility of key pipeline data, but also help identify where to focus our efforts to secure vulnerable renewals and maximize customer retention.

And now on to modernization. We continue to modernize the business to improve performance and the customer experience and fundamental to this is a digital first mindset. We have detailed rollout plans for technology and modernization by functions and division. And recently, transitioned up to our new IT partnership. Outdated and redundant technology and systems are being updated or decommissioned. Applications moves to the cloud, and customer and distribution partner experiences improve through automation. But modernization is much more than just technology. We understand that the business needs to change. So over the last six months, we've challenged ourselves around historic operating structures and work practices, including recognition that the working environment will likely be very different in a post COVID-19 world. To this end. North America has taken some significant steps to sustainably improve operating leverage, which is already becoming evident in their expense ratio. They have reduced, their real estate footprint in New York and Atlanta. In favor of the Sun Prairie campus, and have reset management layers and spans of control. Together, these will deliver a sustained Improvement in efficiency and performance. Modernizing our practices and operating structures remain a priority, as we look to build a high-performing company and culture.

Finally talents and culture, we continue to commit time and energy to our culture accelerator program to enrich our culture. While also building a set of key actions to the future success of our business. This work needs to build on the foundations of our QVA -- QBE DNA, to empower and motivate our people to create a consistently high performing company for all our stakeholders. We have engaged the entire organization in this conversation with input from our people across all geographies enrolls. As a result of the work, we have established clear areas of focus, including many ideas suggested by our people for a recent culture hack. That more closely aligned behaviors to our DNA to build an inclusive workplace, where everyone feels respected and supported. Equally important is our desire to acknowledge and embrace the values of consistent high performance. The group executive committee and the group board have invested significant time in the program and will continue to focus on culture as we deliver the actions identified through this important work.

Before I open up the call to Q&A, I should say this will be my final result as Interim Group CEO. Incoming CEO, Andrew Horton commences enroll in September, and I look forward to supporting him, before I retire from QBE at the end of the year. It's been a pleasure to serve as the Interim CEO, and I wish Andrew, the group board, and the group executives, all the best for the future.

We will now open up for Q&A.

Questions And Answers

Operator

(Question And Answer)

A - Tony Jackson {BIO 1729093 <GO>}

Thanks, Richard. Thanks, Inder. We've got some questions online. The first question is from Kieren Chidgey of Jarden. If you can hear Kieren, go ahead please.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Hi, guys. Couple of questions if I could, starting on the combined ratio, which obviously is improved very strongly. Within that, the attritional loss ratio component looked pretty flat on second half '20 with a lot of the improvement coming in the expense ratio and commission rate. So just wondering if you can talk to why that's the case around the attritional loss ratio, is it issues like the short-tail property claims inflation in the U.S., you flagged or have you also baked in higher accident year lost fix for such '21?

A - Richard Pryce {BIO 5184927 <GO>}

Well, I think the impact of any short-term inflation is de minimis in any of our attritional loss ratios at this stage. Now, I think there is a reasonably material improvement, as we see on the prior year. I think anything, when you go through these phases of increasing rates, it always takes a little bit time for the actuaries to acknowledge exactly what the performance of the business is. They'll take a cautious approach, which we fully support. So you don't always see the improvement in the attritional ratio, maybe as much as you would see in the correspondence to the rate increase at the same time. But as we said, I think we've seen a decent improvement and the trajectory is good.

Q - Kieren Chidgey {BIO 7268946 <GO>}

All right. Thanks. And second question on sort of the catastrophe and large risks and just tying that in with a comment in your outlook statements about considering further strategic reinsurance. Just wonder if you can elaborate on sort of what you flag in there, if that is relating to sort of cat and large risks or if it's more fallout of specific around other initiatives.

A - Richard Pryce {BIO 5184927 <GO>}

Look, I think Kieren, the number one thing for us on cap here it is to work out to really understand our portfolio and make sure we're selecting and pricing correctly. Reinsurance is not a substitute for doing the proper job on underwriting and that's why we haven't increased on cat exposures in the first half of the year. We don't want to be overly reliant on reinsurance. We think we should be able to run our business ourselves. So we always look for insurance options. But at the moment, I think the key priority as far as we're concerned on cat is make sure we optimize the portfolio, get the right price. And if we can't get the right price, like we're already doing in some areas, we will remove our capacity from those particular lines of business. But at the moment, we don't have any plans to materially change our appetite on cat reinsurance.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks. And the final question, Inder, just on the investment book. You seemed to be flagging a bit of a -- sort of re-risking or shift back towards growth assets over the next 18 months. So just wonder if you can talk to sort of how we should be thinking about the percentage mix and what type of changes and what the capital implication is of that change might be.

A - Inder Singh {BIO 20594382 <GO>}

Yes. Sure, Kieren. So effectively at the moment, we have 9-3-7 mix and I think the -- what we flag historically is, more like a 8-5-15 mix would be the optimal strategic asset allocation when we think about combination of growth and risk assets contributing to that 15%. And we're taking a very cautious approach in building back to that level over the next 18, 24 months. And so in terms of capital consumption, the actual capital consumption itself is modest, as you evolve the asset mix, also it brings a little bit more volatility or risk of pull back in the market sector could impact your capital position. So, we're just being cautious at the moment. I think the first call on capital goes towards the underwriting account and we see plenty of opportunities to continue to grow profitability in that underwriting account as we've sort of demonstrated in the first half.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Great. Thank you.

A - Tony Jackson {BIO 1729093 <GO>}

Thank you. Next question is from Andrei Stadnik from Morgan Stanley. Go ahead, Andrei.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Good morning. Can you hear me okay?

A - Richard Pryce {BIO 5184927 <GO>}

Yes. Hi, Andrei.

A - Inder Singh {BIO 20594382 <GO>}

Yes. Hi, Andrei.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Fantastic. Thank you. I wanted to ask two questions. Firstly, you've mentioned that your ultimate COVID cost estimate of about $785 million, now might be looking a little bit too high. What are your plans around that and also how comfortable are you with a longer tail casualty claims?

A - Richard Pryce {BIO 5184927 <GO>}

So I think we actually -- I said that the current accident year provision of $130 million for COVID is looking on the high side. We didn't make any statement around the prior year. I think the prior year, there's a lot of developing obviously with what we have provisioned last year. If you take a look through the key components, the U.K. is settling pretty well, and within our expectations and the important point on that is the reinsurance recoveries have started to come in. So, that's a good move for us.

Australia is in a very different position as you'd know because we are still long way behind in having any legal determination. But it's probably fair to say, we feel a little bit more comfortable on the valuation and the potential claims if they are covered because our analysis shows that maybe they are maybe a little bit less than we initially expected. And also we haven't got a material uptick in claims notification. So I think as far as that's concerned, we feel pretty good but the area we haven't seen many claims this year that we possibly anticipated in $130 million provision is on the credit lines in LMI and trade credit and that has been quiet. But there certainly we trade credit. I think we're a little bit nervous as to what may occur towards the end of the year. If the government's stimuluses around the world are withdrawn and then maybe some volatility. So, trade credit could be more difficult and that's why we're holding the provision in the second half, but we're optimistic. But that was mainly for credit lines and that has been lighter.

As far as casualty, we haven't really seen very much and we keep a vigilant eye on the casualty and COVID impacts, but there's the odd one here and there a little bit in what has come and so on, but really nothing material.

A - Inder Singh {BIO 20594382 <GO>}

Andrei, I'll just give you a couple of numbers just so that saves you hunting around. When you look at the 2020 accident year, we had $655 million of which $355 million was your premium expenses and claims and $300 million was risk margin. On that $355 million, we are now at $343 million, which is about a $12 million release. And then we set up $130 million for this year against which we incurred $23 million, right. So when you look at the $23 million incurred this year versus the $12 million released from prior year, that's a net impact of about $11 million and then risk margins in the round ball from $300 million to $290 million. Those are the three components that just give you the numbers behind kind of context that Richard just provided.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Thank you. And my second question, I wanted to ask around cost. So cost control is particularly impressive in this first half, but what should we be thinking about the second half? Should we be thinking there will be some wage pressures and some bonus pressures emerging given competition for underwriting talent and just overall very strong results of the business?

A - Richard Pryce {BIO 5184927 <GO>}

I'll let Inder answer that. Just first of all, yes, there's always a battle for talent in different parts of the world and we deal with that every day, but I think we feel we are well provisioned in the short term to cover that. You know, we have various cost initiatives, the old one that we're sort of retiring because we've pretty much delivered on and as we said, we're starting to challenge ourselves on new operational structures, which Todd certainly started to do effectively in North America, but I'll let Inder talk you through the numbers.

A - Inder Singh {BIO 20594382 <GO>}

Yes. Andrei, I mean, I think we've been very conscious as we've talked about our efficiency initiatives, that inflation remains a risk, right. So as Richard said, we've got a ton of work underway around relooking at our technology and modernization of that and a lot of program work shifting infrastructure to the cloud and looking at location strategy. We're looking at operating model. We're looking at the functional setup. So there's a ton of work going on, which will drive efficiencies to help offset some of that inflation. And really, our hope is to create some positive jaws as we go forward, right, just to make sure that the expense rates grows modestly relative to the premium base and we get that operating leverage come through.

So -- but we recognize that there are going to be some challenges around wage inflation and also we need to create some capacity to grow. And so, that -- as we think about our targets, the target we put out around 13% expense ratio, that's very much framed with the risk of inflation in mind. But also a real determination to go after some of the opportunities we see including the efficiency utilization.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Thank you.

A - Tony Jackson {BIO 1729093 <GO>}

Thanks, Andrei. Our next question is from Andrew Buncombe at Macquarie. Go ahead, Andrew.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Hi, guys. Just two questions for me. The first one, maybe if you can just give us some color on the potential impact of German floods on your book in the third quarter, please? That's something that pretty much everybody globally has been calling out on these calls. Thanks.

A - Richard Pryce {BIO 5184927 <GO>}

So, yes. We've done a piece of work on that. Our initial expectation on that is, it's a reinsurance loss for us more than insurance loss because we have QBE Re which write business in that region, particularly through our Belgium distribution point. But we're not going to give a number, that I think you'll probably say that we are -- it doesn't materially in any way really impact the international provisions for cat so far in this quarter. So yes, it's a decent-sized loss but it's not anything that's going to materially impact our cat provisions at this time.

A - Inder Singh {BIO 20594382 <GO>}

Just the numbers on that, Andrew. So we had a bit of cat IBNR booked at the end of the first half, some of that is proving a little bit redundant now and so it help to cover part of this. And the other thing is, obviously, it's been taken into account as we think about our premium liabilities that get deducted from capital as at the half year. So it is effectively included in a component of our capital that we reported at the half year.

Q - Andrew Buncombe {BIO 19921333 <GO>}

That makes sense. And then just my other question was, just if you could remind us how much cyber business QBE was writing globally and whether some of the changes recently has impacted that appetite? Thanks.

A - Richard Pryce {BIO 5184927 <GO>}

Well, interestingly, it hasn't impacted our appetite, because I would say the market has largely moved towards our appetite. We had a very tight appetite on cyber smaller limits, very, very disciplined approach to certain sectors. So our global premium is less than $50 million and it's probably closer to $40 million, $35 million depending on where we are in any moment in time, but it's not a material portfolio and it's not a portfolio. Most of it's written here and it is not a portfolio where we have lost money.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Thank you.

A - Tony Jackson {BIO 1729093 <GO>}

Thanks, Andrew. Next question is from Matt Dunger from Bank of America. Go ahead, Matt.

A - Richard Pryce {BIO 5184927 <GO>}

Hi, Matt.

A - Tony Jackson {BIO 1729093 <GO>}

Are you there, Matt? We'll come back to you, Matt. Next question from Sid from JPMorgan. Go ahead, Sid.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

All right, gentlemen. Can you hear me okay?

A - Richard Pryce {BIO 5184927 <GO>}

Well, go ahead, Sid.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay, great. Okay, thank you. So just a couple of questions if I can. Firstly, just on claims inflation. Richard, I was hoping you could make some comments about exactly what you are seeing by region, maybe short tail and long tail. Obviously, you'd called out before that I think that you were seeing some elevated signs in certain long-tail lines. I was just wondering if you could provide us an update on your thinking around that. And just maybe some comments just on short tail as well. Just you mentioned that you think some of the inflation is transitory. Maybe you could just help us provide some numbers to what you're seeing and how that's impacting your numbers?

A - Richard Pryce {BIO 5184927 <GO>}

Okay, happy to, Sid. I think as everybody probably knows when what we said in February where we gave guidance on our inflation assumptions of 3, 3, and 5; 5 being in North America, 3 in the other divisions, which rolled up to about 4% to the group. And we're still comfortable with that assumption. As for the area where we've seen the most is short tail, which we talk about supply impacted labor and materials, and where that's really probably come through the most is in North America and in (inaudible). And a lot of other people in the market have realized that we always used to have something called demand surge after a cat loss where cost of materials and labor went up. That's been more exacerbated this time probably than ever before and I think that is partly the COVID impact of less supply and difficult to get labor and to get materials.

So probably the most heightened place we are seeing is in catastrophe type losses and we probably would have seen a bit of that in Australia as well. So -- and the other thing that probably impacts Australia, as you would know better than me is, the borders are shut and there's less transitory labor, then that does put some demand on labor as well. So it really is very much a short tail. It's not -- we couldn't call it permanent yet, because it may be related to these larger events. As in elsewhere, we talked a little bit about Western Australia, U.K. liability, we're looking at a little bit here, but generally on the whole, it's okay. I suppose one thing I would caution everybody is on social inflation. The courts have not been that active in the U.S. for a while because of obviously the COVID impact. And if there is a heightened backlog of court cases, then you could see some social inflation activity coming through sort of the back end of this year and going into next depending on when normal services resume in the course.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay. Thank you for that. Thank you for that color. Maybe just a second question if I can, just around the comments you made around signs of moderating in the cycle particularly in international. Could you just provide some color as to exactly what is guiding your thinking there and also how that compares with the 3% claims inflation and maybe some comments on the duration of the cycle? I know that's difficult but -- to predict but maybe if you can just make some comments around that?

A - Richard Pryce {BIO 5184927 <GO>}

Yes. I think pretty much everywhere where other than maybe the odd short-tail class I just referred to, we're comfortable that we're getting more rates than inflation and in some areas materially more. The two places where we've probably seen -- three places we've probably seen the most moderation of rate in international markets with the -- in financial lines, international loggers in natural resources. Now they're all 10% to 20% rate increase still, but they -- some of them like financial lines would have been materially more double last year, and I think keep natural resources now just over 10 and it was 20. So that's why we say the momentum is slowing. It is still materially above and actually natural resources is an area where we say claims inflation actually is very low, so that is margin enhancing there. So that's why it's happening the most, but it's actually the lines that went up the most, they are not increasing as much rather than the pressurized lines that didn't have much rate increase. Now going back down, if that makes any sense. So it's still margin enhancing and it's not in any way eroded the whole rate increase eroded by inflation.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

That's very clear. Thank you. Just the last question for me just on crop. Just -- could you provide us just a little bit more color in the picking of a 95% combined ratio for the first half? Just -- could you perhaps book in how you've seen the development so over the year versus perhaps your worst year, which I think was 102% combined ratio, if I remember rightly?

A - Richard Pryce {BIO 5184927 <GO>}

2012, I think was the worst one. Wasn't it?

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

I think so, yes.

A - Richard Pryce {BIO 5184927 <GO>}

Yes. Well, we are not there yet, Sid. Look, as you know, North America is, as we're baking in, hot in some palaces at the moment, particularly as Inder called out, the Dakotas and Minnesota and California is big challenge, but fortunately, it's heavily irrigated and they haven't turned off the water. Inder and I spent some time with the crop team yesterday, going through their synergy, it's very fluid. I don't view 95 as conservative because it could get worse, but it's very difficult for us to call because we don't -- the profits got to come through from the profitable states and Inder can talk to this more intelligent than I can, but there's some states that are performing very well. And as others are performing very badly, we have pretty much written off the Dakotas and Minnesota, but there's some marginal space which could then cause whether it goes up or down from the 95. But Inder can -- Inder is the expert on this compare to me. So I'll pass over to him.

A - Inder Singh {BIO 20594382 <GO>}

I'm not sure how much more insight we can -- depending on how long you've got to. The only comment I'd make is that when you look back to 2012, which was a drought year and potentially comparable. The drought was a lot more widespread. I guess what we're saying now is that the states that are impacted are fewer in number, albeit we do have a decent market share in North Dakota. So yes, as Richard said, I think it's -- we could even make assumptions about these states that are getting worse. The question is, how does the other crops around the country develop which there are some positive signs elsewhere. So look, I think the 95 sort of reflects our current assessment. We're also conscious that you don't get real numbers until you get meaningfully into the second half, so it's just -- for us to give you any more precise guidance, but just wouldn't be sensible because it's probably a conversation we better off having as we get through the second half and get better visibility.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Thanks very much.

A - Tony Jackson {BIO 1729093 <GO>}

Thanks, Sid. We will try Matt Dunger at Bank of America. Are you there, Matt?

Q - Matt Dunger {BIO 20863237 <GO>}

Thank you very much. Can you hear me, gentlemen?

A - Richard Pryce {BIO 5184927 <GO>}

We can hear you, Matt. Hi.

Q - Matt Dunger {BIO 20863237 <GO>}

Appreciate your time. Thanks for taking my questions. So I had a question on North America, some substantial growth in crop, which is particularly cat exposed. You are delivering growth ahead of race in the U.S., but are you happy with the growth given arguably growth in crop does push you more towards catastrophe exposure?

A - Richard Pryce {BIO 5184927 <GO>}

We're very aware of that and interesting, obviously, two-thirds of the GWP growth in crop is because the commodity prices. So -- and the other third is targeted and particularly in places like Illinois where we have recruited a team and fortunately Illinois is not challenged at the moment as far as profitability. So the targeted growth actually has gone into an area that should enhance our margin in a challenging year for crop.

One of the (inaudible) team are meeting at the moment today some of them in Bermuda, with Sam Harris, our Chief Underwriting Officer. When we talk about portfolio optimization really in North America and I referred to a monoline catastrophe. We are catastrophe exposed or weather exposed in crop, so we can't -- we've got to balance it. So we're going to be very careful and selective around the monoline catastrophe business that we support going forward. And that's why we've backed financial lines and also retail, as our growth opportunities, because they do diversify away from the heavier weather exposed of crop and the monoline catastrophe business.

So we are in the phase of a portfolio shift in North America. You can't do it overnight, you can't do it in one year, but we're encouragingly making the right progress to deal with the concern that you probably correctly just raised around the exposure to weather. Does that answer your question?

Q - Matt Dunger {BIO 20863237 <GO>}

Thank you. Can you do this organically, this portfolio shift. Or do you need to look at options in North America to add teams, businesses?

A - Richard Pryce {BIO 5184927 <GO>}

While the teams is our option and we bought the financial lines teams from Berkshire last year and that's turned out to be a success. And we would and are looking at other teams if the right people, the right culture come along, then we would look to organically help to shift the portfolio and that's one of the things that Todd is looking at in the North American business.

Q - Matt Dunger {BIO 20863237 <GO>}

Thank you. If I could just ask a final question. On the $130 million of COVID claims, you're hoping to come in below that. Can you just give us a bit of a rationale as to why you're holding on to $60 million for lenders mortgage insurance given the improving trends in that business and also retaining elevated probability of adequacy? What's the timing for assessing release of some of these provisions?

A - Richard Pryce {BIO 5184927 <GO>}

I'll let Inder to answer that one.

A - Inder Singh {BIO 20594382 <GO>}

Matt, I mean, I think as we are sitting in the middle of the prolonged lockdown here in Australia, in New South Wales, potentially further lockdowns to come as we go through the rest of the year. The environment remains uncertain, right? And so, yes, we feel better about it than what we did as we exited the end of last year, but we're sort of six months on. And we really need to see how the book performs. We're not seeing anything in terms of arrears development, we've been very cautious about where we're writing new business in a way supporting existing partners with focus and the origination is very much focused on first-time buyers and owner-occupiers, what a quota share on the business that's a bit bigger than last year. So, we remain cautious, environment remains uncertain. We will take another look at it at the end of the year.

A - Tony Jackson {BIO 1729093 <GO>}

I think, Matt, you done there. Okay. Next question is Nigel from Citigroup. Go ahead, Nigel.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Thanks very much. So, good morning, gentlemen. Just first of all, just a quick follow-up on the crop. I mean, am I right in thinking that those sort of heat wave impacted states are mostly soybean rather than corn, is that a correct assessment of the situation?

A - Inder Singh {BIO 20594382 <GO>}

The impact for us Nigel -- yes, sorry. (Multiple Speakers) --the weather impact, so we're not expert farmers here, but what happens when you get this drought, it impacts corn and ability of corn to recover with late-season rain is more limited. So it's, a, the mix of business in the state but also corn is going to be more heavily impacted because its ability to recover with any rain we see now is going to be more limited whereas soybeans can recover with a bit of rain as we get closer to the harvest. So we wouldn't want to get crop specific. We feel that these states are at risk and we try to factor that in where we book the combined ratio at the half year.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Yes. So I was just trying to sort of, I think there's been some industry commentary that soybean was most impacted. So I thought that would limit the impact but you are saying there's a fair amount of corn exposure as well.

A - Inder Singh {BIO 20594382 <GO>}

Yes, and the corn doesn't look like it's going to recover, Nigel. That's the other problem.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Yes. Fair enough. Moving on, just on the commission ratio. I mean that was a bit lower than expected and obviously, in the pack, I think you're saying it's due to mix of business and also obviously the extent of the crop growth. Can you maybe just sort of unpack that a little bit more to how much of that sort of is a group gain, how much is at risk of bouncing back again?

A - Richard Pryce {BIO 5184927 <GO>}

You want to take that one, Inder?

A - Inder Singh {BIO 20594382 <GO>}

Yes, happy to. Nigel, I think when we talk about what's genuinely sustainable recurring, the improvements in attritional the improvements in the expense ratio and then commission yes, we're happy with the progress. It is mix related. I mean, obviously with crop we get commission reimbursed partly from the federal government so that the more crop contributes to the overall portfolio, the lower the commission ratio in essence. And then in some of these areas that have been growing a bit more, we've deliberately put quite shares on such as LMI, financial lines, trade credit or impact of the commission ratio.

So I would say it's the mix and it's the reinsurance. Now we can argue some of this we potentially recurring but we're not banking that as a recurring benefit as we think about the outlook going forward, Nigel, is not all of that's going to recur because it is subject to mix and subjective to reinsurance.

A - Richard Pryce {BIO 5184927 <GO>}

I think Nigel, if you take out the issues of crop and some of the reinsurance programs, the business mix is important. If we grow in QBE Re, QBE Re is a low commission business. Europe has a lower commission ratio than the U.K. and then across the company we've been a lot more circumspect on MGA's [ph] delicated and binders and so on, where we're paying other people to work for us. And if we reduce our capacity in some of those, then that will bring the commission ratio down because we're paying them to do quite a lot of the work.

Q - Nigel Pittaway {BIO 3406058 <GO>}

And then just, apologies, if you did cover this, but in the outlook statement, you'll say you'll consider more strategic reinsurance to enhance returns and further optimize the portfolio. Can you give sort of any more color on your line of thinking in that regard?

A - Richard Pryce {BIO 5184927 <GO>}

I think that may be slightly misinterpreted in some ways because that maybe, if we decided to do some form of LPT type transactions to deal with some legacy portfolios which has got very little left to do. There's not a lot of strategic reinsurance buying that one can do anymore. And as I said, I think we are now more focused on getting the portfolios right and managing the inwards business and then we'll deal with reassurance as possible. We don't want to become overly reliant on reinsurance and we don't want to use reinsurance to short-term fix portfolios, we'd fix them then use reinsurance as a short-term lever because that wouldn't necessarily be a reoccurring benefit that we can have. So we're very much about front-end fixing the reinsurance, but of course, we'd always look if there is some optimal way to deal with a particular problem in the short term but that wouldn't necessarily be an overriding strategy of the company.

A - Inder Singh {BIO 20594382 <GO>}

Yes. It's just another tool around capital as well, Nigel, as we think -- we're not trying to look at portfolios where we necessarily worried about but it's more how do we think about the total cost of capital. How do we manage our appetite in some of these areas and that's kind of having think about the role of reinsurance, but as Richard said, it's really more about allocating our capital to the right areas. That's really the focus primarily. And then reinsurance is a source of capital in one sentence.

Q - Nigel Pittaway {BIO 3406058 <GO>}

And then maybe just finally, I mean, it would be remiss with it being Richard's last results and all your experience. Richard, not to ask you about Lloyd's and how you think about the future of Lloyd's and whether or not you think QBE will be writing more or less business through Lloyd's as we move forward?

A - Richard Pryce {BIO 5184927 <GO>}

You put me in a difficult place at my own cost. The great thing we have here with Bill over the last eight years as we have a mixed franchise. So we aren't overly reliant on Lloyd's. So if Lloyd's is success, we will be part of it and will be a vibrant part of it. If it's difficult or problematic, we don't need to be part of it. So we've built an option. We've built an option in Europe. So we have one of the most viable alternatives post Brexit. We also have our U.K. business. So, I think we want Lloyd's to be a success. My personal view is I think they need to move quicker and they need to be more dynamic and deal with stuff. It's still a place where you would think it's inefficient and the cost of doing business is too high and the acquisition cost is too high. But it's something we want to see successful and we want to be part of it but we're very pleased that we've got options if it doesn't suit QBE's strategy.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Great. Thank you very much.

A - Tony Jackson {BIO 1729093 <GO>}

Thanks, Nigel. We've got two final questions.

Next question is from Steve (inaudible) from Hester. Are you there, Steve?

Q - Analyst

Yes, I am. Can you hear me okay?

A - Richard Pryce {BIO 5184927 <GO>}

Hi, Steve.

Q - Analyst

Fantastic. Richard, spot on a great set of numbers and to the team as well. Came down the center how you're monitoring your people and key underwriters and how you seen the health and the turnover within those kind of really important people within the business?

A - Richard Pryce {BIO 5184927 <GO>}

That's the one area we've probably focused a lot more since we've had the COVID experience. And unfortunately you guys have got a bit in Australia what we've had here in the past. So we're sort of bit of past masters in the company. We do far more regular check-ins with staff, these are formally and informally with surveys and quick snap surveys. And managers are very aware of keeping connected with people. In the office here, we're seeing a lot more of the underwriters and the young underwriters come in, so that's good.

We want to stay connected with our customers and with our staff. I think it's incumbent and when we say to all our managers, they've got to be far more active and proactive in trying to make sure that people are -- feel part of the organization, particularly new joiners because we're still hiring people. We do online training courses. I know there was a big one right up here yesterday for professional indemnity.

So we're really working quite hard to find any way we can to connect with people. As far as monitoring them, we're pretty granular around ourselves and we know which underwriters work and which don't. Our underwriting authorities are very strict. We don't have people who can write all sorts of different business. You very much are authorized to write in one area in your expertise or in one country or whatever. So we can very quickly look at performance of the sale and the team who work within that. So we can align individual performance to their sales and they're remunerated on that basis as well. So then we look very carefully to make sure that the profitability and the activity is right, including the growth and the profitability, but also the health and the well-being of our people which has become obviously our biggest concern over the last 18 months as we lived through these difficult times.

Q - Analyst

Thank you.

A - Tony Jackson {BIO 1729093 <GO>}

Thanks, Steve. Final question is from Doran [ph] from Credit Swiss. Go ahead, Doran [ph]?

A - Richard Pryce {BIO 5184927 <GO>}

I think you're on mute.

A - Tony Jackson {BIO 1729093 <GO>}

You are on mute, Doran [ph].

Q - Analyst

Sorry about that. Can you hear me now?

A - Richard Pryce {BIO 5184927 <GO>}

Hi, Doran [ph]. Yes.

Q - Analyst

Thank you. So just looking at reserve releases, they were very quite a big top-ups last year. I was just wondering it seems quite soon after just six months experience to be releasing some of that prior already. So maybe just a bit more colored motivations around that and I suppose also just in the context of social inflation as you've mentioned, there hasn't been much coming through but still cautious on how that plays out when courts reopen in the second half?

A - Richard Pryce {BIO 5184927 <GO>}

Yes. That's a really fair observation definitely and I'll let Inder answer in some detail if needed, but we are not going looking to reduce our reserves, quite contrary. And when you look at the IBNR in the large loss and what we're doing there we are holding more IBNR than we ever have because we're not dropping it at each quarter like we could have done in the past. What's come out of releases this time is really almost in matter of the mathematical process rather than any judgment calls, we've made no judgment calls as far as I'm aware of saying, oh, that's a lot better, so we're going to do it. To the contrary and things like financial lines, we're not touching anything in financial lines. So we worked out as 2017/'18 was a massive watershed in financial lines and we've seen all this rate, we've got relatively high loss picks and we're not touching it.

Where we did get some reserve release and particularly here which probably did inflate the overall numbers, is we didn't take some of the lockdown savings that came through in motor and casualty, particularly in the U.K. at the back end of last year and we didn't release those as part of the year-end process 2020 and some of that has come through and we just wanted to make sure that was definitely there and that's how I view that. We actually will think, take two or three steps before we make a decision to release reserves or make decisions. We are a lot more cautious on all of that.

So we're certainly not going looking and we haven't had any judgment changes.

A - Inder Singh {BIO 20594382 <GO>}

Richard, I might just add one or two things. So, Doran [ph], we haven't released -- none of these releases come from any of the areas we spent the last year. The other thing I'd say is you're looking at numbers that are net numbers and within that there's a bunch of movement. So if you look at Australia, within the net number of $24 million, we have -- if you look last 12 months, right, we strengthened in my ability, we strengthened the workers comp, in the aggregate amount that strengthening is probably close to $150 million. So -- and offsetting that is some releases in areas like CTP, trade credit, et cetera, so what we're looking at is really net numbers and as Richard mentioned in the U.K., you've got to do some further strengthening in financial lines in that net number. And similarly in the U.S., we're not releasing anything even though we're not actually seeing some of the claim trends in line with some of the social inflation assumptions we've made because courts have been closed and there's a backlog. So what you're hearing from us is a level of caution around reserves.

A - Tony Jackson {BIO 1729093 <GO>}

Okay. I think we'll wrap it up there. There's no further questions. So I'll hand back to you, Richard to close.

A - Richard Pryce {BIO 5184927 <GO>}

Thank you, Tony. And thank you everybody for joining us today. And I wish you all a good day. And it's 2 a.m. I'm going to try and get some sleep. Thank you very much for joining us.

Operator

Goodbye.